WAKE FOREST JOURNAL OF BUSINESS & INTELLECTUAL PROPERTY LAW

VOLUME 23 WINTER 2022 NUMBER 3

COMBATING MONEY LAUNDERING AND THE FINANCING OF CORRUPT AND ILLICIT ACTIVITIES: THE CORPORATE TRANSPARENCY ACT OF 2021

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I. INTRODUCTION

On January 2, 2021, some of the most significant amendments to the United States anti-money laundering ("AML") regime became law when the Senate overrode former President Trump's veto of the National Defense Authorization Act of 2021 ("NADA").[1] NADA includes the Anti-Money Laundering Act of 2020, which dramatically changes current AML legislation, including the Bank Secrecy Act ("BSA").[2] The AML Act includes the Corporate Transparency Act ("CTA") of 2021, which requires certain entities to disclose their beneficial ownership information.[3] The purpose of the CTA is to combat the variety of bad actors who use anonymous shell companies to hide and move funds associated with corrupt and illicit activity.[4] However, critics of the CTA claim that it is an invasion of privacy and creates an administrative burden on small, legitimate companies.[5]

This comment will focus on the implications of the Corporate Transparency Act of 2021. The background section discusses the events leading up to the enactment of the CTA, and the analysis section addresses the impact of the CTA. The background section discusses three different aspects of the CTA: (A) illustrates how the initial proposed legislation was altered to eventually become the current CTA, (B) explores the potential interplay between the CTA and existing legislation regarding beneficial ownership information, and (C) analyzes privacy concerns and the burden on small businesses due to the CTA. Finally, the analysis section will: (A) suggest changes and clarifications that need to be made to the CTA and (B) explain why these changes and clarifications are necessary. Part (A) proposes the following terms be clarified: (1) reporting company, (2) beneficial

[1] Kerry O'Rourke Perri et al., *Corp. Transparency Act and New Implications for US Special Purpose Vehicles, Wealth Structuring and Other Arrangements*, WHITE & CASE (Jan. 26, 2021), https://www.whitecase.com/publications/alert/corporate-transparency-act-and-new-implications-us-special-purpose-vehicles.

[2] Thomas Oppenheimer, *CTA to Impose Reporting Obligations, Penalties on Many Fla. LLCs, Corp.*, FOX ROTHSCHILD L.L.P. (Feb. 3, 2021), https://www.foxrothschild.com/publications/cta-to-impose-reporting-obligations-penalties-on-many-fla-llcs-corporations.

[3] *Id.*

[4] Tom Cosgrove, *The Corp. Transparency Act: AML Program Impacts for Fin. Inst.*, DUN & BRADSTREET (Apr. 7, 2021), https://www.dnb.com/perspectives/corporate-compliance/corporate-transparency-act-aml-program-impacts.html.

[5] Oppenheimer, *supra* note 2.

owner, and (3) applicant. Part (A)(4) recommends the safe harbor provision be clearer. Part (A)(5) suggests that beneficial ownership information being reported should be verified.

II. BACKGROUND

Other countries have criticized the United States ("U.S.") for decades about the lack of availability of beneficial ownership information.[6] However, in June 2006, the global community formally criticized the United States when the Financial Action Task Force ("FATF") issued a report urging the U.S. to remedy its failure to comply with a FATF standard on the need to collect beneficial ownership information.[7] The FATF is an intergovernmental body comprised of more than 200 countries and jurisdictions that sets international standards to prevent money laundering, organized crime, corruption, and terrorism.[8] In response to the global community's criticism, senators introduced the Incorporation Transparency and Law Enforcement Assistance Act in May 2008, attempting to amend the Homeland Security Act of 2002.[9] The bill intended to ensure that corporations disclosed their beneficial ownership information in order to prevent money laundering.[10] Nevertheless, Congress never enacted the Incorporation Transparency and Law Enforcement Assistance Act.[11]

The Incorporation Transparency and Law Enforcement Assistance Act was not the only legislation introduced in Congress in response to the global criticism about the lack of beneficial ownership reporting. There were four other versions of proposed legislation introduced to Congress in the decade that followed the introduction of the Incorporation Transparency and Law Enforcement Assistance Act, including: the Closing Loopholes Against Money-Laundering Practices ("CLAMP") Act, the Counter Terrorism and Illicit Finance Act, the True Incorporation Transparency for Law Enforcement ("TITLE") Act, and the 2017 Corporate Transparency Act.[12] Unfortunately, none of the

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[6] *See* Robert W. Downes et al., *The Corp. Transparency Act – Preparing for the Fed. Database of Beneficial Ownership Information*, A.B.A. BUSINESS: LAW SECTION (Apr. 16, 2016), https://businesslawtoday.org/2021/04/corporate-transparency-act-preparing-federal-database-beneficial-ownership-information/#_ftnref7.

