

Congress enacts enhanced beneficial ownership reporting for US-formed entities

February 1, 2021

In brief

Key takeaways from the legislation:

- The legislation imposes a significant reporting obligation on all US-formed corporations and LLCs, and certain foreign-owned entities doing business in the US.
- Even for entities that will be excluded from reporting specific beneficial ownership information, the general due diligence and reporting framework creates serious potential compliance burdens.
- Treasury/FinCEN will have to adopt implementing regulations within 12 months, which will define much of the reporting framework.

In detail

Background

The National Defense Authorization Act of 2021 (H.R. 6395) was enacted on January 1, 2021 (P.L. 116-283) after Congress overturned a presidential veto. The legislation includes the Corporate Transparency Act (CTA), a long-sought bipartisan addition to the anti-money laundering (AML) regime to require enhanced disclosure of beneficial ownership information for law enforcement purposes. The new provisions amend the Bank Secrecy Act in Title 31 to add strict reporting measures and confidentiality protections.

Scope

The CTA rules are potentially sweeping in scope in that they broadly apply to two categories of entities: (i) any corporation, LLC, or 'similar entity' that is formed under US state or tribal law, or (ii) a foreign entity registered to do business in the US. The term 'State' is broadly defined to include the District of Columbia and any US territory or possession. Any entity falling within these definitions is considered a 'Reporting Company'. The CTA notes that more than two million entities are formed each year, with the total population of potentially affected entities in the tens (or hundreds) of millions.

Observation: The Implementing Regulations will have to address what types of entities might be considered a 'similar entity,' such as whether partnerships, trusts, or other legal persons are to be covered. Many civil society and AML groups have urged governments to expand beneficial ownership reporting to any type of legal person operating within a jurisdiction. However, these entities typically are not required to file formation or registration paperwork in many US states and therefore are unlikely to be covered in the ambit of the Implementing Regulations.

Exclusions

The statute provides an extensive list of 24 specific exclusions from being considered a Reporting Company. For the most part, a company subject to federal regulatory oversight in the US (especially if registered with the SEC) is likely covered by an exclusion. For example, the following entities are generally excluded from being a Reporting Company: issuers of securities; government entities; banks and credit unions; registered money transmitting businesses; SEC-registered brokers/dealers; insurance companies/producers; and public utilities.

With regard to investment vehicles, exclusions are made for investment companies and advisers, as well as a pooled investment vehicle. An excluded investment company or adviser must be defined in the Investment Company Act (ICA) or Investment Advisor Act (IAA), and be properly registered consistent with the appropriate governing act (or else be defined in the ICA and have filed a Form ADV with the SEC). The exclusion for a pooled investment vehicle extends to a vehicle that is operated or advised by an excluded bank, credit union, SEC-registered broker/dealer, investment company, or investment adviser.

An exclusion also covers any non-profit entity falling within IRC sections 501(c) or 527, or an entity that exclusively assists or governs the non-profit.

A threshold-based exclusion is made for a corporation or LLC with a US office that has more than 20 US full-time employees and filed a US income tax return reporting more than \$5 million in gross receipts in the previous year.

Another exclusion is given for corporations and LLCs that have existed for more than one year, have no active business, have no foreign ownership, have no assets, and within the past 12 months have not experienced any ownership change or sent/received funds greater than \$1,000.

An important exclusion is made for any lower-tier entities of an excluded entity mentioned above. With the exception of money transmitting businesses, pooled investment advisers, and 501(c)-affiliated entities, a corporation or LLC that is owned or controlled, directly or indirectly, by another excluded entity will also not be considered a Reporting Company.

A final discretionary exclusion is allowed if the Treasury Secretary and Attorney General set out a class of entities to be exempt from reporting because of public interest concerns with no or limited enforcement value.

Observation: the list of excluded entities in the statute is extensive and the summary above does not detail every exclusion provided for. Moreover, the statutory definitions for certain types of excluded entities are quite technical, so care should be exercised to understand the necessary qualifications.

For businesses operating in the financial services sector, where numerous separate entities may be created to handle risk issues and/or legal requirements, it will be important to ensure the tax structure is well documented to understand how ownership will affect reporting requirements.

Identifying beneficial owners

A Reporting Company will be required to provide FinCEN with the following information regarding each applicable Beneficial Owner:

- Full legal name;
- Date of birth;
- Current street address; and
- Unique identification number.

A Beneficial Owner is defined in the Act as any natural person who either exercises substantial control over the entity or else owns/controls at least 25 percent or more of the entity. Several types of individuals are not considered Beneficial Owners under the statute: minor children; nominee/agent/custodian acting for another individual; a company employee whose only control comes from being an employee; someone whose interest comes from a right of inheritance; or a creditor of the entity (unless they also meet the earlier control tests).

Observation: the definition of Beneficial Owner in the statute largely conforms to the anti-money laundering standards established by the Financial Action Task Force (FATF).

Reporting details

Treasury has 12 months from the date of enactment of the statute to issue Implementing Regulations. The release of these regulations will constitute the Effective Date for the new reporting regime, and entities formed after the Effective Date will have up to a year from the date of formation to make necessary disclosures. Entities which are formed before the Effective Date will have up to 2 years in which to first report information to FinCEN.

Observation: the Implementing Regulations are statutorily required to minimize reporting burdens and utilize existing information sources and processes where practical, with attention to efficiency and effectiveness for the small business sector. Potentially affected entities should therefore proactively engage in the rulemaking process to ensure compliance concerns are adequately raised and considered by Treasury before final regulations are issued.

With the need to take into account any requirements contained in the Implementing Regulations, Reporting Companies will need to provide FinCEN with any updates arising from ownership changes. Although this updated reporting is envisioned to occur within 12 months of a triggering change, Treasury could (in consultation with the Attorney General and Homeland Security) shorten the reporting period if there is a law enforcement need, taking into account the corresponding burden on Reporting Companies.

Certain reporting accommodations are allowed in the statute. For exempt entities with ownership interests in a Reporting Company, a report will only need to list the exempt entity rather than the full Beneficial Ownership information. For foreign pooled investment vehicles, a report will need to provide a written certification with an identification number of an individual having substantial control over the vehicle. If exempt subsidiaries or grandfathered entities ever lose their exempt status, they must file with FinCEN under applicable time limits.

Failure to comply with reporting obligations under the CTA may result in a civil penalty of \$500 for each day of compliance failure, or a fine of not more than \$10,000 or up to two years of imprisonment (or both).

Use of data

The Beneficial Ownership information provided to FinCEN under the CTA is required to be held under strict data protection protocols, with use outside of Treasury functions limited to authorized law enforcement activities. The information may be provided to foreign governments pursuant to international treaties and agreements.

Observation: the use of Beneficial Ownership information for tax administration purposes is expressly permitted, likely allowing the IRS to exchange such information with other tax authorities where permitted under a bilateral/multilateral treaty or tax information exchange agreement.

The takeaway

In-scope reporting companies should consider preparing now to understand their potential filing obligations under the CTA. Although certain elements of the reporting framework will not be understood until Implementing Regulations are issued, determining the breadth of potential compliance is important. Even for business organizations expecting to qualify for exemptions, there will be significant technical analysis required to ensure each separate entity is appropriately characterized. In certain circumstances, exempt entities will still have reporting obligations, even if not as extensive as Reporting Companies.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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