



The End of the Anonymous Shell Company in the United States

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Over a veto of President Trump, on January 1, 2021, the Corporate Transparency Act (“CTA”) went into effect as part of the National Defense Authorization Act (“NDAA”). The CTA, many years in the making, introduces major changes to transparency requirements of entities registered in the United States. No longer can anonymous shell companies, limited liability companies, and the like hide the identities of their owners. In aiming to end this phenomenon, which resulted in the United States becoming a leading “safe haven” jurisdiction for those seeking anonymity of ownership, the CTA establishes a central database of beneficial owners of corporations, LLCs, and other corporate entities, available to law enforcement agencies (but not the public), and an affirmative obligation on the entity to identify and report its ownership. The CTA requires, with very limited exceptions, all U.S. registered corporations, LLCs, or similar entities to report beneficial ownership information to the U.S. Department of Treasury’s Financial Crimes Enforcement Network (“FinCEN”). The new registry will collect the names, dates of birth, addresses, and identification documents of individuals who own at least a 25 percent equity stake in the entity, or exercise substantial control over the entity, which will more directly tie the responsibility of the entity’s conduct to specific individuals.

The stated objective of the CTA is to limit the ability of individuals to disguise transactions behind anonymous shell companies. Significantly, the registry will not be accessible to the public but may only be used by the U.S. enforcement community to assist with investigations into money laundering allegations and other financial crimes. There are some exceptions to the reporting requirement.

There are some exemptions to the CTA. Many types of entities, including public companies, governmental entities, banks and bank holding companies; credit unions; broker dealers; registered investment advisors and companies; insurance companies; registered public accounting firms; public utilities; charities and certain other non-profit entities; companies with more than 20 full-time employees in the United States, or more than \$5 million in gross receipts or sales, and an operating presence in the United States, are exempt.

Previously, under the Bank Secrecy Act (“BSA”), such beneficial ownership information had only been required to be recorded by financial institutions as part of their due diligence and Know Your Customer (“KYC”) procedures. This process was often flawed, and contained a number of potential weaknesses as the government relied upon the efforts of the financial institutions in complying with BSA and KYC requirements and properly collecting and verifying the information.

If such institutions were not diligent in their procedures and processes, significant holes would remain in the data.

Significantly, the CTA now imposes such reporting requirements on the entities themselves, which will bolster the ability of these financial institutions to verify the information provided and lessen their burdens—and empower U.S. enforcement agencies tasked with investigating financial crimes. The passage of the CTA is the first major step in ending the United States’ perceived status as a “safe haven” jurisdiction and eliminating the use of anonymous shell companies in corporate formation in the country, which the government has claimed has long been utilized as opaque conduits to hide financial misconduct.

The CTA was a bipartisan effort, developed over a decade and after years of complaints from law enforcement officials that the lack of beneficial ownership information allowed for concealment of financial misconduct and the proceeds of financial crime. Government officials have long complained that they were at a disadvantage due to the lack of the requirement for owners to be identified. The purpose of the CTA is to shift the burden and responsibility of identifying beneficial ownership information of companies from financial institutions to the companies and the individuals who own them, and to put an end to disguising financial misconduct, the entities used to hide proceeds and the fruits of financial crime.

The CTA’s requirements are straightforward. If an entity qualifies as a “reporting company,” it must submit a report to FinCEN containing the identifying information of the entity’s beneficial owners. FinCEN will hold the information in a confidential and secure database, only releasing the information upon: (i) a request from certain federal or state agencies engaged in national security, intelligence or law enforcement activity; (ii) certain types of requests from a federal agency on behalf of foreign authorities; (iii) a request by a financial institution “subject to customer due diligence requirements”; or (iv) a request by a federal regulator.

Who Must Report

The scope of the definition of what constitutes a reporting company is broad, and includes any corporation, limited liability company, or other similar entity created by the filing of a document with the secretary of state or similar office of any U.S. state or territory, or formed under the laws of a foreign country and registered to do business in the United States. Effectively, this means that all such entities—with the notable exception of foreign companies that do not formally register to do business in the United States—will be subject to these requirements, **unless** they fall into one of 24 enumerated categories.

Who Qualifies as a Beneficial Owner

Each reporting company will have to file a report disclosing each beneficial owner’s name, date of birth, residential or business street address, and unique identifying number from an identification document. The information is required for any individual who, directly or indirectly, exercises “substantial control” over the entity **or** owns or controls 25 percent or more of the ownership interest in the entity. The term “substantial control” is not defined in the CTA. Nevertheless, the regulations implementing FinCEN’s beneficial ownership due diligence obligations for financial institutions provide guidance, as they parallel the CTA. “Substantial control” exists when an individual has “significant responsibility to control, manage, or direct” the entity. Such individuals

who are deemed to possess substantial control include executive officers, senior managers, or any other individuals who regularly perform similar functions. Notably, however, the CTA does **not** include within the definition of “beneficial owner” persons who receive principal benefits from the reporting company.

Penalties for Non-Compliance

The penalties for non-compliance, such as failing to report or providing false information, include fines up to \$10,000 and a prison term of up to two years. The CTA will also facilitate financial institutions' compliance with customer due diligence obligations, as FinCEN will conform financial institutions' obligations based on the information required under the CTA. These developments are important for financial institutions. Instead of those institutions bearing the burden of verifying beneficial ownership information, the burden now shifts to the reporting companies to file with FinCEN, against which financial institutions will verify information they collect from their customers and counterparties. Sanctioned individuals who attempt to operate in the United States under the cloak of anonymity through shell corporations will lose their corporate veil of disguise, at least from regulators.

Separately, in response to a number of Supreme Court cases addressing the scope of the SEC's authority to assess disgorgement against companies under investigation for certain offenses, such as Foreign Corrupt Practices Act (FCPA) violations, money laundering offenses, as well as other financial crimes, the NDAA expanded the SEC's authority to seek disgorgement, as well as other equitable relief, for federal securities laws violations.

Accordingly, we recommend that corporate clients who may be subject to the CTA promptly confirm their status, and make the requisite filing with FinCEN in order to comply with the statute.