Transparency Enters A New Stage – Defense Act Anti-Laundering Provisions Now in Place

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President Trump's recent veto and the subsequent override aside, the National Defense Authorization Act (H.R. 6395) (NDAA), while designed to affect our national defense, will also have significant implications for businesses using state incorporation laws to create anonymous entities. Further, this groundbreaking legislation will have implications for many businesses creating new entities regardless of their intended purpose.

Included in one of the NDAA's eight parts is a section designed to implement anti-money laundering laws. Specifically, and relevant to many businesses, the Corporate Transparency Act (CTA) requires all "reporting companies," which include "corporations, limited liability companies, or other similar entities" that are created by the filing of a document with the secretary of state or an equivalent office under the law of the state, or formed under foreign law and registered to do business in any given state, to disclose information about their true owners to the Treasury Department. This information would be reported to the Treasury's Financial Crimes Enforcement Network (FinCEN) and stored in a database for, as legislated, its use only. Query whether, *inter alia*, a general partnership, limited partnership, limited liability partnership, or a business trust fall within this legislation.

The CTA exempts certain entities such as banks that are highly regulated by the federal government, dormant companies, companies that have more than 20 employees on a full-time basis, filed a federal tax return in the previous year reporting gross receipts greater than $5 million, have a physical presence in the U.S., public companies, or any entity owned by an exempt entity.[1] Further, it exempts from disclosure "beneficial owners" that are minors (however, parental information is required), an agent acting on behalf of another individual, individuals controlling an entity entirely because of their employment, and individuals whose sole interest in an entity is through a right of inheritance.

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However, the CTA very well could cause significant issues and concerns not only for business that use entities to maintain anonymity, but for any creation of a new legal entity. The CTA requires all non-exempt new entities to report not only their owner's names, but also addresses, dates of birth, and government-issued ID numbers. Additionally, the "applicant," which is typically an attorney, accountant, or other individual completing the application to form a reporting company, must provide personal information. For existing entities, the CTA allows for a two-year transition window before these entities are required to disclose the above information.[2] However, if at any point during those two years the ownership of an entity changes, under the CTA, it must immediately disclose the identity of its new owners to FinCEN.[3]

Additionally, the CTA sets forth civil and criminal penalties for willfully providing false information or failing to report or update information. These penalties could apply to a variety of individuals. Not only could beneficial owners be held civilly or criminally liable, but also any agent, such as a lawyer, accountant, real estate broker, or other corporate formation officer that puts her/his name on the reporting documents, can be liable for its contents. Thus, those affected by this legislation are far and wide, and the penalties of failure to correctly comply are steep.

The legislation is purportedly aimed to force corporate transparency and discourage companies from using state incorporation laws to hide funds and activities. To state the obvious, many businesses create new entities under state law for specific purposes that it wishes to keep separate from an existing corporation, as most states do not require information about beneficial owners of an entity. However, this process can be abused and used as a way for businesses to avoid tax on certain funds and/or assets. Thus, the CTA is attempting to cut down on companies using state incorporation laws for anonymity and exploitation of tax havens. Why seek to address this in the NDAA? Specifically, the legislation provides that its connection to national defense would be aiding in "efforts to combat terror financing, corruption, money laundering, drug and human trafficking, and tax evasion."

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Additionally, the NDAA provides for a whistleblower rewards program as another part of its anti-money laundering initiatives. The program provides compensation for individuals that assist the Treasury Department or Department of Justice to reveal certain money laundering cases. The program is said to mimic a similar initiative undertaken by the Securities and Exchange Commission (SEC) in 2012 that has, since its inception, rewarded over 100 whistleblowers and provided billions of dollars in penalties for various infractions. Along with compensation, the NDAA provides full whistleblower anonymity and legal protections, further encouraging individuals that may fear personal repercussions to come forward.

It is anticipated that the monetary compensation for whistleblowers under the NDAA may be less than the reward provided by the SEC program. Instead of guaranteeing the whistleblower 10 to 30 percent of any fine ultimately recovered, H.R. 6395 alternatively leaves the amount of the reward to the discretion of the Treasury. Some may argue this could damage the program's effectiveness, as it is believed that whistleblowers require more guarantee for a significant reward in order to come forward. However, the Treasury Department and Department of Justice greatly depend on testimony from whistleblowers to detect and punish money laundering, and thus the program has received continuing support.

We will continue to monitor and report on what various facets of the NDAA mean for businesses and their corporate and tax policies. For more information, visit Frost Brown Todd's Tax Law Defined Blog. You can also subscribe to get updates sent directly to your inbox.

Frost Brown Todd's Corporate Transparency Act Team is staying up to date on the important rule changes that will likely have significant impacts on your business operations. Click below to read the latest information about the Corporate Transparency Act.

- ***Corporate Transparency Act: Who Can Exert Substantial Influence on My Company? Part I***
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[1] Developing FinCEN guidance clarifies that the "wholly owned" exemption may not be available depending upon the exemption applicable to the CTA-exempt parent. For example, money transmitters and money services businesses typically cannot shield subsidiaries from the CTA's reporting regime.

[2] Regulations subsequently changed this requirement to provide that companies existing before January 1, 2024 must file their initial beneficial ownership reports no later than January 1, 2025.

[3] Regulations subsequently adopted by FinCEN provide that reporting companies must file an update to report any changes in their beneficial ownership within 30 days after the change occurs.

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