it expires in 2026. However, the MSR will continue to apply and, therefore, foreign corporations that were not subject to the MSR on account of being subject to the Act 154 excise tax would then be subject to Puerto Rico income tax under the MSR."

Parés said "a reasonable reading" of the proposed Treasury regs is that Puerto Rico's income tax imposed under the MSR should continue to qualify as a creditable tax under section 901 because the MSR can be viewed as satisfying the jurisdictional nexus requirement in proposed reg. section 1.901-2(c). "Puerto Rico's international tax rules are consistent with the rules under section 864(c) for taxing income effectively connected with a U.S. trade or business," Parés said. "In this sense, the MSR should be viewed as an expansion of Puerto Rico's ECI rules, as recognized by the IRS in Notice 2011-29, and is designed to allocate income reasonably attributable to business or sources within Puerto Rico."

In his letter, Parés requested that the proposed regulations be amended to include a carveout to the CFC income attribution rules to ensure that income taxed under the MSR qualifies under section 901.

He also requested that if any section of the final regulations affects the FTC treatment of the excise tax payments covered by IRS Notice 2011-29, it not become effective until the end of the third tax year beginning on or after the date the regulations are published in the *Federal Register*. ■

Piercing the Veil: Do New U.S. Transparency Rules Make the Cut?

by Kiarra M. Strocko and Stephanie Soong Johnston

Anti-corruption advocates are cheering new U.S. beneficial ownership reporting rules, but it's not yet clear whether they go far enough to meet global tax transparency standards — or what they will ultimately mean for tax practitioners.

After more than a decade of fighting for the United States to update its anti-money-laundering regime, the Financial Accountability and Corporate Transparency (FACT) Coalition had much to celebrate on January 1. The Senate had just voted to override President Trump's veto of the National Defense Authorization Act (NDAA, H.R. 6395), and by doing so, it had effectively enacted the Corporate Transparency Act (CTA) embedded within.

The CTA is fairly simple, according the FACT Coalition. It updates the United States' anti-money-laundering regime by requiring corporations and limited liability companies to report the names, addresses, dates of birth, and driver's license or other identification numbers of the individuals who control and own them. This "beneficial ownership" information must now be reported to Treasury's Financial Crimes Enforcement Network and updated to reflect any changes.

Broadly, the new rules are meant to tackle the abuse of anonymous shell companies for nefarious purposes, such as money laundering of proceeds from ill-gotten gains and the hiding of assets for tax evasion purposes.

> ***The new legislation equips U.S. law enforcement with a new set of tools to carry out its existing work against anti-corruption and money laundering, Kumar said.***

The United States, long criticized for its "tax haven" states, such as Delaware, now joins a growing number of jurisdictions around the world that require beneficial ownership transparency. They include the United Kingdom — and its crown dependencies and overseas territories — as well as the 27 EU member states.

"For years, experts routinely ranked anonymous shell companies — where the true, 'beneficial' owners are unknown — as the biggest weakness in our anti-money-laundering safeguards," FACT Coalition Executive Director Ian Gary said in a January 1 statement.

Gary noted the bipartisan support in Congress and the support of nearly all national security experts, law enforcement officials, and human rights advocates for ending anonymous shell companies. "It's the single most important step we could take to better protect our financial system from abuse," he said.

Lakshmi Kumar, policy director at Global Financial Integrity, also praised the act. "This is the most significant anti-money-laundering reform in the last couple decades," she told *Tax Notes*. The new legislation equips U.S. law enforcement with a new set of tools to carry out its existing work against anti-corruption and money laundering, she said. "This legislation signals to other countries that the U.S. is going to move much stronger and firmer than they have moved in the past," Kumar added.

A Closer Look

Nearly 2 million corporations and LLCs are formed under state laws annually, and only a few of those states require beneficial ownership information reporting about those entities, according to the legislation. The process of incorporation requires less information than opening a bank account or obtaining a driver's license, it adds.

According to the act, such lax procedures have allowed criminals to anonymously exploit corporations and LLCs in the United States for nefarious purposes.

"Criminals have . . . used the newly created entities to commit crimes affecting interstate and international commerce such as terrorism, proliferation financing, drug and human trafficking, money laundering, tax evasion, counterfeiting, piracy, securities fraud, financial fraud, and acts of foreign corruption," the act says.

