Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #321

Date: **11-May-16**
From: **Steve Leimberg's Asset Protection Planning Newsletter**
Subject: **FLASH John Terrill & Michael Breslow: FinCEN Issues Final Customer Due Diligence Regulations Requiring Financial Institutions to Gather Beneficial Ownership Information on Entity Bank Accounts**

"This commentary explains regulations recently issued by the Financial Crimes Enforcement Network (FinCEN) relating to new customer due diligence (CDD) procedures requiring financial institutions to gather information on the identity of the beneficial owners of, and an individual who controls, certain types of legal entities when opening entity bank accounts. This commentary also describes how these regulations will impact trusts and estates lawyers."

John Terrill and **Michael Breslow** provide members with their analysis of FinCEN's final customer due diligence regulations requiring financial institutions to gather beneficial ownership information on entity bank accounts.

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Michael A. Breslow is an associate at **Heckscher, Teillon, Terrill & Sager, P.C.** Michael's practice focuses on tax and estate planning, charitable planning, and trust and estate administration. Michael follows and writes about developments in the law in the United States and abroad pertaining to the international effort to combat money laundering and terrorist financing. He earned a J.D. from Temple University Beasley School of Law and an LL.M. in taxation from New York University School of Law.

Here is their commentary:

EXECUTIVE SUMMARY:

This commentary explains regulations recently issued by the Financial Crimes Enforcement Network (FinCEN) relating to new customer due diligence (CDD) procedures requiring financial institutions to gather information on the identity of the beneficial owners of, and an individual who controls, certain types of legal entities when opening entity bank accounts. This commentary also describes how these regulations will impact trusts and estates lawyers.

COMMENT:

Introduction

On May 11, 2016, the Financial Crimes Enforcement Network (FinCEN) issued final regulations under the Bank Secrecy Act to strengthen the customer due diligence (CDD)

requirements for financial institutions (the "CDD/BO Regulations").[1] The CDD/BO Regulations will require financial institutions to gather "beneficial ownership" (BO) information on the substantial owners of, and the individuals that control, a "legal entity" when the entity seeks to open a bank or other financial account. The CDD/BO Regulations will be effective 60 days after May 11 and financial institutions will have until May 11, 2018 to comply with the regulations. The purpose of the CDD/BO Regulations is to assist law enforcement to combat the abuse of shell corporations and other legal entities by money launderers, tax evaders and terrorist financers. These developments and what they mean for American trusts and estates lawyers are the subject of this newsletter.

Background on CDD/BO

The problems that shell corporations, LLCs and partnerships present have drawn significant recent attention as a result of the Panama Papers scandal.[2] Sensational discoveries from the files of the Panamanian law firm Mossack Fonseca include revelations that the firm formed thousands of anonymous shell corporations for the wealthy and elite (including athletic stars and heads of state) and the corrupt and criminal (including known drug lords and the Hezbollah terrorists).[3] The Panama Papers have revealed tax evasion, corruption and other criminality deploying the opacity of shell corporations as the primary vehicle for evading exposure.

Beginning decades before the revelation of the Panama Papers, international efforts had been underway to eliminate the secrecy with which bad actors may access the financial system through anonymous corporations and trusts. The Financial Action Task Force (FATF), an international organization dedicated to fighting money laundering and terrorist financing, has long recommended that financial institutions (and lawyers) in its member states conduct CDD when forming customer/client relationships. [4] The purpose of CDD is to "know your customer" so that the gatekeepers to the financial system do not do business with or permit access to the bad actors, and so that law enforcement can more effectively track criminal activity.

Because anonymous legal entities could circumvent CDD rules, the recent focus of international regulatory efforts has been to require actors in the financial system to gather and retain information on the "beneficial ownership" of legal entities—that is, the natural persons who own or control an entity such as a corporation, a partnership, an LLC or a trust. Beneficial ownership requirements have existed throughout Europe since the Parliament of the European Union approved the Third E.U. Anti-Money Laundering Directive in 2005,[5] and E.U. member states began the Directive's implementation.[6] The Fourth E.U. Anti-Money Laundering Directive, approved last summer, will require E.U. member states to create central national registries (part public and part private) of the beneficial ownership information for corporations and trusts.[7]

Although news reports will likely suggest that the CDD/BO Regulations, and related efforts to push BO legislation, are being issued in response to the Panama Papers scandal, in fact FinCEN has been working on these regulations for years.

FinCEN's May 11, 2016 CDD/BO Regulations

FinCEN's CDD/BO Regulations are fairly similar to beneficial ownership regulations existing in Europe with a few important differences. Under the new regulations, when opening a new account, a financial institution will be required to gather identifying information on the individuals that own a 25% or greater equity interest in a "legal entity customer," and on a single individual who has "significant responsibility to control, manage

or direct a legal entity customer," such as a director or officer of a corporation or a manager of an LLC.[8] The regulations offer an optional Certification Form for this purpose. Under the regulations, financial institutions will be required to maintain updated information on beneficial ownership as such information changes. The recordkeeping requirements are imposed only at the level of the financial institutions; however, the records are subject to government subpoena in connection with investigations by law enforcement. Unlike the laws and regulations that will be enacted in Europe to comply with the Fourth E.U. Anti-Money Laundering Directive, the CDD/BO Regulations do not create national registries of beneficial ownership information for corporations and trusts.

