

## United States: Beneficial Ownership Reporting, Part III

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### In brief

On 29 September 2022, FinCEN released the final regulations regarding Beneficial Ownership Information Reporting Requirements ("**Final Regulations**") which implement the beneficial ownership information reporting provisions of the Corporate Transparency Act (CTA). In our prior client alerts, [Updates on Beneficial Ownership Reporting in the United States](#) and [Beneficial Ownership Reporting, Part II](#), we discussed the implications of the CTA and the Proposed Regulations. Here, we summarize the Final Regulations and draw special attention to the modifications that FinCEN made to the Proposed Regulations.

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### Background

On 29 September 2022, the Financial Crimes Enforcement Network (FinCEN) of the US Department of the Treasury ("**Treasury**") released the final regulations regarding Beneficial Ownership Information Reporting Requirements ("**Final Regulations**"), which implement the beneficial ownership information reporting provisions of the Corporate Transparency Act (CTA). The CTA was passed in January 2021 and requires "Reporting Companies" to report to "FinCEN" information regarding the Reporting Company's "Beneficial Owners" and "Company Applicants."

The Final Regulations largely track the earlier proposed regulations issued by FinCEN on 8 December 2021 ("**Proposed Regulations**") but include several changes regarding "Company Applicants" and the timing of reports that could be welcomed by businesses. The Final Regulations are effective 1 January 2024.

In our prior client alerts, [Updates on Beneficial Ownership Reporting in the United States](#) and [Beneficial Ownership Reporting, Part II](#), we discussed the implications of the CTA and the Proposed Regulations. Below we summarize the Final Regulations and draw special attention to the modifications that FinCEN made to the Proposed Regulations.

### Reports Required

The CTA requires Reporting Companies to disclose specific information regarding their Beneficial Owners and Company Applicants to FinCEN.<sup>1</sup> In addition, the Final Regulations require specific information on the Reporting Company itself to be disclosed to FinCEN.<sup>2</sup>

<sup>1</sup> 31 USC §5336(b)(1) & (2).

<sup>2</sup> 31 CFR 1010.380(b)(1)(i).



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## Form and Due Dates of Reports and Penalties for Failure to File.

### Form of Reports

The CTA and the Final Regulations require that the Reporting Company disclose specific information about itself, its Beneficial Owners and its Company Applicant.<sup>3</sup> For each Reporting Company, the Reporting Company must report its:

- Name (including d/b/a)
- Business Address
- Jurisdiction of formation
- Unique identification number

For each Beneficial Owner and Company Applicant, the following information is required to be submitted to FinCEN:

- Legal name
- Date of birth
- Residential address for Beneficial Owners
- Business address for professional Company Applicants, and residential address for other Company Applicants
- unique identifying number from an acceptable identification document or FinCEN identifier

### Due Dates for Reports

The CTA imposes a series of deadlines for submitting reports to FinCEN. Reporting Companies in existence prior to 1 January 2024 must file their initial reports under the CTA with FinCEN by 1 January 2025.<sup>4</sup> Reporting Companies formed (for domestic) or registered (for foreign) on or after 1 January 2024, must file their initial reports within 30 days after formation or registration.<sup>5</sup> If there is a change in beneficial ownership information, the entity will have to file an updated report within thirty days of the change.<sup>6</sup>

### Penalties

The CTA imposes criminal and civil penalties for willfully providing false or fraudulent beneficial ownership information, or willfully failing to report complete or updated beneficial ownership information.<sup>7</sup> A violation may result in a civil penalty of USD 500 per day for each day that the violation continues or is not remedied, or a criminal fine of not more than USD 10,000, imprisonment for not more than two years, or both.<sup>8</sup>

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## Definition of Beneficial Owner

The CTA defines a "Beneficial Owner" as an individual who, directly or indirectly, either (i) exercises substantial control over the Reporting Company, or (ii) owns or controls at least 25% of the ownership interests of the Reporting Company. To clarify this definition, the Proposed Regulations contained certain exceptions to the term Beneficial Owner and provided guidance on how to interpret the term "substantial control" and "ownership interest" for the purpose of identifying Beneficial Owners. The Final Regulations largely adopt the language proposed, with some clarifications and minor modifications.