[7] *Id.*; *see* Fin. Action Task Force, Third Mut. Evaluation Report on Anti-Money Laundering and Combating the Fin. of Terrorism (June 23, 2006), table 2, ¶¶ 5.1, 5.2.

[8] *Who we are*, FATF, https://www.fatf-gafi.org/about/ (last visited Aug. 28, 2021).

[9] S. 2956, 110th Cong. 2d Sess; Downes et al., *supra* note 6.

[10] S. 2956, 110th Cong. 2d Sess., Preamble; Downes et al., *supra* note 6.

[11] Downes et al., *supra* note 6.

[12] *Id.*

proposed legislation became law.[13]

While the U.S. has been facing pressure to make beneficial ownership information available for decades, the "Panama Papers" scandal–which concerned leaked documents from the former Panamanian law firm Mossack Fonseca–forced the U.S. to act.[14] The first documents were leaked in April of 2016,[15] revealing that bad actors were utilizing offshore and U.S. "shell companies" for illicit purposes, such as purchasing expensive homes in South Florida.[16] While shell corporations are not per se illegal, "their anonymity and lack of transparency mean that they can be used for tax evasion, fraud, and evading sanctions."[17] Specifically, the ownership and financial history of shell companies are difficult to determine.[18] The "Panama Papers" scandal convinced Congress that existing AML legislation was insufficient to combat money laundering.[19] Thus, Congress enacted the CTA of 2021, which imposed "reporting obligations on reporting companies and their beneficial owners in addition to title companies and certain financial institutions."[20]

A. How the Corporate Transparency Act of 2019 Became the Current CTA

In May 2019, Representative Maloney introduced the Corporate Transparency Act of 2019 (the "2019 Transparency Proposal").[21] The 2019 Transparency Proposal is the basis for the current CTA, but it only passed after some revisions.[22] The 2019 Transparency Proposal was better received by Congress because it differed in several significant ways from the previously introduced federal legislation, especially regarding the collection of beneficial ownership information.[23] These differences include the creation of a federal database of beneficial ownership information, the regulation of applicants instead of formation agents, and the definitions of "reporting company" and "beneficial

[13] *Id.*

[14] Oppenheimer, *supra* note 2.

[15] Elizabeth Teague, *Panama Papers*, ENCYC. BRITANNICA (Oct. 9, 2019), https://www.britannica.com/topic/Panama-Papers.

[16] Oppenheimer, *supra* note 2.

[17] Jeff Blumenfeld, *Is It Still as East to Hide $1 Billion 5 Years After the Panama Papers?*, BLOOMBERG TAX (May 7, 2021), https://news.bloombergtax.com/daily-tax-report/is-it-still-as-easy-to-hide-1-billion-5-years-after-the-panama-papers.

[18] *Id.*

[19] Oppenheimer, *supra* note 2.

[20] *Id.*

[21] Downes et al., *supra note* 6.

[22] *See* H.R. 116-227, at 1-2, 18 (2019).

[23] Downes, et al., *supra* note 6.

owner."[24]

The first difference from previously introduced legislation was that the 2019 Transparency Act contemplated the creation of a federal database for beneficial ownership information, while previously proposed federal legislation placed the burden of collecting beneficial ownership information and making it available to parties on the states.[25] This was problematic because "many states indicated that their reporting systems were not designed to collect the beneficial ownership information contemplated and that they lacked enforcement resources to pursue delinquent and deficient reporting."[26]

Second, the 2019 Transparency Proposal regulated applicants instead of formation agents.[27] Previous legislation would have required formation agents (people who assisted in the formation process) to report their clients' beneficial ownership information.[28] In contrast, the 2019 Transparency Proposal allowed applicants to file an application to form a corporation or limited liability company ("LLC").[29] An applicant's only obligation under the 2019 Transparency Proposal was to file an exempt entity report on behalf of the reporting company.[30] Additionally, a reporting company was required to include information about its applicant in its report to Financial Crimes Enforcement Network ("FinCEN").[31] FinCEN is part of the U.S. Department of Treasury ("Treasury").[32]

Finally, the definitions of "reporting company" and "beneficial owner" evolved from formulations in previously proposed federal legislation.[33] The 2019 Transparency Proposal, like previously proposed legislation, required corporations and LLCs to report beneficial ownership information.[34] However, the 2019 Transparency Proposal also required non-U.S. entities that were eligible for registration or registered to do business as a corporation or LLC to report beneficial ownership information.[35] Additionally, the 2019 Transparency Proposal expanded the list of entities exempt from reporting requirements to include the following: (1) entities otherwise