Fighting criminal abuse of anonymous shell entities, strengthening law enforcement efforts, and aligning the United States with global anti-money-laundering standards therefore requires federal laws to collect beneficial ownership information on corporations and LLCs, the act states.

The legislation defines a beneficial owner as an individual who directly or indirectly, "through any contract, arrangement, understanding, relationship, or otherwise," exercises substantial control over or owns 25 percent or more of the equity in the corporation or LLC. The legislation defines a reporting company as a corporation, LLC, or related entity that is created in the United States or a foreign company that is registered to do business domestically.

Some corporations and LLCs may not have to disclose beneficial ownership information, however. Under the legislation, corporations and LLCs are defined to exclude businesses that have more than 20 full-time U.S. employees with a physical U.S. presence and more than $5 million in gross receipts. Violating the reporting provisions could result in civil penalties of up to $10,000 and not more than two years' imprisonment, which is a one-year decrease from the previous draft.

Under the legislation, reporting companies need to provide the relevant information, which will indicate who owns or benefits from an entity, within two years of the enactment of the U.S. legislation. If there are any changes in beneficial ownership information, the new act requires the company to submit the updated information to FinCEN within one year of the change.

FinCEN will keep and maintain a central federal register containing beneficial ownership data, which will not be public but can be shared with federal, state, local, and tribal law enforcement authorities, according to the FACT Coalition. It's now up to Treasury to write implementing regulations within a year of the CTA's enactment.

Connecting the Dots

The concept of beneficial ownership transparency has long been associated with the fight against money laundering, terrorism financing, corruption, and other crimes under international recommendations from the Financial Action Task Force (FATF).

The G-7 established the FATF in 1989 as a standard-setting intergovernmental global anti-money-laundering and counterterrorism financing watchdog. But in 2012 the relationship between tax and beneficial ownership transparency became more apparent after the FATF updated its standards. The changes included expanding the scope of its list of money laundering predicate offenses to include tax crimes. In doing so, the FATF standards became a tool to support the fight against tax evasion as well.

The OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, the organization's primary tax transparency body, then incorporated FATF beneficial ownership transparency standards in its second round of peer reviews evaluating countries' adherence to international standards on exchange of information on request (EOIR).

The Global Forum's initial round of peer reviews evaluated each member jurisdiction's legal and regulatory framework and its practical implementation of the international EOIR standard, awarding ratings of compliant, largely compliant, partially compliant, or noncompliant.

Those jurisdictions got a second look in another round of reviews, which combined elements of the first peer review process, plus a special assessment of the availability of beneficial ownership information of legal entities and arrangements, and tax authorities' access to that information, in line with FATF standards. Under the enhanced peer review process, jurisdictions are also rated as compliant, largely compliant, partially compliant, or noncompliant.

In its second peer review, published in July 2018, the United States received an overall largely compliant rating. However, the report recommended that the United States do more to ensure that the availability of beneficial ownership information fully aligns with new international standards.

The report noted that under U.S. law at the time, companies, including LLCs, and partnerships were required to provide some kinds of beneficial ownership information to the IRS, but that data were out of line with FATF standards. U.S. law also did not clearly require the reporting of beneficial ownership details for trusts, according to the report.

The Global Forum also suggested ways in which the United States can align its beneficial ownership information availability with the FATF standard.

For example, it said the United States should ensure that beneficial ownership data is available to authorities for all bank account holders that are entities; require banks to identify and verify the details of all beneficial owners of trusts that hold accounts at U.S. banks; and monitor new U.S. obligations, which took effect in May 2018, to identify the beneficial owners of bank account holders to ensure the requirements are working in practice.

Falling Short?

Despite its progress, the United States has more to do to meet international tax transparency standards, particularly at the OECD level, according to Zayda Manatta, head of the secretariat at the Global Forum.

The adoption of the CTA is a "very welcomed step in the direction of the international standards of transparency and exchange of information," Manatta told *Tax Notes*. The legislation offers "a more robust and less fragmented beneficial ownership framework organized at the federal level," she added.

However, there needs to be further clarification for implementation purposes, including a clearer definition of substantial control, Manatta said. Even though updates to beneficial ownership information only need to be provided within one year of the change, the act "also foresees that the secretary of Treasury will assess whether updates should be reported under a more ambitious deadline," she added.

