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Selected US Tax Developments

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DISCLOSURE REQUIREMENTS AIMED AT SHELL COMPANIES

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The US Corporate Transparency Act ("the CTA") will affect Canadian individuals who control or invest in US companies that are reporting companies under the CTA, including with respect to investments made, or control exercised, indirectly or through blocker corporations. Such individuals may be required to provide their personal information to the US company, and their information would be reported to the US government under the CTA. Moreover, US blocker corporations are likely to be reporting companies under the CTA even if the US companies in which they invest are not reporting companies. The CTA will also require many Canadian companies that register to do business in a US state to report the personal information of their individual beneficial owners and individual control persons. Companies formed or registered prior to 2024 will be required to report by January 1, 2025, and companies formed or registered after 2023 will be required to report within 30 days of formation or registration.

KEYWORDS: ACCOUNTABILITY ■ BUSINESS OWNERSHIP ■ FATCA ■ MONEY LAUNDERING ■ TRANSPARENCY ■ UNITED STATES

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INTRODUCTION

The US Corporate Transparency Act ("the CTA")[1] creates remarkably broad reporting requirements with respect to the companies and individuals subject to the legislation,

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1 Pub. L. no. 116-283, enacted on January 1, 2021.

which include reporting of personally identifying information about individuals who control, own a large position in, or form or supervise the formation of a reporting company. With few exceptions, the requirements will apply to all US corporations, limited liability companies, limited partnerships, and similar entities that are formed by filing a document with any US secretary of state, or that are formed under non-US law and have registered to do business in any US state by filing a document with a secretary of state. Notable exceptions include tax-exempt organizations and their subsidiaries, large operating companies, and certain pooled investment vehicles. Accordingly, pension funds that are tax-exempt under section 501(c) of the Internal Revenue Code[2] and their subsidiaries are not expected to be subject to the CTA.

Penalties for non-compliance can rise to $10,000 and could include criminal charges. Unless the scope of these rules is further narrowed, the rules will increase the cost of creating and maintaining US companies or non-US companies registered to do business in the United States.

The CTA was introduced as a reporting regime separate from the common reporting standard (CRS)[3] and the Foreign Account Tax Compliance Act (FATCA),[4] and with different goals: protecting US national security and economic prosperity by assisting law enforcement in detecting, preventing, and punishing terrorism, money laundering, and other misconduct involving US companies or non-US companies doing business in the United States. These goals overlap with those of the CRS and FATCA, which are aimed at fighting tax evasion and promoting voluntary compliance with tax laws, but the CTA has more of the flavour of an anti-money-laundering regime because the personal information provided under the CTA must include photographic identification (such as a passport).

The US Financial Crimes Enforcement Network (FinCEN) recently released final regulations implementing the beneficial ownership information reporting requirements under the CTA.[5] These are the first of three sets of regulations required under the CTA; the other two will cover access to and disclosure of beneficial ownership information, and revisions to regulations concerning customer due diligence requirements for financial institutions.

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2 Internal Revenue Code of 1986, as amended (herein referred to as "the Code").

3 The CRS was developed by the Organisation for Economic Co-operation and Development, and approved on July 15, 2014. Organisation for Economic Co-operation and Development, Automatic Exchange Portal, "What Is the CRS?" (www.oecd.org/tax/automatic-exchange/common-reporting-standard).

4 Pub. L. no. 111-147, enacted on March 18, 2010 as part of the Hiring Incentives To Restore Employment Act.

5 US Department of the Treasury, Financial Crimes Enforcement Network, "FinCEN Issues Final Rule for Beneficial Ownership Reporting To Support Law Enforcement Efforts, Counter Illicit Finance, and Increase Transparency," September 29, 2022 (www.fincen.gov/news/news-releases/fincen-issues-final-rule-beneficial-ownership-reporting-support-law-enforcement).

This article describes the CTA and the FinCEN regulations (hereinafter, "the regulations") generally, but is not intended to be a detailed guide. Instead, the article compares the new rules with existing reporting obligations under the CRS and FATCA.

DISCUSSION

The CTA creates a framework that requires every "reporting company" to report information about its individual "beneficial owners" and "company applicants." Each of these terms is explained below. As a practical matter, it is likely that companies would have access to corporate service companies and law firms to prepare any required filings, but there may also be self-service and online filing options for CTA reporting in connection with forming or registering new companies or maintaining CTA compliance for existing entities.