[24] *Id.*
[25] *Id.*
[26] Downes et al., *supra* note 6.
[27] *Id.*
[28] *Id.*
[29] *Id.* quoting Corp. Transparency Act of 2019, H.R. 2513, 116th Cong. § 3(a)(1) (2019).
[30] Downes et al., *supra* note 6.
[31] *Id.*
[32] O'Rourke et al., *supra* note 1.
[33] Downes et al., *supra* note 6.
[34] *Id*.
[35] *Id.*

subject to a Federal regulatory regime; (2) any business that has more than 20 full-time employees in the U.S., files income tax returns demonstrating more than $5,000,000 in gross receipts or sales, and operates at a physical office within the U.S.; (3) any corporation or LLC formed and owned by an entity that is not subject to reporting requirements; and (4) other entities exempted by the Secretary of the Treasury and the Attorney General of the U.S.[36] The 2019 Transparency Proposal incorporated language from previously proposed legislation as well as the FinCEN's Customer Due Diligence Rule ("CDD Rule") requirements to define beneficial owner.[37]

The Corporate Transparency Act, passed in January of 2021, requires certain business entities to file their beneficial ownership information with FinCEN.[38] FinCEN's mission is to "safeguard the financial system from illicit use, combat money laundering and its related crimes including terrorism, and promote national security through the strategic use of financial authorities and the collection, analysis, and dissemination of financial intelligence."[39] The CTA has a similar purpose.[40] According to 31 U.S.C. § 5311(2), the purpose of the subchapter, which includes the CTA, is to "prevent the laundering of money and the financing of terrorism through the establishment by financial institutions of reasonably designed risk-based programs to combat money laundering and the financing of terrorism."[41] This provision within the declaration of purpose as well as other provisions,[42] indicate Congress is concerned about "the relative ease in which criminals can hide behind shell companies formed under laws of many [s]tates, including Florida and Delaware, which do not require disclosure of beneficial ownership."[43]

[36] Downes et al., *supra* note 6.
[37] *Id.*
[38] *Id.*
[39] *Mission*, FINCEN, https://www.fincen.gov/about/mission (last visited Oct. 14, 2021).
[40] 31 U.S.C. § 5311(2).
[41] *Id*.
[42] *See* § 5311(3)-(5).
[43] Oppenheimer, *supra* note 2.

B. Interplay Between Current Legislation

Since the passage of the CTA, financial institutions have been confused about how the CTA will impact prior legislation regarding beneficial ownership information.[44] On June 9, 2003, the Customer Identification Program ("CIP") went into effect.[45] The CIP creates "the minimum standards for financial institutions and their customers regarding the identity of the customer that shall apply in connection with the opening of an account at a financial institution."[46] The CIP was implemented through § 326 of the USA PATRIOT Act, which has several provisions "intended to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism."[47] The CIP has six general requirements for financial institutions:

> (1) A written program
> (2) Four pieces of identifying information - customer name, date of birth, address, and identification number
> (3) Identity verification procedures
> (4) Recordkeeping
> (5) Comparison with government lists
> (6) Customer notice.[48]

On May 11, 2016, FinCEN issued the Customer Due Diligence Rule, though FinCEN later made certain technical corrections in 2017.[49]

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[44] FinCEN Final Rule: Federal Register; Vol. 87, NO. 189, Sept. 30, 2022, Section III- Discussion of Final Rule, page 59515; *Fin. Crimes Enf't Network*, BENEFICIAL OWNERSHIP INFO. REPORTING REQUIREMENTS (Jan. 1, 2024), https://www.govinfo.gov/content/pkg/FR-2022-09-30/pdf/2022-21020.pdf.

[45] *Customer Identification Program*, FRAUDFIGHTER, https://www.fraudfighter.com/education/compliance/customer-identification-program (last visited Oct. 14, 2021).

[46] FED. DEPOSIT INS. CORP., *Customer Identification Programs for Banks, Savings Assoc., Credit Unions and Certain Non-Federally Regulated Banks* (2003), https://www.fdic.gov/resources/regulations/federal-register-publications/03joint326.html.

[47] *Id.*

[48] BOS. ALL. FOR ECON. INCLUSION, FIVE THINGS YOU SHOULD KNOW ABOUT . . . CUSTOMER IDENTIFICATION PROGRAMS (2012), https://www.fdic.gov/consumers/community/aei/regional/other-resources/baei-fact-sheet-cip.pdf.

