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VOLUME 254—NO. 98

An ALM Publication

FRIDAY, NOVEMBER 20, 2015

## OUTSIDE COUNSEL

## Expert Analysis

# Knock! Knock! Who's There? Anonymous LLC Ownership

Real estate ownership by limited liability companies (LLCs) has increasingly received attention as their use, particularly in the case of residential real estate, has grown. LLCs are used for various reasons, such as protection against potential liabilities and privacy concerns, similar in many respects to many older ownership structures. More recently, however, local, national and international governmental entities, as well as non-profit watchdog organizations, are more and more focused on greater real estate ownership transparency, primarily to address concerns regarding the circumvention of anti-money laundering and counter-terrorism financing measures.

Critics of LLCs in their current form have made a number of proposals to improve transparency of beneficial ownership, either requiring the filing of beneficial ownership information

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with government agencies or requiring stronger due diligence efforts by real estate industry participants. To date, these proposals have not gained sig-

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nificant traction in the United States, where state laws on company formation continue to provide anonymity to LLC beneficial owners.

In contrast, efforts to implement transparency measures have been more successful in Europe and in particular, the United Kingdom, which

is proceeding with the development of a public registry. Although such efforts raise concerns with respect to either privacy or the administrative burdens to be borne by the real estate industry, implementation of measures elsewhere will keep the focus on transparency efforts in the United States.

### Prevalence

The use of companies to own residential real estate has become increasingly prevalent in the United States as well as Europe. In New York City, the use of LLCs to own residential real estate has grown significantly, as The New York Times' "Towers of Secrecy" series<sup>1</sup> highlighted, particularly in Manhattan. According to The New York Times, 54 percent of Manhattan residential sales above \$5 million were made to LLC purchasers in 2014 as compared to 39 percent in 2008. In London, the watchdog group Transparency International UK reviewed Land Registry and Metropolitan Police investigations data and showed a high rate of property ownership by

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companies registered in offshore jurisdictions (e.g., British Virgin Islands, Jersey, Isle of Man, Guernsey) where beneficial ownership does not need to be disclosed. Entities incorporated in such jurisdictions owned 9.3 percent of property in Westminster, 7.3 percent of properties in Kensington and Chelsea, and 4.5 percent of properties in the City of London.

Most real estate purchasers have valid, non-criminal reasons to use LLCs in transactions, including for estate and tax planning purposes in the case of residential purchases. In the context of residential real estate leased to third-party tenants, LLCs are frequently favored as a means of limiting owners' personal liability in the event of landlord-tenant disputes. Moreover, given the heightened accessibility of personal information on the Internet, owners increasingly rely on LLCs to protect their privacy.

Despite such valid reasons for the use of LLCs, legislators and non-profit watchdog organizations have sought greater transparency of real estate ownership, particularly in an effort to combat money laundering and terrorism financing. In an October 2012 Reuters article, "It's Time to Eliminate Anonymous Shell Companies," Manhattan District Attorney Cyrus Vance Jr. argued that the anonymity afforded by LLCs often hinders law enforcement's "follow the money" investigation strategy, which involves tracing financial activity upstream from low-level criminal activities to leaders of such activities.<sup>2</sup>

More recently, Jennifer Calvery, director of the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), commented at the West Coast Anti-Money Laundering Conference in May 2015 on the need to focus on increasing transparency in real estate transactions, noting that "[t]hrough [FinCEN's] analysis of [Bank Secrecy Act] reporting and other information, FinCEN continues to see the use of shell companies by international corrupt politicians, drug traffickers and other criminals to purchase luxury residential real estate in cash."

### Few States Require Disclosure

As most U.S. states do not require the disclosure of beneficial ownership to establish an LLC, masking such ownership is routine. In fact, neither Delaware (which has longstanding popularity as a jurisdiction in which LLCs are formed) nor New York requires such disclosure. The U.S. Government Accountability Office and FinCEN conducted surveys of states' entity formation requirements and found that only Alabama, Arizona, Connecticut and New Hampshire require beneficial ownership information to be provided at the time of formation.

In the United States, proposals to increase LLC transparency have been made at the local and national level, generally in one of two forms, requiring that: (1) beneficial ownership information be filed with governmental entities or (2) real estate industry participants undertake

more due diligence efforts. On the federal regulatory front, the Incorporation Transparency and Law Enforcement Assistance Act has been introduced multiple times in both houses of Congress. This bill would require an LLC to file information on the natural persons who are its ultimate beneficial owners with either the LLC's state of formation or the U.S. Department of the Treasury. The information would be available upon subpoena by domestic law enforcement agencies or upon request for investigative assistance from foreign jurisdictions.

The bill, which most recently was sponsored in 2013 by New York Representative Carolyn Maloney and Michigan Senator Carl Levin, has been proposed in the Senate four times since 2008 and in the House of Representatives three times since 2010, and each time has been referred to committee without further development.

At the local level, small steps have been taken toward the goal of greater transparency. In 2014, Delaware enacted legislation requiring an LLC to maintain a current record of the name and last known address of each member and manager of the LLC, and upon the request of a communications contact, to provide the name, business address and business telephone number of a natural person who has access to the record that contains the name and address of each member and manager of the LLC. While not necessarily an ultimate beneficial owner, this contact person would be able to

disclose the managers and partners of an entity.

In New York City, the city's Department of Finance recently amended real estate transfer tax forms requiring corporate entity purchasers to disclose all of their direct members or general partners. These measures do not require the identification of beneficial owners higher up in the ownership structure so they will likely have only limited impact on beneficial ownership transparency in the case of both residential and commercial real estate transactions.

