WHO *REALLY* OWNS THE ABC COMPANY?

FinCEN WANTS TO KNOW.

BY ALAN B. RABKIN, ESQ.

Last May when the presidential elections were starting to go from mildly amusing to red-hot, a Final Rule, in the making for four years and enacted under the Bank Secrecy Act, was published in the Federal Register through a governmental agency called FinCEN (Financial Crimes Enforcement Network). FinCEN is the anti-money laundering (AML) enforcement arm of the U.S. Department of the Treasury (find it at www.fincen.gov).

I am on FinCEN's notice list and receive many and varied FinCEN rules changes every year. Often these pronouncements are narrow in scope of the industry involved and do not target wide-ranging groups or impact general practice lawyers. This rule change is different and may have been accelerated by the now infamous *Panama Papers* debacle.

Many of your clients may be impacted by the rule discussed below, even if you are a family lawyer, practice in the patent area or litigate. That is because FinCEN, through this now-effective change, wants to know, going forward, who really owns entities that open new accounts (and here "accounts" includes loans), at covered financial institutions (banks, credit unions, brokers, mutual funds, commodities dealers, etc.) both directly, and more importantly, when the entity is, in turn, owned by another legal entity. FinCEN needs the institution to be advised regarding which natural person(s) own the entity until a defined stopping point of beneficial ownership or control is reached: a classic case of a new level of transparency for ownership and control of an entity for which those elements are not already clear. Many of the banks I work with have already implemented at least parts of this rule, following the effective date even though full compliance by covered institutions is not due until May 11, 2018.

A little background may help you better see the underpinnings of this Final Rule. Banks and other covered institutions must comply with a myriad of preopening requirements for account opening when faced with a legal entity (as opposed to a real person who merely presents basic identification). Legal entities include the usual business entities (corporations, LLCs, limited partnerships, etc.), but also take care to consider associations, fraternal groups, religious entities, charities and similar groups that could cross into that category if not exempt or excluded. However, entities that do not have true beneficial ownership, such as nonprofits, are likely outside of the ownership prong of this rule, but may still be subject to the control prong (see below).

Usually with any legal entity there is a core governmental filing or other underlying document that created the legal entity, and the covered institution will need this so-called birth certificate for the legal entity to open an account (including any foreign qualifications entitling the entity to operate in Nevada, if necessary). Most legal entities are owned and controlled by individuals, so the inquiry stops at this first direct level of ownership.

Next, there is a required tax identification number (TIN) issued by the IRS for every entity and the bank or other covered institution will need that TIN number for its records. (Note that many institutions now have the ability to immediately verify that the number provided matches the same entity or individual name in the IRS system).

Of course, and next, the signers on the account must be identified, because legal entities operate through real people; so the covered institution will need the signer's identification (valid

passport, current driver's license or other governmental identification). If a fictitious name is used with regard to an account (for example, ABC Company doing business as Fred's Hardware), and especially if checks or other deposits will bear the hypothetical Fred's Hardware fictitious name, the bank will need proof of entitlement to use that assumed name in order to avoid identity theft.

The above customer identification protocol is all part of the existing Know Your Customer regime (sometimes abbreviated CIP) and the Customer Identification Rule (referred to in the rule as CDD), and this degree of inquiry has existed for many years within financial services. But the new FinCEN rule may require more than the above when the legal entity opening the account is in turn owned by another legal entity. This indirect ownership inquiry is discussed below. The new rule continues to look for ownership by individuals, even if it must look beyond the entity actually opening the account. Fortunately, reliance can be placed on a certification that establishes all of this detail.

Assuming we have indirect ownership or control, the rule directs a covered institution to look through the legal entity opening the account and determine certain direct or indirect individual ownership in the potential chain of legal entities involved in that entity. Only then does the covered institution comply with the rule. That may be no easy task for complex entity structures and could substantially lengthen account openings for multi-level legal entities, as the financial institution tries to understand the structure.

While legal entities that own or control other legal entities are uncommon generally, they are not that unusual in certain specific planning areas. Examples include large real estate transactions, tax-motivated deals or high-risk/high-liability situations. Therefore, this rule will not go unnoticed, as most multi-tiered legal entities need a bank, brokerage or other financial account and should anticipate the need to certify ownership and/or control.

The new rule continues to look for ownership by individuals, even if it must look beyond the entity actually opening the account.

This significant new Final Rule can be found in its entirety at: www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf. The following are some of its most critical points:

- Covered financial institutions at account opening must identify each natural person with direct or indirect beneficial equity ownership of 25 percent or greater in a legal entity. This is often referred to as the *ownership prong* of the rule. In the end, there may not be an individual with the required beneficial ownership (for example, if five separate individuals beneficially own 20 percent). Most nonprofits, religious groups and charities are excluded from the ownership test, as there is no ownership of such entities.
- If applicable, and at account opening, covered institutions must also identify any natural person who has the ability to control, manage or direct the legal entity (normally this would be only one person, by the defined nature of control, although more may be possible). Often a title or position at the legal entity will indicate control. This is often referred to as the *control prong* of the rule. This control test could apply to a nonprofit, religious group or charity, even when the ownership test is inapplicable.
- The above determination of ownership and/or control is

continued on page 10

continued from page 9

WHO *REALLY* OWNS THE ABC COMPANY?

FinCEN WANTS TO KNOW.

made by a signed certification form with a format suggested by FinCEN in the rule. Of course, the individual signing the certification is making positive representations to the covered institution (and, indirectly, FinCEN), and could face harsh penalties set forth in the rule for misstating actual ownership and/or control. The covered institution may rely on the certification as long as they have no reason (knowledge) to question it.

- As for either the beneficial owner prong or the control prong, the covered financial institution must, at a minimum, identify the owner and/or controlling party, as if that party was a signer on the account (even if that party is not actually a signer). In essence, the institution applies CDD rules to the beneficial owner(s) and/or controlling party(ies).

As counsel for legal entities, you are provided with planning opportunities through the definitions in the Final Rule. A 25 percent or greater direct equity owner is relatively easy to identify. Harder, however, is a 25 percent or greater indirect equity ownership in the customer opening the account, and that may involve more complex analysis. Harder, still, is the control prong set out, above. The control test, if not obvious by titling, may involve serious, expensive and detailed document review, and possibly opinions on the issue. For example, what if potential control could be argued as arising from a joint ventureship, a branding agreement or unexercised stock options?

Other complications include the covered financial institution's obligation (or lack thereof) to update ownership and/or control. There is also the added burden of a customer determining if one of the exclusions or exemptions apply and, if so, convincing the institution that it, in fact, does apply.

There are still many practical questions to answer as I confer and help draft implementation plans and policies for banks and other institutions with which I consult regarding this new rule. All this information must be accessible for cash transaction reporting and suspicious activity reporting, so there is an entire technology interface to address.

What is clear is that in the future, lawyers may be called upon more frequently to explain and certify the direct and indirect ownership and/or control aspects of complex entity clients. This new transparency effort cannot help but put pressure on you, as counsel, as you balance between the safeguarding of your client confidences, sensitive tax decisions and liability avoidance with governmental attempts, such as those demonstrated by the new FinCEN rule, to bring all of your entity ownership and control into the full daylight for the purposes of detecting financial fraud and money laundering. **NL**

ALAN RABKIN is a retired bank general counsel with more than 37 years of financial services experience, and he provides independent financial services through Rabkin Consulting, LLC as an expert and consultant to legal counsel, certified public accountants and the banks and other financial institutions they represent. Rabkin may be found at www.rabkin.consulting; his email address is arabkin@rabkin.consulting.