[49] Stuart K. Fleischmann et al., *FinCEN's Customer Due Diligence Rule Becomes Effective; FinCEN & FINRA Guidance Provides Interpretive Color for Firms Working to Comply*, SHEARMAN & STERLING (May 21, 2018), https://www.shearman.com/perspectives/2018/05/fincens-customer-due-diligence-rule.

Under the CDD Rule, when a company opens an account with a bank, broker, or other financial institution, the financial institution is required to gather and verify identities of the actual individuals who own and control a company.[50] Specifically, the CDD Rule requires covered financial institutions to establish and maintain writing policies and procedures designed to:

> (1) identify and verify the identity of customers
> (2) identify and verify the identity of the beneficial owners of companies opening accounts
> (3) understand the nature and purpose of customer relationships to develop customer risk profiles
> (4) conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.[51]

Regarding beneficial ownership information, financial institutions must identify and verify the identity of any individual who owns 25 percent or more of a legal entity, in addition to the individual who controls the legal entity.[52] Critics claimed the CDD Rule was not effective enough at preventing shell company abuse.[53] With this existing legislation regarding beneficial ownership, financial institutions are asking, how will the CTA interplay with the CTA and the CIP?

Regarding the interplay between the CTA and CDD, as written, the CTA does not require FinCEN to repeal the CDD Rule, as evidenced by the multiple references to the CDD Rule throughout the CTA.[54] However, FinCEN will likely revise the CDD Rule to take into consideration the beneficial ownership information that will be supplied to FinCEN by reporting companies under the CTA.[55] Revising the CDD Rule will be a lengthy process because FinCEN will not be able to revise the CDD Rule until it is practical for financial institutions to rely on the online beneficial ownership registry, and bringing the beneficial

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[50] *Customer due diligence rule: the fin. indus. new role of law enf't*, THOMSON REUTERS, https://legal.thomsonreuters.com/en/insights/articles/customer-due-diligence-rule-the-financial-industrys-new-role-of-law-enforcement (last visited Oct. 14, 2021).

[51] *Info. on Complying with the Customer Due Diligence (CDD) Final Rule*, FINCEN, https://www.fincen.gov/resources/statutes-and-regulations/cdd-final-rule (last visited Oct. 14, 2021).

[52] *Id.*

[53] *Customer due diligence rule: the fin. indus. new role of law enf't*, *supra* note 51.

[54] 31 U.S.C. § 5336(b)(1)(F)(iv)(II), (c)(2)(B)(iii).

[55] Cosgrove, *supra* note 4.

ownership registry online will take at least two or three years.[56] Even after the registry is online, financial institutions may not be able to rely on the registry unless "verification through the registry is seamless and contemporaneous with account openings."[57] Additionally, financial institutions may seek more information from their customers than what is required by the CTA, so they can manage their risks relevant to the beneficial ownership of their customers.[58]

"FinCEN should implement the CTA in a manner that would enable the CDD rule and related know-your-customer requirements, like the [CIP], to be harmonized with the CTA. Aligning these expectations with the law will limit implementation and reporting complexities for covered legal entities."[59] Currently, there are many discrepancies between the requirements in the CTA and the other rules regarding beneficial ownership information.[60] Notably, there is a material discrepancy between the customer information required under the CIP and CDD as compared to the CTA.[61] Under the CIP and CDD, banks collect customer and beneficial owners' social security numbers, but this is not required identifying information under the CTA.[62] "Harmonizing CIP and CDD expectations with the statutory standard set forth in the CTA will create a clear, coherent framework for mitigating relevant illicit finance risks and prevent financial institutions and reporting companies from facing unnecessary and duplicative burdens that can distract them from detecting and preventing criminal activity."[63]

C. Invasion of Privacy and Burden on Small Businesses

Critics have argued that the CTA's reporting requirements regarding beneficial ownership information invade privacy and burden small businesses.[64] Regarding privacy, the passage of the CTA will prevent many individuals and organizations from anonymously conducting business through private entities, specifically corporations and limited

[56] O'Rourke et al., *supra* note 1.
[57] *Id.*
[58] *Id*.
[59] Peter D. Hardy & Shauna Pierson, *Implementing the Corp. Transparency Act: A Guest Blog*, BALLARD SPAR L.L.P. (July 19, 2021), https://www.moneylaunderingnews.com/2021/07/implementing-the-corporate-transparency-act-a-guest-blog/.
[60] *Id.*
[61] *Id.*
[62] *Id.*
[63] *Id.*
[64] Oppenheimer, *supra* note 2.