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<sup>3</sup> 31 USC §5336(b)(2) and 31 CFR 1010.380(b)

<sup>4</sup> 31 CFR 1010.380(a)(1)(iii).

<sup>5</sup> 31 CFR Part 1010.380(a)(1)(i) and (ii).

<sup>6</sup> 31 CFR Part 1010.380(a)(2).

<sup>7</sup> 31 USC §5336(h)(1).

<sup>8</sup> 31 USC §5336(h)(3).



## Substantial Control

The Proposed Regulations set forth three specific indicators of substantial control, followed by a catch-all provision that brings in "any other form of substantial control over the reporting company." The three indicators are: "(i) serving as a senior officer<sup>9</sup> of a reporting company; (ii) authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of director (or similar body) of a reporting company; and (iii) direction, determination, or decision of, or substantial influence over, important matters<sup>10</sup> of a reporting company."

The Final Regulations retain the three indicators and the catch-all provision with the following alterations and clarifications:<sup>11</sup>

- Corporate secretary or treasurer is removed from the list of roles that qualify as "senior officer" as they usually have little control of the company.
- The second indicator, which is the power to appoint or remove senior officers or "a majority or dominant minority of" the board of directors, is revised to delete the reference to a "dominant minority of the board of directors" to avoid the ambiguity in the term "dominant minority."
- To provide more clarity, the third indicator, which goes to having substantial influence over "important matters affecting" the company, is revised to say having substantial influence over "important decisions made by the reporting company."

Importantly, the Final Regulations clarify that "a trustee of a trust or similar arrangement" can exercise substantial control over a Reporting Company through the exercise of his or her powers as a trustee over the corpus of the trust.<sup>12</sup> For example, a trustee may control a Reporting Company by exercising control rights associated with the company shares held in trust.

Further, the Final Regulations reaffirm that a Reporting Company can have multiple Beneficial Owners for this purpose, all of which need to be reported.

One notable issue that has not been addressed by the Final Regulations is whom to report when the party with substantial control is a corporate trustee (such as a trust company). As noted above, the CTA defines a "Beneficial Owner" as an **individual** who, directly or indirectly, exercises substantial control over the Reporting Company. Since a corporate trustee is not an individual, it is possible that one or more employees of the trust company who are responsible for the trust would need to be reported as individuals with **indirect** substantial control.

## Ownership Interest

### Definition of Ownership Interest

Largely adopting the language in the Proposed Regulations, the Final Regulations provide that "ownership interests" include both equity and other types of interests in a Reporting Company, such as capital or profit interests (including partnership interests), as well as convertible interests, warrants or rights, and other options or privileges to acquire equity, capital or other interests.<sup>13</sup> Notably, debt interests are included if they enable the holder to exercise the same rights as holders of these specified equity or other interests, including a conversion right.

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<sup>9</sup> Proposed 31 CFR 1010.380(f)(8) defined "senior officer" as "any individual holding the position or exercising the authority of a president, secretary, treasurer, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function." (emphasis added)

<sup>10</sup> Proposed 31 CFR 1010.380(d)(1) provided a non-exhaustive list of "important matters" - "important matters affecting the reporting company, including but not limited to: (A) The nature, scope, and attributes of the business of the reporting company, including the sale, lease, mortgage, or other transfer of any principal assets of the reporting company; (B) The reorganization, dissolution, or merger of the reporting company; (C) Major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the reporting company; (D) The selection or termination of business lines or ventures, or geographic focus, of the reporting company; (E) Compensation schemes and incentive programs for senior officers; (F) The entry into or termination, or the fulfillment or non-fulfillment of significant contracts; and (G) Amendments of any substantial governance documents of the reporting company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures."

<sup>11</sup> 31 CFR 1010.380(d)(1).

<sup>12</sup> 31 CFR 1010.380(d)(1)(ii).

<sup>13</sup> 31 CFR 1010.380(d)(2)(i).