Also unlike in Europe, and of particular importance to readers of this newsletter, is that private trusts ***are not included*** in the definition of "legal entity customer" under the regulations. Therefore, a trustee opening a bank account for a trust will not be required to provide the bank with information on the trust's individual beneficiaries. In the Preamble to the CDD/BO Regulations, FinCEN noted that identifying a beneficial owner of a trust "would not be possible" given the unique space that private trusts occupy in the American legal system, and the legal relationship between the settlor, trustees and beneficiaries.[9] Financial institutions already gather information on individual trustees when opening trust bank accounts under existing Customer Identity Protocols (CIP), and FinCEN notably did not expand the requirements in this regard. The American College of Trust and Estate Counsel (ACTEC) offered commentary to the proposed regulations and explained that trustees will have information regarding the settlor and beneficiaries, and the trustees will be answerable to law enforcement in appropriate circumstances.[10] For now, FinCEN appears to appreciate that gathering and maintaining identifying information on the trustees of private trusts, which financial institutions already do, is sufficient to satisfy concerns of law enforcement.

Additionally, for entities with multiple layers of entity owners, financial institutions will be required to "look through" each layer of entities until individual beneficial owners can be identified. Trusts and estates lawyers are familiar with the scenario in which a trust owns 25% or more of a family limited partnership or an LLC. Under the proposed regulations issued in August 2014, it appeared that a bank would have been required to identify the individual beneficiaries of a trust that owned 25% or more of a corporation or LLC. ACTEC's commentary to the proposed regulations highlighted this inconsistency.[11] In the CDD/BO Regulations, a bank is permitted to "stop" looking through legal entities when it reaches a trustee—"[i]f a trust owns directly or indirectly . . .25 percent or more of the equity interests of a legal entity customer, the beneficial owner. . . shall mean the trustee."[12]

Also noteworthy as it pertains to law firm practice, FinCEN confirmed that, for purposes of these regulations, the legal entity customer for an attorney escrow account is the lawyer or the law firm, and not the lawyer or law firm's clients, meaning that lawyers will not need to provide information to banks on their clients who have funds deposited in their client escrow accounts.[13]

Trusts and estates practitioners must be aware that these regulations will impact their clients when opening bank accounts, particularly where clients are forming corporations, limited partnerships or LLCs. Lawyers must be prepared to explain to clients why the bank is asking for names, addresses and social security numbers of a client and his or her family members when he or she is opening a bank account for a family entity. Although in some

circumstances, the ownership structure may not include any one individual who meets the 25% ownership threshold for a particular entity, the bank still will require identifying information on one individual who controls the entity. If a client is forming a non-profit corporation, the client must be prepared to identify to the bank an individual that controls the non-profit. Explaining that these regulations were designed to alleviate the concerns raised by the Panama Papers scandal and to fight terrorist financing could be an effective way to communicate the reasons for these regulations to the privacy-minded client who is vexed by them.

Conclusion

The CDD/BO Regulations represent an effort to combat money laundering and terrorist financing through reducing the secrecy with which bad actors may access the American financial system. Other legislative and regulatory efforts in this regard are underway and new developments should be expected to continue. For example, starting in May 2015, the New York City Department of Finance began requiring LLCs or partnerships to provide identifying information on their natural owners in real estate transactions.[14]

In January 2016, FinCEN issued geographic targeting orders requiring title insurance companies to provide beneficial ownership information for legal entities used to make high-end cash purchases of real estate in Miami and New York.[15] In connection with issuing the CDD/BO Regulations, Secretary of the Treasury Jacob Lew sent a letter to ranking members of Congress urging them to enact beneficial ownership legislation requiring entities to report their BO information to the Department of Treasury. In Congress, Senator Sheldon Whitehouse recently introduced S. 2489, the Incorporation Transparency and Law Enforcement Assistance Act,[16] to create a national requirement for states to acquire and maintain beneficial ownership information to combat the problems that shell corporations represent.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

John Terrill
Michael Breslow
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CITATIONS:

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[1] 81 F.R. 29397, available at http://1.usa.gov/1X0QXgb
[2] http://www.theatlantic.com/national/archive/2016/04/panama-papers-nevada/476994/?google_editors_picks=true; http://www.theatlantic.com/business/archive/2016/04/panama-papers-crimes/477156/; http://www.nytimes.com/roomfordebate/2016/04/07/cracking-shell-company-secrecy
[3] https://www.publicintegrity.org/2016/04/04/19518/center-unit-icij-releases-panama-papers

[4] Customer identification procedures have been a recommended practice since the first version of the FATF Recommendations in 1990. http://bit.ly/1TaR3z6
[5] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:309:0015:0036:en:PDF
[6] For an excellent chart summarizing the laws implementing the Third E.U. Anti-Money Laundering Directive, see http://www.anti-moneylaundering.org/EU_Chart.aspx
[7] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849
[8] 31 C.F.R. §1010.230(d)(1), (2).
[9] See 81 F.R., at 29412.
[10] ACTEC's comments to the proposed regulations are available at https://www.regulations.gov/#!documentDetail;D=FINCEN-2014-0001-0061
[11] *Id.*
[12] 31 C.F.R. §1010.230(d)(3).
[13] See 81 F.R., at 29416.
[14] http://nyti.ms/27dzoOC
[15] https://www.fincen.gov/news_room/nr/pdf/LA_GTO_Order9-25-14.pdf; https://www.fincen.gov/news_room/nr/pdf/GTO_Miami.pdf
[16] https://www.govtrack.us/congress/bills/114/s2489/text

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