liability companies.[65] Before the CTA, in most states, parties did not have to disclose beneficial ownership information when they formed and used private entities to conduct business.[66] "For example, a party could purchase, finance, or sell real estate using an authorized agent, such as an attorney, to sign paperwork in the applicable entity's name, obscuring the identity of the ultimate beneficial owner."[67]

However, the CTA thoroughly addresses FinCEN's data protection.[68] First, the information must be stored in a private database that the public cannot access.[69] According to the CTA, FinCEN can only disclose beneficial ownership information to "a Federal agency engaged in national security, intelligence, or law enforcement activity, for use in furtherance of such activity" or "a State, local, or Tribal law enforcement agency, if a court of competent jurisdiction, including any officer of such a court, has authorized the law enforcement agency to seek the information in a criminal or civil investigation."[70] This information can also be released to a federal agency requesting on behalf of a foreign law enforcement agency under mutual legal assistance protocols, and a financial institution conducting due diligence under the Banking Secrecy Act or USA PATRIOT Act, with customer consent.[71] The CTA limits the use of beneficial ownership information to three purposes: an "authorized [law enforcement] investigation or national security or intelligence activity."[72] In addition to the information not being available to the general public, it cannot be queried under the Freedom of Information Act.[73]

Further, critics have argued that the CTA creates an administrative burden on small, legitimate companies that are obviously not the target group of the legislation.[74] Even the drafters of the CTA recognized the burden on these companies imposed by the CTA.[75] That is why the CTA directs the Secretary of the Treasury, to the "greatest extent practicable" to "minimize burdens on reporting companies associated

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[65] Neil Hood, *Corp. Transparency Act Impact on Real Est. Transactions*, FRIED, FRANK, HARRIS, SHRIVER & JACOBSON LLP (Mar. 8, 2021), https://www.friedfrank.com/siteFiles/Publications/FFTOCReCorporateTransparencyAct03092021.pdf.

[66] *Id.*

[67] *Id.*

[68] Lewis Zirogiannis, *What You Need to Know about the Corp. Transparency Act*, NAT'L L. REV. (Jan. 12, 2021).

[69] *Id.*

[70] 31 U.S.C. § 5336(c)(2)(B)(i)(I)-(II).

[71] Zirogiannis et al., *supra* note 70.

[72] § 5336(c)(2)(B)(ii)(II)(bb).

[73] Zirogiannis et al., *supra* note 70.

[74] *See* Downes et al., *supra* note 6.

[75] *Id.*

with the collection of the information…, in light of the private compliance costs placed on legitimate businesses, including by identifying any steps taken to mitigate the costs relating to compliance with the collection of information."[76]

In addition to compliance with the CTA being a burden on companies, noncompliance is a danger. The CTA has criminal and civil penalties associated with lack of compliance,[77] even though this is a new piece of beneficial ownership reporting legislation, which desperately needs clarification. This means some entities may be unsure of whether they need to report their beneficial ownership information under the CTA. There is a safe harbor in the CTA, which shields some individuals from criminal and civil penalties.[78] However, the safe harbor provision is slightly unclear, and this discrepancy will be addressed in more detail in Part (A)(4) of the analysis section.

While the CTA is not a perfectly crafted piece of legislation, drafters of the CTA have contemplated the public's concerns about privacy and the administrative burden on companies and even addressed these potential issues in the CTA itself.[79] Thus, the biggest concern for covered entities should be compliance with the CTA, which is difficult due to the ambiguity of key terms within the CTA.

III. ANALYSIS

A. Suggested Changes and Clarifications to the CTA

Treasury Regulations must clarify the CTA to alleviate the burden on companies trying to comply with the CTA requirements and prevent small, legitimate companies from facing criminal and civil penalties. As previously discussed, FinCEN needs to harmonize the CDD Rule with the CTA. FinCEN must align the CDD Rule with the CTA in two material areas.[80] First, the definition of "legal entity customer" in the CDD Rule should be aligned with the definition of "reporting company" in the CTA.[81] Second, the different definitions of "beneficial owner" in the CDD Rule and the CTA should be aligned.[82]

Further, harmonizing the CDD Rule and the CTA is not enough to effectively implement the CTA. The CTA also needs clear and easily applicable definitions because several terms within the CTA are

