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New law will require disclosure of entity owners

TAXING MATTERS
Josh Gewolb

The United States is one of the easiest places in the world to set up a corporation or LLC without revealing any personal identifying information of those in charge.

A new federal law enacted at the end of last year will change this by requiring disclosure of certain ownership information to the federal government.

The law will take effect in two years, once guidance has been issued. However, it will apply to existing entities, and accordingly it is not too early to take its effects into account.

Though filing requirements vary from state to state, there are many places where the names of the incorporators or organizers are not a part of the public record. The best example is Delaware, the business haven of the country.

Forming an LLC in Delaware can be done entirely through a third party; a registered agent simply signs and files the formation documents on your behalf. Only the company name and the registered agent's name and address will appear on the Certificate of Formation. Although the registered agent is required to keep a record of the contact person for the LLC including the contact person's address, this information is kept not filed with the government.

The process for forming a corporation is similar, though the Delaware Franchise Tax requires an annual filing of a list of the names and addresses of all corporate directors and officers.

This list is technically available to the public, though a specific request must be made to the Delaware Division of Corporations to produce it, and there is a fee associated with production. Further, those who manage the company may not always be the same as the owners.

Owners of LLCs and corporations that are set up in this way can operate with near-perfect anonymity.

This anonymity is convenient and has become an expected part of American business. However, it does have a dark side in that it can be allow entities to be a vehicle for conducting illegal activities such as money laundering and tax fraud.

With no way to trace who's responsible for the company's activities behind the scenes, these companies present a virtual dead-end for investigators.

A common use for these companies is to funnel ill-gotten gains through the high-end real estate market. A 2015 report by the New York Times dug into more than 200 shell companies, trying to confirm the true owners of the condominiums in New York City's Time Warner Center. The investigation revealed at least 16 foreign owners who had been the subject of government inquiries across the world for illegal activities ranging from environmental violations to financial fraud.

Similarly, in 2016, the nonprofit organization Global Witness released hidden camera footage of a man meeting with over a dozen firms in New York City to discuss facilitating multi-million dollar plans while maintaining the buyer's anonymity. The man hinted that money came from illegal government bribes in Africa. All but one of the firms offered anonymous LLCs as a way to make the purchases without revealing the purchaser's identity.

After years of calls for reform by international organizations and U.S. law enforcement agencies alike, Congress has finally taken a step to limit the ability to set up LLCs and corporations anonymously.

The National Defense Authorization Act of 2021, passed at the beginning of January over President Trump's veto, includes the Corporate Transparency Act, which aims to curb these activities by establishing reporting requirements for the owners of most corporations and LLCs.

Under the terms of the Act, corporations and LLCs will have to file a list of the entity's beneficial owners with the Treasury Department.

Beneficial owners are defined as individuals that exercise substantial control over the corporation or LLC, or that have an ownership interest of 25% or more.

The list will need to contain the individual's full legal name, date of birth, current residential or business address and a unique identifying number from an acceptable identification document or from the Financial Crimes Enforcement Network (FinCEN).

An acceptable identification document is a current U.S. passport, driver's license or other government identification document. The information will be stored by the Treasury Department in a centralized, non-public database that law enforcement agencies can use in investigations. The database will not be subject to public records laws.

Existing corporations and LLCs will have two years from the effective date of the Act to register; corporations and LLCs formed after the effective date will have to register at the time of formation. If there is a change in beneficial ownership, the company shall have one year to update the filing information.

The Act lists numerous types of companies that are exempt from the reporting requirements. These include banks, credit unions, insurance companies, exempt organizations and companies that employ more than 20 full time employees in the U.S. whose most recent tax return shows gross receipts in excess of $5,000,000.

If any entity shall have direct or indirect ownership of an entity that is subject to the reporting requirement, however, the owning entity will have to register as an owner of the reporting company. In that instance, only the name of the owner entity will be required.

The requirements under the Act are at least a step towards eliminating the use of anonymous shell companies in the U.S. Though it will be some time before the regulations are finalized, current and prospective business owners should prepare for the changes to come.

Josh Gewolb is a tax partner at Harter Secrest & Emery LLP. Autumn J. Young assisted in the preparation of this article.