> ***'The legislation does not align with the levels of transparency exhibited by the EU and the U.K. with regards to private trusts,' Gascoigne said.***

Further, Manatta noted that the government should clarify the availability and conditions of information for exchange of information purposes. "It is clear the information will be available for U.S. tax administration purposes, but it is still to be clarified if this encompasses foreign tax administrations' requests," she said.

The legislation also does not address the United States' weaknesses outlined in its latest peer review report regarding beneficial ownership information of trusts and partnerships, as the legislation only focuses on corporations and LLCs, according to Manatta. "It will not improve the ability of the U.S. to collect and exchange information about controlling persons, where the account holders of the U.S. financial institutions are either non-U.S. entities or U.S. trusts or partnerships," she said.

Manatta emphasized that the legislation may improve the possibility of reciprocal exchanges of information between the United States and other countries if the IRS can access the information and use it for automatic exchange of information purposes.

Under the Global Forum's EOIR peer review process, if a jurisdiction has adopted measures that are likely to upgrade its overall rating, it can request a supplementary review to take those actions into account. "So far, we have not received any signal the U.S. will request a supplementary review," Manatta said.

Clark Gascoigne, senior policy adviser at the FACT Coalition, also pointed to the CTA's shortcomings where trusts are concerned. "The legislation does not align with the levels of transparency exhibited by the EU and the U.K. with regards to private trusts," he said. "Trusts will be an area of concern in the U.S.," which should be focused on moving forward, he added.

Gascoigne also noted that the new legislation does not necessarily establish a public directory, but will allow for access for information through protocols, agreements, conventions, and treaties.

Andres Knobel, senior researcher at the Tax Justice Network, suggested that "the U.S. could follow the lead of the [FATF's] and the EU's fifth anti-money-laundering directive in such cases, which would require every party to the trust — the settler, trustee, protector, beneficiaries, and any other individual with control over the trust — to be registered as a beneficial owner."

In its 2020 Financial Secrecy Index, which ranks jurisdictions according to their secrecy and the scale of their offshore financial activities, the Tax Justice Network described the Cayman Islands, the United States, and the United Kingdom as "an Anglo-American axis of secrecy [which] constitutes by far the greatest global threat of corruption and tax abuse." The index places the United States in second place, overtaking Switzerland.

Knobel said that although the CTA is "an incredible achievement that sets the world's largest economy on the right track," it doesn't go far enough to improve the United States' transparency rating.

"Due to the limited scope of the Corporate Transparency Act and numerous exceptions to its application, we cannot yet say the U.S. is practicing effective beneficial ownership registration," Knobel said. He added, however, that "the law does mark a seismic shift in course for the super-economy toward tax transparency — the potential of which can be monumental down the line."

Tommaso Faccio, head of the secretariat of the Independent Commission for the Reform of International Corporate Taxation, told *Tax Notes* that any move to reduce secrecy is welcome. "The devil is in the details regarding the exemptions, but this will spearhead further transparency measures," he said.

Headaches Ahead

Nathan Pysno, director of economic crime and procedural justice at the National Association of Criminal Defense Lawyers (NACDL), told *Tax Notes* that the association opposes the legislation, calling it "a paperwork requirement that has a criminal penalty for noncompliance."

However, Pysno said the legislation as enacted is preferable to the version passed by the House in October 2019 because of the shorter prison term and the inclusion of a safe harbor provision. He also noted that the new version has clearer definitions of beneficial owner and said removing vague language defining a beneficial owner as a person who "receives substantial economic benefits" from a company is a step in the right direction.

The National Federation of Independent Business, the American Civil Liberties Union, and the NACDL had voiced their concerns in April and May 2019 letters to the House of Representatives that were posted by the American Bar Association.

The ACLU/NACDL letter raised pointed objections to the lack of clarity in the 2019 legislation's definition of beneficial owner, which included any person receiving "substantial economic benefits from the assets of a corporation or limited liability company." Acknowledging the enumerated exceptions to the definition, the letter argues that those too are unclear. It specifically cites the exemption of creditors, which was not changed in the new legislation, saying that creditors could commonly exercise substantial control over or receive substantial economic benefits from borrowers.

Severiano Ortiz of Kozusko Harris Vetter Wareh Duncan LLP raised red flags about the reporting obligations and penalties under the act from a private client perspective. He noted that the CTA would mostly target small businesses with 20 or fewer employees since the act exempts from its reporting requirements companies employing more than 20 full-time employees who file U.S. tax returns reporting more than $5 million in gross revenues and have a physical office in the United States.