### **FinCEN Proposed Rule**

Proposed rulemaking by FinCEN reflects one effort to require greater diligence efforts by the financial industry with respect to LLCs owning real estate. In 2014, FinCEN published a proposed rule that would require financial institutions that are already regulated under the USA PATRIOT Act of 2001<sup>3</sup> to, among other things, identify and verify the identity of their customers, including the natural-person beneficial owners of their legal entity customers and conduct ongoing monitoring to maintain and update customer information and identify and report suspicious transactions.

The proposed rule would require financial institutions to collect the identities of all natural persons owning 25 percent or more of new legal entity customers, both directly as immediate shareholders and by aggregating that individual's equity in parent companies. When no natu-

ral person owns 25 percent or more, the financial institutions would collect the identity of an individual exercising significant managerial control, such as holding a senior officer position. However, the proposed rule would not obligate financial institutions to consider whether clients have provided reasonable information.

It should be noted that real estate industry participants are currently exempt from the Patriot Act and would not be covered by the proposed FinCEN rule. Section 352(a) of the Patriot Act requires every financial institution to establish an anti-money laundering program, and persons involved in real estate

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Unless courts say what the law is, we will have no law, much less clearly established law. This approach can lead to a qualified immunity merry-go-round: The law remains unknown, and defendants are qualifiedly immune.

settlements were initially included in the law's definition of "financial institution." However, after the enactment of the Patriot Act, FinCEN in 2002 temporarily exempted such persons from the anti-money laundering requirements while seeking comments on defining "persons involved in real estate closings and settlements." Ultimately, FinCEN took no action, so the exemption for real estate transaction participants has continued.

The efforts by a coalition of 17 non-profit watchdog organizations, including Transparency International, Global Integrity and Global Witness, demonstrate steps to require even greater due diligence by real estate industry participants in the case of both residential and commercial real estate transactions. After "Towers of Secrecy" was published, the coalition penned an open letter to FinCEN suggesting stronger measures be taken to increase transparency by requiring that financial institutions conduct due diligence to determine whether the information provided by their customers is reasonable as well as to assess money-laundering risk for legal entity customers.

The coalition also advocated that FinCEN end the Patriot Act exemption for real estate transaction participants. The coalition argued that repealing the exemption would align U.S. policy with measures recommended by the Financial Action Task Force (FATF), an inter-governmental organization promoting regulatory and operational measures to combat money laundering, terrorist financing and other related threats to the integrity of the international financial system. The coalition also advocated for the enhanced rule to apply retroactively, essentially requiring financial institutions to collect and assess beneficial ownership data on all of their existing customers.

Reactions to such transparency proposals reflect varying concerns—law enforcement's priorities competing

with the private market's focus on privacy and minimal administrative burdens. Comments from law enforcement agencies and non-governmental organizations on FinCEN's proposed rule favor improving the ability to pursue leads and assist foreign jurisdictions' investigations. Private sector comments focus on the burdens and costs associated with categorical requirements to collect beneficial ownership information and concerns that financial institutions may be unable to verify the status of beneficial owners without an independent source such as state registries. Others argue that real estate transaction participants are ill-equipped to evaluate purchasers and that any proposal should heavily rely on banks and the federal government to scrutinize purchasers through established channels.

## Activities Abroad

While there has been little significant change in the United States on increased LLC ownership transparency, that is not the case with activities abroad. In 2012, FATF set forth recommendations in the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation in an effort to persuade individual countries to establish international anti-money laundering and counter-terrorist financing standards, with each jurisdiction adapting standards to their particular circumstances.

FATF, for example, recommends requiring real estate agents and lawyers who represent buyers and sell-

ers of real estate to perform customer due diligence and record-keeping procedures, including identifying and verifying the beneficial owners of their clients. This would include understanding both the ownership and control structures of their customers.

There have also been efforts to develop registries for beneficial owners. The European Union's Fourth Anti-Money Laundering Directive (AMLD), effective as of June 26, 2015, requires EU member states to build central registries of beneficial owners. The AMLD leaves to individual member states the determination of whether beneficial ownership listings should be made public.

The United Kingdom has taken a more aggressive approach to public disclosure by creating public registries of ultimate beneficial ownership. The U.K.'s Small Business, Enterprise and Employment Act 2015 requires companies to maintain a registry of people with significant control, defined to include anyone directly or indirectly: (i) holding at least 25 percent of the company's shares, (ii) holding 25 percent or more of the company's voting rights, (iii) having the right to appoint a majority of the board of directors and (iv) having the right to exercise or actually exercising significant influence or control over the company. The act seeks to limit the misuse of companies, including in the case of real estate ownership. This information is scheduled to become publicly accessible in April 2016.

Increased attention in the United States regarding anonymous LLC ownership of real estate reflects a more global focus on corporate structures that potentially inhibit the ability of law enforcement to effectively combat activities such as money laundering and financing of terrorism. As countries like the United Kingdom implement measures to facilitate greater transparency for LLC beneficial ownership, greater pressure will exist for the United States to conform to such measures.

While the ultimate form of such measures is yet to be determined, recent proposals in the United States and actions in Europe indicate that either public registries or stronger diligence requirements for real estate industry participants will be used to address the potential misuse of LLCs as a means of hiding illegal or otherwise undesirable activities.



1. L. Story and S. Saul, "Towers of Secrecy" series, N.Y. Times, beginning Feb. 7, 2015, <http://www.nytimes.com/2015/02/08/nyregion/stream-of-foreign-wealth-flows-to-time-warner-condos.html>.

2. Vance, Cyrus. "It's Time to Eliminate Anonymous Shell Companies." Reuters. 9 October 2012. <http://blogs.reuters.com/great-debate/2012/10/09/its-time-to-eliminate-anonymous-shell-companies>.

3. Pub. L. No. 107-56. 115 Stat. 272.