Corporate Transparency Act of 2019 Broadens Beneficial Ownership Reporting

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Proposed Legislation Would Require Beneficial Ownership Disclosure at Entity Formation

Second Post in a Three-Post Series

In early March, the House Financial Services Committee released three proposed bills to codify many of the suggested reforms discussed during ongoing conversation among financial agencies, law enforcement, financial institutions, and commentators regarding the Bank Secretary Act (“BSA”) and Anti-Money-Laundering (“AML”) and Combating the Financing of Terrorism (“CFT”) laws. In this post, we summarize one of the proposed bills, The Corporate Transparency Act of 2019 (the “Act”), which seeks to ensure that persons who form legal entities in the U.S. disclose the beneficial owners of those entities. Although such a law would have broad application, the Act does not include “formation agents,”—i.e., those who assist in the creation of legal entities such as corporations and LLCs—in the definition of financial institutions subject to the BSA.

As we previously blogged, another proposed bill — entitled, “To make reforms to the Federal Bank Secrecy Act and anti-money laundering laws, and for other purposes” — seeks to reform the BSA and AML laws (the “BSA/AML Reform Bill”) and is divided into three main sections: Strengthening the Treasury; Improving AML/CFT Oversight; and Modernizing the AML System. Next week, we summarize the last of the three related bills, the Kleptocracy Asset Recovery Rewards Act, which seeks to create an asset recovery rewards program to help identify and recover stolen assets linked to foreign government corruption.

The Purpose of the Act

The Act focuses on bolstering beneficial ownership disclosure, an issue repeatedly flagged by FinCEN, the U.S. Senate Banking Committee, and the FATF as key in combatting money laundering and terrorist financing. In response to a 2006 FATF report criticizing the United States for failing to collect beneficial ownership information, the federal government repeatedly urged the states to make their incorporation systems more robust by obtaining beneficial ownership information as part of the formation process. Having had little success with voluntary compliance, the Act would amend the BSA to compel the Secretary of Treasury to set minimum standards for state incorporation practices. Thus, applicants forming a corporation or LLC would be required to report beneficial ownership information directly to FinCEN, and to continuously update such information.

The Act defines a “beneficial owner” as a natural person who “(i) exercises substantial control over a corporation or limited liability company; or (ii) has a substantial interest in or receives substantial economic benefits from the assets of a corporation or limited liability company.” The Act’s definition is similar in some respects to that in the Customer Due Diligence Requirements for Financial Institutions Rule (the “Beneficial Ownership Rule,” about which we blog frequently and have provided practical tips for compliance here and here), but lacks the precision found in the Rule. In fact, the Act completely fails to define the terms “exercises substantial control” or “substantial interest.”

The purpose of the Act is to level the playing field by requiring beneficial ownership information no matter the state of formation. In this way, the Act could motivate states to enact more demanding formation systems, and demotivate persons from forming entities in states which require little information about beneficial ownership.
**A Long Time in the Making**

The Act has been through several incarnations over the years. Most recently, the Corporate Transparency Act of 2017 was introduced by Representatives Carolyn Maloney and Peter King of New York in June 2017. Subsequently, Senators Ron Wyden and Marco Rubio introduced companion legislation in the Senate. For more on the previous iterations of the Corporate Transparency Act, please refer to our two-part series published September 20, 2017 and September 21, 2017.

**An Important Change**

Under previous iterations of the Act, “formation agents,”—i.e., those who assist in the creation of legal entities such as corporations and LLCs—would be considered financial institutions subject to the BSA’s AML and reporting obligations. As we blogged previously, this expanded definition of “financial institution” could encompass many individuals and businesses not previously subject to the BSA, including attorneys whose practices involve the formation of legal entities. This, the ABA has contended, “would undermine the attorney-client privilege, the confidential attorney-client relationship, and traditional state court regulation of the legal profession, while also imposing excessive new federal regulations on lawyers engaged in the practice of law.”

In an apparent win by the ABA and other stakeholders, however, the Act in its current iteration has removed references to the proposed “formation agents” classification. The Act, introduced by Representative Maloney, still would primarily serve to bolster the beneficial ownership identification requirements to prevent the use of shell companies for various illicit reasons, including facilitating tax and money laundering schemes as seen in the Panama Papers scandal.

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