[76] 31 U.S.C. § 5336(b)(1)(F)(iii).
[77] *See* § 5336(h)(3).
[78] *See* § 5336(h)(3)(C).
[79] *See* §§ 5336(b)(1)(F)(iii), 5336(i)(1).
[80] Hardy & Pierson, *supra* note 60.
[81] *Id.*
[82] *Id.*

ambiguous. These terms should be clarified in regulations prescribed by the Treasury.[83] While the CTA does not contain a mechanism for the Treasury to modify the terms of the statute, the Treasury does have the authority to interpret the meanings of the constituent parts of the statute through regulations.[84] The Treasury's authority is evidenced by the fact that various provisions within the CTA direct the Treasury to establish regulations consistent with certain goals.[85]

i. Reporting Company

First, what constitutes a "reporting company" within the CTA needs to be clarified. The CTA defines reporting company as "a corporation, limited liability company, or other similar entity that is created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe…."[86] Under this definition, "reporting company" clearly includes corporations and limited liability companies.[87] In contrast, the term does not include general partnerships, which are created by agreements between partners,[88] nor donative trusts, which are "traditional estate planning and property-owning vehicles and are not required to register with any state or territory."[89] However, it is unclear whether other entities, such as limited partnerships, business trusts, testamentary trusts, and non-U.S. entities similar to corporations and limited liability companies, are included in the definition of reporting company.[90]

The meaning of "similar entity" within the definition of "reporting company" is ambiguous. Similar entity could mean an entity with characteristics of a corporation or limited liability company or just an entity that is created by filing with the Secretary of State or similar office.[91] FinCEN's CDD requirements and the related adopting release add clarity to the meaning of covered entities.[92]

Under the CDD rule, a "legal entity customer," which is the equivalent of a "reporting company" under the CTA, is "a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office; a general

[83] Downes et al., *supra* note 6.
[84] *Id.*
[85] *See* 31 U.S.C. § 5336(c)(3).
[86] 31 U.S.C. § 5336(a)(11)(A)(i).
[87] *Id.*
[88] Downes et al., *supra* note 6.
[89] *Id.*
[90] *Id.*
[91] *Id.*
[92] *Id.*

partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account."[93] The adopting release clarifies that "legal entity customer" includes business trusts that are created by a filing with a state office and statutory trusts created by a filing with a Secretary of State or similar office but would not include other trusts.[94] The American Bar Association ("ABA") emphasizes that the definition of "reporting company" must be straightforward and clear because many entities will be reporting for the first time.[95]

Another area of ambiguity is the CTA's exemption of certain entities from the definition of a "reporting company." The CTA states that "any corporation, limited liability company, or other similar entity of which ownership interests are owned or controlled, directly or indirectly, by one or more entities" is exempt from the definition of a reporting company.[96] The rationale is that if the parent entity is exempt from reporting beneficial ownership information, then the subsidiary entity should not have to report the beneficial ownership information of its parent entity.[97] On its face, the exemption seems to refer to subsidiaries of certain exempt entities.[98] However, the reference to "owned or control" may suggest that "the subject entity must be wholly-owned or wholly-controlled by one or more exempt entities."[99] Alternatively, the exemption could mean "control, which is achieved at a level below that necessary to treat the subject entity as a subsidiary, is sufficient to satisfy that requirement that the ownership interests of the subject entity are controlled by an exempt entity."[100] Thus, the Treasury should clarify that this exemption refers to the subsidiaries of certain exempt entities.

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[93] *See* Fin. Crimes Enf't Network, "Customer Due Diligence Requirements for Financial Inst.," 81 Fed. Reg. at 29412 (effective July 11, 2016); Downes et al., *supra* note 6.

[94] Downes et al., *supra* note 6.

[95] *See* Shauna Pierson, *Am. Bankers Association Weighs in on the Corp. Transparency Act*, BALLARD SPAHR L.L.P. (May 13, 2021), https://www.moneylaunderingnews.com/2021/05/american-bankers-association-weighs-in-on-the-corporate-transparency-act/.

[96] 31 U.S.C. § 5336(b)(2)(D) (2022).

[97] Downes et al., *supra* note 6.

[98] *Id.*

[99] *Id.*

[100] *Id.*

2. Beneficial Owner

The CTA also has an ambiguous definition of "beneficial owner." Under the CTA, a beneficial owner is "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise— (i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity."[101] This definition raises two major issues: (1) what does "substantial control" mean? and (2) what constitutes 25% ownership interest of the entity?