The compliance burden on owners of small businesses will be significant, as many lack the resources to regularly keep up with changes in the law, according to Ortiz. They also face severe civil and criminal penalties if they fail to file complete and updated beneficial ownership reports, he added.

As is the case with foreign bank account reporting, CTA reporting obligations are under title 31 of the Bank Secrecy Act rather than title 26 of the IRC. "Accordingly, the civil penalties will be payable to the United States, meaning everything from enforcement to collections may be different from traditional tax penalties," Ortiz said.

Although the legislation is meant to tackle money laundering, terrorism financing, tax fraud, and other crimes, "there will be many people who end up suffering the penalties for failing to file their initial or updated forms simply because they don't know any better, are misinformed, or they forget," Ortiz added. "So the question remains just how rigorously the penalties will be imposed."

FBAR penalties can be high, especially when it comes to non-U.S. trusts, according to Ortiz. Although some people will deserve to be penalized because they are willfully evading taxes by hiding their assets, many more will be subject to the same penalties even if they didn't intend to act nefariously, he said.

"Will Treasury and FinCEN adopt a new version of reasonable cause? Will they be lenient regarding these beneficial ownership reports? Will your average person suffer the same consequences as those who are engaged in the types of activities this legislation was intended to fight?" Ortiz said.

"Or will the application of the rules and assessment of the penalties become just as convoluted, irregular, and confusing as those currently applicable to FBARs and other international informational forms, bouncing between courts, IRS guidelines, [and] IRS personnel?" Ortiz added.

Certainly, "the act creates more questions than solutions," said Kenneth Rubinstein of Gallet Dreyer & Berkey LLP. Rubinstein noted that the United States is the number one tax haven in the world because of the Bank Secrecy Act and the ability to acquire real estate through entities without disclosing shareholders or members. He said that "the U.S. is the best country to park foreign assets anonymously."

Rubinstein said that foreign individuals will either circumvent the new reporting requirements or move their assets to another country, which will have a huge impact on sectors like the New York real estate market.

Rubinstein said his clients haven't expressed concerns about the new compliance procedures, saying that it is too soon to make any predictions. "Clients do not have this supreme expectation of anonymity or secrecy. If they have been structuring on that basis, then this act does not change much," he said.

Although there are many outstanding questions about the CTA, perhaps the wait for answers won't be long. During her January 19 Senate confirmation hearing, Treasury Secretary Janet Yellen acknowledged the importance of tackling anonymous shell company abuses.

"This is a very important problem, and . . . the act recently passed by Congress gives us an enormously potent tool to address this problem," Yellen said, adding that, if confirmed, she and her

Treasury team will try to get the rules implemented as soon as possible.

"We'll be certainly looking to give this very high priority," Yellen said. ■

Democrats Look to Further Limit Deductions for Corporate Bonuses

by Alexis Gravely

Publicly traded corporations would face an additional cap on the amount of bonus compensation that can be deducted from their revenue under a bill reintroduced by Democrats in both chambers of Congress.

The Stop Subsidizing Multimillion Dollar Corporate Bonuses Act — introduced February 2 as S. 178 by Sen. Jack Reed of Rhode Island and as H.R. 697 by House Ways and Means Committee member Lloyd Doggett of Texas — would extend the current section 162(m) $1 million deduction limit on bonuses for senior executives to all of the company's employees.

The Tax Cuts and Jobs Act borrowed provisions from an earlier version of S. 178 by eliminating the exemption for performance-based compensation, which had allowed compensation deductions above $1 million if an executive met performance benchmarks.

The latest bill goes a step further because "while these steps were a start, even more should have been done," Reed said on the Senate floor February 2.

"Under this legislation, publicly traded corporations would still be permitted to pay their executives as much as they desire, but compensation above and beyond $1 million would no longer be subsidized through our tax code," Reed said.

The Joint Committee on Taxation found that the TCJA's changes to section 162(m) increased revenues by $9.2 billion, according to a February 11 release from the new bill's sponsors. The JCT estimates that if the latest bill were enacted, revenues would be increased by an additional $27 billion, the release says.

In the Senate, cosponsors of the bill include Finance Committee members Sherrod Brown, D-Ohio, Sheldon Whitehouse, D-R.I., and Elizabeth Warren, D-Mass. In the House, cosponsors include Ways and Means members Earl Blumenauer, D-Ore., and Gwen Moore, D-Wis. ■