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AUGUST 5, 2020 | PUBLICATION

Client Alert: Proposed Federal Beneficial Ownership Reporting

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Are small businesses with fewer than 20 employees and $5 million or less in revenues routinely laundering money for terrorists, drug dealers, and human traffickers? If you say "no," you may be concerned about new attention paid to an old proposal to ferret out who owns those businesses. If you say "yes," you probably support H.B. 2513, the "Corporate Transparency Act of 2019" (the "Act"). The Act passed the U.S. House of Representatives last October, and recently, a virtually identical measure was added by amendment to the more important National Defense Authorization Act (the "NDAA").

The Act creates a new regulatory database within Financial Crimes Enforcement Network (FinCEN), a law enforcement unit within the U.S. Department of Treasury. When submitting the initial charter to the Secretary of State (in most states), the appllcant must also submit a new form to FinCEN disclosing information about the owners. Penalties for failure to file are $10,000 fine or up to three years in prison. **The information is available to enforcement agencies.**

The concept of ownership reporting is not new. Foreign countries have long required the disclosure of equity ownership. Over a decade ago, the inter-governmental Financial Action Task Force made anti-money laundering proposals. Citing the burden on small business, early versions of the Act were defeated, most notably in 2012. Opposition has come from various sectors, including the National Association of Secretaries of State (see, e.g., https://www.nass.org/sites/default/files/surveys/2017-08/report-nass-company-formation-task-force-092112.pdf). In July 2019, the Act was reproposed amid strong, but lessening opposition (see, e.g., https://www.wsj.com/articles/a-new-small-business-burden-11563232900). Even the initially strong opposition of the American Bar Association is lessening, reportedly due to opposition from its international members.

The Act focuses not on record owners, but on "beneficial owners" of corporations and limited liability companies. (The government will study application of the requirements to partnerships and similar entities.) The term "beneficial owner" is broadly defined and does not require actual equity ownership. It means a natural person who, directly or indirectly by contract, arrangement, understanding, relationship, or otherwise (a) exercises substantial control; (b) owns 25 percent or more of the equity interests; or (c) receives substantial economic benefits from the entity's assets (to be further defined by the Secretary of Treasury). However, the following are not "beneficial owners": a minor child (as defined under state or tribal law); a person acting as nominee, intermediary, custodian, or agent on behalf of another person; a person acting solely as an employee and whose control or economic benefits derive solely from such employment; a person whose only interest is through a right of inheritance; or a creditor, unless the creditor also satisfies the basic test of beneficial ownership, described above.

The following information about "beneficial owners" must be reported:

- Full legal name
- Date of birth
- Current residential or business street address
- Unique identifying number from a non-expired passport issued by the United States, a non-expired personal identification card, or a non-expired driver's license issued by a state. An alternate rule applies to those with only foreign non-expired identification.

Although the information must be updated annually, the Act confers upon the U.S. Secretary of the Treasury the authority to promulgate regulations that require shorter reporting periods upon a change in beneficial ownership information. Existing corporations and limited liability companies will have two years to make a FinCEN filing, unless the Secretary of Treasury imposes a shorter time period.

Certain entities are exempt, although the applicant must file a certification with FinCEN identifying the applicable exemption and providing identification information for the person making the filing. Exempt companies include companies that file reports with the Securities and Exchange Commission, a state entity, certain financial institutions, insurance companies, public utilities, a charity (including church) described in Section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code of 1986, or a financial market utility. Also exempt is a business concern that (a) employs more than 20 full-time employees in the United States; (b) files income tax returns in the United States demonstrating more than $5 million in gross receipts or sales; and (c) has an operating presence at a physical office within the United States. An entity formed by an exempt entity also qualifies for exemption.

Federal contractors (unless exempt) will be required to make the disclosure in any bid or contract proposal if the job satisfies the current "simplified acquisition threshold," which is now $250,000. The Act directs the Administrator for Federal Procurement Policy to revise the Federal Acquisition Regulation no later than the first day of the first full fiscal year beginning at least one year after the date of the Act's enactment.

While the proposed legislation is not law yet, it may be getting close. As mentioned above, the Act passed the House last October by a vote of 249 to 173, though the vast majority of House Republicans opposed it. The House-passed bill was not considered in the Senate but reportedly, serious discussions began between leading Republicans and Democrats on the Senate Banking Committee to reach a compromise on a similar measure.

In a new effort to push the legislation forward, in late July the House sponsor of the legislation, Rep. Carolyn Maloney (D-NY), offered a version of her bill as an amendment to separate legislation, the NDAA. The NDAA is a defense policy bill that Congress considers and passes each year, providing funding authorization for the military and other national security priorities. Couched as a national security measure itself, the Act was adopted as part of a larger package of amendments ("en bloc") during floor debate. As such, it was not debated independently and did not receive a separate, up-or-down vote. With most members supportive of the national security funding authorized in the underlying bill, the NDAA ultimately passed the House, with the Act included, by a comfortable margin. The U.S. Senate passed its version of the NDAA a few days later, though importantly, its version of the bill does not contain similar language.

The House and Senate will now proceed to what is called a "Conference Committee" where designated

House and Senate “conferees” will reconcile the differences between the House and Senate-passed legislation and negotiate a final bill to be approved by the House and Senate and presented to the President for signature.

While the Act has support in the House and Senate and in the financial services sector, many other members of Congress (as demonstrated by the House vote in October) and outside business groups, including the National Federation of Independent Business (NFIB), remain concerned about the expense and privacy risks associated with the new reporting requirements and continue to oppose it.

Advocates supporting passage cite examples of money laundering, http://slnews.us/pbgl073120b. Financial institutions are already subject to “know your customer” and reporting laws. If these “bank secrecy” rules are insufficiently stringent to prevent money laundering evils, such as those recited in the article, those laws could be enhanced, rather than burden small business. Financial institutions are reported to be a major advocacy group in favor of the Act.

If you, too, are concerned about the legislation, there is still time to register your views. The best way to do so is to call, email, or write your elected federal officials – both of your United States Senators and your member of Congress (find your member of Congress) – to convey your concerns and ask them to remove this provision from the final version of the NDAA. The final legislation will be negotiated by the Conference Committee over the course of the next month, so there is still an opening and an opportunity to reject it for members of Congress who hear from constituents concerned about the impacts of the provision.