The term "substantial control" within the definition of "beneficial owner" is not further defined in the CTA and is an inherently ambiguous expression because this term could have a variety of different meanings.[102] For example, Robert Downes and his fellow authors in their article, *The Corporate Transparency Act – Preparing for the Federal Database of Beneficial Ownership Information*, asked the following questions about the term "substantial control:"

> [S]hould substantial control focus on day-to-day decision-making, strategic oversight or major decision consent rights (or vetoes)? Similarly, could a third-party manager, a lender or an important customer be considered to exercise substantial control through contractual rights or other arrangements or relationships? Can more than one person exercise substantial control? Could officers of an entity who are otherwise exempt but who own more than 25% of the ownership interests of a reporting company be seen to exercise substantial control?[103]

With all these unanswered questions, this term needs to be clarified by Treasury Regulations. The ABA has suggested that "substantial control" be defined as "the power to vote, direct votes, appoint board members, make decisions involving the share or merger of the company, or direct the control or disposition of the assets of the company."[104] The Treasury should also make it clear in its regulations that only one person can exercise substantial control so that entities can determine what information to collect and report.[105]

Further, the Treasury should clarify what 25% of the ownership

[101] 31 U.S.C. § 5336(a)(3)(A)(i)-(ii).
[102] *See generally id.*
[103] Downes et al., *supra* note 6.
[104] Pierson, *supra* note 96.
[105] Downes et al., *supra* note 6.

interest of the entity means. First, it is unclear whether this 25% calculation includes both direct and indirect ownership.[106] Second, this 25% calculation will be difficult for entities to comply with, depending on their structure. For example, applying this clause to a corporation with one class of ownership interest will be relatively simple.[107] In contrast, applying that clause to an LLC with multiple classes of interests, consent or veto rights, and negotiated distribution priorities will be very complex.[108] "Reporting companies will have to determine how to deal with and promote interests, payment waterfalls, contingent payment rights, and agreements between or among equity holders."[109] When prescribing regulations under the CTA, the Treasury should explain the calculation of beneficial ownership as well as provide examples, as requested by the ABA.[110]

Additionally, Treasury regulations ought to address what constitutes "contract, arrangement, understanding, relationship, or otherwise" that would cause a person to be deemed to own or control a 25% ownership interest. Robert Downes and his fellow authors in their article, *The Corporate Transparency Act – Preparing for the Federal Database of Beneficial Ownership Information*, asked the question: "Will the principles applied under the federal securities laws be applicable?"[111]

3. Applicant

Perhaps the most important clarification that needs to be made is regarding the term "applicant." Under the CTA, an applicant is defined as "any individual who—

> (A) files an application to form a corporation, limited liability company, or other similar entity under the laws of a State or Indian Tribe; or
> (B) registers or files an application to register a corporation, limited liability company, or other similar entity formed under the laws of a foreign country to do business in the United States by filing a document with the Secretary of State or similar office under the laws of a State or Indian Tribe.[112]

[106] Pierson, *supra* note 96.
[107] Downes et al., *supra* note 6.
[108] *Id.*
[109] *Id.*
[110] Pierson, *supra* note 96.
[111] Downes et al., *supra* note 6 at 32.
[112] 31 U.S.C. § 5336(a)(2)(A)-(B).

The term "applicant" is used twice in the CTA: (1) information for each applicant must be reported to FinCEN,[113] and (2) the applicant has a reporting obligation.[114] Providing clear guidance on the term "applicant" is critical, considering the compliance burdens associated with reporting beneficial ownership and the penalties for lack of compliance.[115] One of the problems with the current definition is that many individuals can be involved in the filing of an application to form an entity or registering an entity.[116] "For example, a lawyer or law firm employee could prepare the documentation for electronic submission or submission via filing agent, which could file the documentation personally or via messenger; and one or more of those parties may be the incorporator or organizer."[117] In this example, who would be an applicant?

Robert Downes and his fellow authors asked that the following questions be addressed by the Treasury regulations, regarding a definition of an "applicant":

> - Should lawyers or law firm personnel be considered applicants when acting on behalf of a client? For example, is a lawyer or law firm employee acting on behalf of a client an applicant if the lawyer or employee: (i) acts as an incorporator or organizer; (ii) files or electronically transmits formation documents; or (iii) coordinates with a service company to file or transmit documents with a secretary of state or similar office?
> - Similarly, are filing agents or employees of registered agents, service companies or messenger services considered applicants if they file, deliver[,] or electronically transmit formation documents on behalf of others?[118]

When prescribing regulations under the CTA, the Treasury should clarify that the applicant is "the person on whose behalf the entity is being formed and not the individual or entity that effects the drafting of the organizational document and its submission to the secretary of state for filing."[119] Additionally, the requirement to file the applicant's

[113] § 5336(b)(2)(A).
[114] 31 U.S.C. § 5336.
[115] Downes et al., *supra* note 6 at 32.
[116] *Id.*
[117] *Id.*
[118] *Id.* at 32, 33.
[119] *Id.*

information should not be applied retroactively, but should only apply to entities organized after the effective date of the legislation.[120] It would be unreasonable to require reporting companies who existed prior to the effective date of the CTA to report applicant information when the reporting companies "had no awareness of the need to capture information on incorporators and organizers[,] and those incorporators and organizers had no awareness of the future filing obligation with respect to personal information."[121]

