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The Corporate Transparency Act and its impact on the foreign national market

On January 1, 2024, many US entities will have a new reporting requirement thanks to the Corporate Transparency Act (CTA). Reporting requirements for US entities lag behind many other countries. In fact, according to the Tax Justice Network's 2022 Financial Secrecy Index, the US ranks number one.[1] The CTA is an effort to bring more transparency to US entities. It will be a headache for tax and legal professionals — it could be a real game-changer for nonresident foreign nationals with US assets.

With the CTA, passed as part of the Anti-Money Laundering Act of 2020, many entities will have to report certain information to FinCEN, a part of the Treasury Department. Currently, such information will not be made public, but it may be made available to other parts of government. The newly required reports include information about the underlying beneficial owners of an entity (more than 25% of an interest in an entity) as well as anyone with control (including all officers of the entity). Entities will need to report the name, date of birth, address, and a copy of a passport (or other official identification) for all beneficial and controlling owners. In addition to the initial reporting requirement, any material change must be reported within 30 days.

Perhaps more striking than the breadth of information required are the penalties for noncompliance. As of now, there are no extensions of time for any reason. In addition to civil penalties of up to $500 per day, there are also criminal sanctions, including jail time, for noncompliance. Although the form of information reporting is still being worked out, this change is going to have a significant impact on foreign investors.

Many foreign nationals who own US assets do so through entities. While there are many reasons to own assets through such entities, a big draw is the ability to conceal the underlying owner. The CTA removes this veil.

The CTA does nothing to change the taxation of foreign nationals; however, because it will expose the underlying ownership, and impose steep penalties

for noncompliance, it is likely to have a disproportionate impact on estate planning for foreign nationals – and not just ultra-high-net-worth families.

Consider, for example, a Mexican family where the parents (G1) are Mexican citizens and their children (G2) are dual citizens of the US and Mexico. G1 owns a $560,000 property in Dallas, TX through a limited liability company (LLC), of which one of the children is the manager. When G1 dies, the property passes in equal shares to G2; however, G2 may not know that any amount over $60,000 that passes from G1 to G2 is subject to US estate taxes (in this example, the tax would be just over $155,000). Even though the beneficial owners of the LLC have changed, because G2 is still managing the LLC, G2 may have no obligation to update the LLC records filed with the state. Even if there were an obligation to update the state filing, the federal government would have no way of knowing that a transfer subject to estate taxes has taken place. If G2 later sells the property, it is even less likely that the federal government would ever find out that a taxable transfer occurred.

In contrast, under the CTA G2 will have 30 days to notify FinCEN of the change in beneficial ownership and management of the LLC; after that, they will be subject to civil and possibly criminal sanctions. Even if the failure to pay was not intentional (as in the above example), the penalties will still apply and can add up quickly.

Because every entity must be registered in at least one state, FinCEN could cross-reference registered entities with the informational reports they receive; this reality, in addition to the penalties for noncompliance, adds further encouragement for entities to file the required returns. Once the information is provided to FinCEN, there will be a database of beneficial owners, with their birth dates. Even if no death certificate is filed for G1, at some point it will be obvious that a transfer has occurred.

There is currently no way to trace how much US-based property is owned by foreign nationals. However, some statistics are instructive. In 2021 alone, foreign buyers purchased $59 billion worth of residential real estate and an additional $57.7 billion of commercial real estate.[2] Between 2010 and 2022, foreign buyers purchased $1.1 trillion worth of residential real estate in the US.[3] As of June 30, 2022, foreign holdings of US securities totaled $24.9 trillion.[4] Yet of the 41 taxable returns filed by nonresidents of the US in 2021, only 23 paid any estate tax.[5] These numbers suggest that there is a great deal of underreporting of foreign estate tax — a CNBC calculation from 2015 estimated several billion dollars every year went unpaid by foreign owners.[6]

In the past, the IRS has had no way to determine what US property was owned by foreign nationals, nor to know when an underlying owner had passed away. The CTA is a step toward providing that information. This increased transparency will help not only to combat money laundering and financing of terrorism (its purported goals), but also to enforce existing estate and gift tax laws. It will remove the veil from foreign individuals who are trying to skirt US transfer taxes, as well as putting those who are simply unaware of the laws on notice.

With this greater transparency and awareness around estate taxes for foreign nationals comes an opportunity. As with US citizens, a life insurance policy can help provide protection by offering liquidity to pay estate taxes or to satisfy debt obligations, like a mortgage. In addition, a US-based life insurance policy may also provide the individual with diversification, value, and safety compared with a policy in their country of residence.

While the CTA will create a significant reporting burden for legal and tax professionals, the increased transparency in ownership is a great opportunity to offer life insurance to a new market that may not have known they needed it. A US life insurance policy can help to provide liquidity where there is a US tax liability, and unlike residents of the US, nonresident foreign nationals can personally own a life insurance policy outright without it being subject to US income or estate taxes. There are, however, additional underwriting requirements and rules for nonresidents that need to be considered. If the client is worth at least $5 million, John Hancock can partner with you to find the right policy.

1. Tax Justice Network, "Financial Secrecy Index 2022," https://fsi.taxjustice.net/. The Financial Secrecy Index considers a jurisdiction's financial and legal system as well as the volume of financial services provided to non-residents to rank each state.

2. Statista, "Total property sales to foreign buyers in the United States from 2010 to 2022," October 27, 2022, https://www.statista.com/statistics/610369/total-property-sales-to-foreign-buyers-in-the-us/;
National Association of Realtors, "Foreign Investor Acquisitions of US Commercial Real Estate Increased 49% in 2021," Feb 16, 2022, https://www.nar.realtor/blogs/economists-outlook/foreign-investor-acquisitions-of-u-s-commercial-real-estate-increased-49-in-2021

3. Statista, "Total property sales to foreign buyers in the United States from 2010 to 2022."

4. Department of the Treasury, "Foreign Portfolio Holdings of U.S. Securities As of June 30, 2022," https://ticdata.treasury.gov/resource-center/data-chart-center/tic/Documents/shla2022r.pdf

5. Internal Revenue Service, "SOI Tax Stats – Estate Tax Statistics," https://www.irs.gov/pub/irs-soi/21es02st.xlsx

6. See, e.g., Eamon Javers, "Look who's getting away with not paying this estate tax," CNBC, November 4, 2015, https://www.cnbc.com/2015/11/03/why-foreigners-ignoring-this-tax-could-be-costing-us-billions.html

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