As indicated above, the definition of a reporting company initially includes any corporation, limited liability company, limited partnership, or similar entity that is formed by filing a document with any US secretary of state, or that is formed under non-US law and has registered to do business in any US state by filing a document with a secretary of state. Importantly, many state-law general partnerships and trusts are not required to file a document with a secretary of state as a condition of formation, and many non-US companies are able to do business in the United States without registering with any secretary of state, so these entities may not come within the initial definition. The exclusions in the regulations are generally intended to limit the scope of the rules to small companies that are lightly regulated and not otherwise subject to beneficial ownership reporting requirements. For example, companies that are tax-exempt under section 501(c) of the Code and their wholly owned or controlled subsidiaries,[6] Securities and Exchange Commission registered companies, and investment companies are generally excluded, as are large companies that (1) have more than 20 full-time US employees, (2) have a physical operating presence in the United States, and (3) file US tax returns demonstrating more than $5 million in US-source gross receipts or sales.[7] Another notable exclusion applies to pooled investment vehicles, which include investment companies under the US Investment Company Act[8] (or certain companies that are not investment companies solely because of exceptions to the definition thereof related to smaller, private funds) that are operated or advised by specified entities (which are also excluded from being reporting companies). Public or private funds may be able to benefit from this latter exclusion.

6 Entities that operate exclusively to assist tax-exempt entities are also excluded if they are US persons, are owned by US persons, and derive at least a majority of their funding or revenue from US persons.

7 Non-US companies should note that some of the exclusions may not be available to them, with the possible result that some large, highly regulated non-US companies registered to do business in the United States may be required to report under the CTA.

8 Investment Company Act of 1940, as amended.

- Compare the CRS and FATCA, which generally require reporting by financial institutions, including many funds or other investment vehicles, but generally do not require reporting by government entities and pension funds.
- FATCA also requires certain passive non-financial entities to disclose their 10 percent owners to counterparties.
- FATCA does not apply to US companies.

A reporting company must report information about itself as well as personally identifying information about each of its beneficial owners and company applicants, including name, date of birth, address, and an image of an identification document with a unique identifying number. A non-US individual who does not have a US driver's licence or other identifying document issued by a US state will be required to submit an image of the individual's passport.

- Compare the CRS and FATCA, under which reporting with respect to account-holders generally includes only personally identifying information and financial information such as the account number, balance, income earned, and, under FATCA, withdrawals.

Beneficial owners include each individual who, directly or indirectly, either exercises "substantial control" over the reporting company or owns or controls at least 25 percent of the ownership interests in the reporting company. The definition is broad and encompasses many forms of control and ownership, both direct and indirect, and provides only limited exceptions. Exercise of substantial control includes acting as a senior officer, having authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body), having authority or substantial influence to direct or determine important decisions made by the reporting company, or any other form of substantial control over the reporting company. Ownership interests generally include all forms of equity ownership and also include options, convertible instruments, or other instruments, contracts, arrangements, understandings, relationships, or mechanisms used to establish ownership.

Company applicants include the individual who directly files the document that creates the reporting company or, for a non-US entity, the individual who directly files the document that first registers the reporting company, and also include the individual who is primarily responsible for directing or controlling the filing if more than one individual is involved in the filing of the document.[9]

The deadline for reporting will be January 1, 2025 for US companies formed, and non-US companies that were reporting companies, before January 1, 2024, and 30 days after formation (of a US company) or registration (of a non-US company) for all other reporting companies. After a company files its initial report, it will not

9 The preamble to the regulations provides an example in which both a paralegal who directly files incorporation documents and the supervising attorney would be company applicants.

be required to make other filings unless and until there is a change with respect to required information previously submitted concerning the company or its beneficial owners, including any change with respect to who is a beneficial owner or information reported for any particular beneficial owner.

- Compare the CRS and FATCA, which generally require annual (or more frequent) reporting.

Civil and criminal penalties for wilful failure to properly report or for knowingly providing inaccurate information may be imposed on the reporting company or any person and include a fine of up to $500 per day while the violation continues, plus a possible criminal fine of up to $10,000 and prison time.

- Compare the CRS, which also imposes financial penalties, and FATCA, which applies a 30 percent withholding tax penalty on certain US-source payments made to a non-compliant financial institution.

Information reported under the CTA will be retained by the US government for at least five years after the dissolution of a reporting company and can be shared (without the consent of the reporting company) with US federal agencies, US state agencies upon court order, and federal agencies on behalf of non-US law enforcement agencies under an international treaty or other agreement, but, in each case, only for law enforcement, national security, or intelligence purposes.

- Compare the CRS and FATCA, which are directed at preventing tax evasion and generally provide for automatic sharing of information with the country of residence of the individuals whose information is reported.

CONCLUSION

With the addition of the CTA, there will be three regimes that require reporting of information about individuals to governments, casting even wider nets to catch tax evasion and other criminal activity. More than ever, investors will need to understand whether a potential investment could require them to provide information that would be reported to the US government, and companies will need to ensure that they know who their owners are at all times to remain in compliance.