4. Safe Harbor Provision

Additionally, the ambiguity within the safe harbor provision of the CTA ought to be remedied. Currently, the CTA shields an individual from civil and criminal penalties if the individual submits a report containing the correct information no later than 90 days after the submission of the original report.[122] However, this is only if the individual does not act for the purpose of evading the reporting requirements or does not possess actual knowledge that any information contained in the report is inaccurate.[123] The safe harbor provision is an extremely important piece of the CTA, especially since it is a new piece of beneficial ownership reporting legislation. Thus, the Treasury should clarify how "evasion of the reporting requirements" and "actual knowledge of inaccuracies" will be interpreted.[124]

5. Verification of Beneficial Ownership Information

Additionally, to ensure that beneficial ownership information is reliable for both law enforcement and financial institutions, FinCEN must verify the information in the directory.[125] Other countries have experienced issues regarding the reliability of beneficial ownership registries, so it is essential that this is "thoughtfully addressed at the outset to ensure that the data housed in the directory is highly useful to law enforcement and other government entities."[126]

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[120] *Id.*
[121] *Id.*
[122] *See* 31 U.S.C. § 5336(h)(3)(C)(i)(I) (2021).
[123] *See* § 5336(h)(3)(C)(i)(II) (2021).
[124] Downes et al., *supra* note 6.
[125] Hardy & Pierson, *supra* note 60.
[126] *Id.*

B. Why Clarify?

The CTA's requirements need to be clearer and more precise because of the "criminal and civil penalties associated with lack of compliance and the challenges and burdens facing business entities in complying with the [CTA]."[127] Under the CTA, it is unlawful for any person to "willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN…; or willfully fail to report complete or updated beneficial ownership information to FinCEN…."[128] The penalty for these reporting violations is a civil penalty of up to $500 for each day the violation is not remedied, and the individual may be fined up to $10,000 and/or imprisoned for up to two years.[129] The CTA prohibits knowingly disclosing or using beneficial ownership information.[130] Unauthorized disclosure or use violations are "punishable by civil penalties of $500 for each day the violation continues and criminal penalties of imprisonment of up to 10 years and fines of up to $500,000."[131]

Additionally, providing clarity and precision will have the following effects: (1) reduce the burden on reporting companies and applicants and (2) increase compliance and the accuracy of the information reported.[132] Thus, the above terms in the CTA must be clearly defined to alleviate the burden on companies trying to comply with the CTA requirements as well as to prevent small, legitimate companies from being subject to criminal and civil penalties.

IV. CONCLUSION

The CTA is obviously a step in the right direction in terms of combatting the variety of bad actors who use anonymous shell companies to hide and move funds associated with corrupt and illicit activity. However, FinCEN needs to harmonize existing rules regarding the reporting of beneficial ownership information, such as the CDD Rule and the CIP, with the CTA. "Harmonizing CIP and CDD expectations with the statutory standard set forth in the CTA will create a clear, coherent framework for mitigating relevant illicit finance risks and prevent financial institutions and reporting companies from facing unnecessary and duplicative burdens that can distract them from

[127] Downes et al., *supra* note 6.
[128] 31 U.S.C. § 5336(h)(1) (2021).
[129] § 5336(h)(3)(A)(i)-(ii).
[130] *See* § 5336(h)(2)(A)-(B).
[131] Downes et al., *supra note* 6.
[132] *Id.*

detecting and preventing criminal activity."[133]

However, harmonizing the CTA with existing beneficial ownership information reporting rules is not enough to give clarity to covered entities. There are various terms used throughout the CTA that must be clarified by Treasury regulations. The need for clarifying these terms is three-fold: (1) criminal and civil penalties associated with lack of compliance, (2) reducing the burden on covered entities, and (3) increasing compliance and the accuracy of information reported.

As noted previously, critics have argued that the CTA is an invasion of privacy and administrative burden for small, legitimate companies. However, the CTA confronts these concerns by the following action: (1) thoroughly addressing FinCEN's data protection; (2) directing the Treasury to minimize the burden on reporting companies, regarding collection of beneficial ownership information; and (3) identifying steps to mitigate costs related to compliance.

"Time will tell if the CTA and its implementing regulations will be an effective tool in the fight against money laundering or an invasion of privacy and administrative burden on small, legitimate companies as argued by critics."[134] However, Treasury regulations clarifying terms within the CTA will increase the likelihood that the CTA will be effective at combatting money laundering.

[133] Hardy & Pierson, *supra* note 60.
[134] Oppenheimer, *supra* note 2.