U.S. BENEFICIAL OWNERSHIP LAW: STRONG IMPLEMENTATION IS CRITICAL

SUMMARY

Negotiations over the Corporate Transparency Act (CTA) often centered on the logistics of how data would be collected, and who would have access to it. Yet perhaps even more important to police and prosecutors, national security personnel, and others who will use the directory is the quality of the information collected. Fortunately, the CTA includes a comprehensive and effective definition of beneficial owner that will help ensure high-quality data in the U.S. directory. The rules implementing this definition should reflect the clear intent and plain language of the new law.

THE DEFINITION OF BENEFICIAL OWNERSHIP IS AMONG THE MOST CRITICAL ASPECTS OF THE NEW LAW.

> **“The term beneficial owner means, with respect to an entity, an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, exercises substantial control over the entity; or owns or controls not less than 25 percent of the ownership interests of the entity…”**

The definition specifically separates the ‘substantial control’ provision from the ‘ownership’ provision in recognition of alternative arrangements and how ownership stakes can be manipulated or masked.

“OWNERSHIP,” IN LEGAL PARLANCE, DOES NOT MEAN WHAT MOST PEOPLE THINK.

To the average person, the owner of a company is a straightforward matter. In fact, approximately **80% of all U.S. companies** are sole proprietorships. For the plumbers, tax preparers and others who set up these companies, there is, generally, one person who is the owner, boss, and sole employee. But companies can divide up ownership shares of a company in many ways, including ways that mask the person who controls how funds are allocated and who benefits from the proceeds. A company can easily, for example, create a class of nonvoting shares specifically to decouple equity ownership from company control.

Including the **“substantial control”** provision makes the U.S. law more comprehensive and effective than some other similar laws. It requires companies to list every person who exercises substantial control over the company *beyond any written ownership structure and whether or not the person owns any stock.* In addition, the law states explicitly that a company can’t name an agent, nominee, or other stand-in as a beneficial owner. That means a company can’t name a lawyer, employee, or corporate formation agent unless that person also has ultimate control over the company.

THE LAW DOESN'T RELY SIMPLY ON A 25% OWNERSHIP THRESHOLD.

One provision in the law uses a minimum 25% ownership stake to name those who hold a company's ownership interests. But imagine a company created and controlled by a corrupt official with a brother, spouse, and two children. If each has an equal 'ownership' stake of 20%, then no one would have to be reported as owning the company. The law doesn't allow such a simple evasion. That's why it also requires naming those who exercise substantial company control.

THE NEW LAW CLOSES LOOPHOLES IN THE U.S. CUSTOMER DUE DILIGENCE (CDD) RULE.

Currently, the U.S. CDD rule defines "beneficial owner" as a person who owns 25% or more of the shares of a company. If no one meets that threshold, the CDD rule allows the company to name an officer or manager instead. But an officer or manager isn't necessarily a company owner. That's why the new law closes the CDD loopholes and requires disclosure of persons who either own or control the company. The law compels disclosure of the people with ultimate control, not an employee who can be fired by the true owners.

THE NEW STRONG U.S. DEFINITION MEETS INTERNATIONAL STANDARDS.

The Financial Action Task Force — the multilateral body that sets international anti-money laundering standards — defines beneficial owners by looking at both ownership and control.

So do the UK and EU. They require companies to consider, not just the ownership of shares, but also who has power to vote, direct votes, replace board members, and direct the selling of securities – all indicators of company control. Some countries also look at who receives economic benefits from the company such as dividends. If a company claims no one meets either the ownership threshold or exercises those types of control over its operations, the UK and EU allow the company to list a senior manager instead. But, again, a manager who can be fired isn't a beneficial owner. The better approach is to follow the FATF and now U.S. standard requiring the company to name who controls it – because someone always does. Especially companies engaged in wrongdoing.

NEXT STEP: CLARIFYING COMPANY CONTROL.

A key issue for the regulations implementing the new U.S. law is specifying the indicators of company control. **At a minimum, they should include the power to vote, direct votes, appoint and replace board members, decide on the sale or termination of the company, and direct who takes possession of company funds or assets.** Clarifying the indicia of company control is the next step needed to enforce the law's new strong definition of beneficial owner.

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