Further, the Final Regulations add a catch-all provision<sup>14</sup> to the list of "ownership interests"<sup>15</sup> so that "ownership interests" for this purpose include "any other instrument, contract, arrangement, understanding, relationship, or mechanism used to established ownership."

### Ownership or Control of Ownership Interest

As in the text of the CTA, an individual may "own or control" interests directly or indirectly. The Final Regulations provide a non-exhaustive list of examples illustrating how individuals may own or control ownership interests directly or indirectly.<sup>16</sup> A Reporting Company must consider all the facts and circumstances in assessing who owns or controls ownership interests.

The Final Regulations also reaffirm that an individual may own or control ownership interests in Reporting Companies via trust that holds the ownership interest, if the individual is as the grantor or settlor and has the right to revoke the trust or otherwise withdraw all of the trust assets, a trustee or other individual with the authority to dispose of trust assets (which again raises the corporate trustee issue identified above), or a beneficiary who is the sole permissible recipient of both income and principal of the trust, has the right to demand distributions, or may withdraw substantially all of the assets of the trust.<sup>17</sup> This is a notable distinction from other information reporting regimes including FATCA and CRS, pursuant to which discretionary beneficiaries are usually only reportable in the event that they actually receive distributions out of the trust directly or indirectly.

In addition, the language of the Final Regulations leave room to argue that beneficiaries of trusts with multiple beneficiaries could also be deemed to own or control ownership interests in Reporting Companies. However, there is also be room to conclude that only the specific types of trust beneficiaries noted in the Final Regulations (set forth above) are considered Beneficial Owners.

### Calculation of the Total Ownership Interests of a Reporting Company

Following the Proposed Regulations, the Final Regulations provide that in all circumstances an individual's total ownership interests are compared to the outstanding ownership interests of the Reporting Company. In addition, the Final Regulations provide specific guidance for calculating ownership interest when different types of entities and convertible interests are involved.

- For Reporting Companies that issue capital and profit interests, including entities taxed as partnerships, the Final Regulations clarify that the individual's total capital and profit interests are compared to the total outstanding capital and profit interests of the Reporting Company.
- For corporations, entities taxed as corporations, and other entities that issue shares, the Final Regulations clarify that a "vote or value" approach should be used. Under this approach, the individual's percentage of ownership interests is the greater of: (1) the total combined voting power of all classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote, or (2) the total combined value of the ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests. These rules are similar to rules used by entities for federal tax purposes.
- If neither the calculation for entities that issue capital and profit interests nor the calculation for entities that issue shares can be performed with reasonable certainty, the Final Regulations provide a catch-all provision: the individual is deemed to hold 25% or more of the total ownership interests in the Reporting Company if the individual owns or controls 25% or more of any class or type of ownership interests.

All of these calculations are performed on the ownership interests as they stand at the time of the calculation. Options and similar interests are treated as though exercised when the calculation is conducted.

### Exceptions to Beneficial Owners

The Final Regulations exclude from Beneficial Owner minor children, nominees, employees, inheritance, and creditors as follows:<sup>18</sup>

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<sup>14</sup> 31 CFR 1010.380(d)(2)(i)(E).

<sup>15</sup> 31 CFR 1010.380(d)(2)(i).

<sup>16</sup> 31 CFR 1010.380(d)(2)(ii).

<sup>17</sup> 31 CFR 1010.380(d)(2)(ii).

<sup>18</sup> 31 CFR 1010.380(d)(3).



- Minor children are excluded from the scope of Beneficial Owners, provided that the information is reported with respect to a parent or legal guardian.
- In the case of a nominee, intermediary, custodian, or agent, a Reporting Company must report the individual on whose behalf an apparent Beneficial Owner is acting, rather than the apparent Beneficial Owner. The Final Regulations also clarify that this exception applies to a tax or legal professional designated as an agent of the Reporting Company.
- Employees are out of scope where acting solely as employees and substantial control of economic benefits is derived solely from employment status. Senior officers are distinguished from employees, however, and are not exempt from reporting on this basis.
- The inheritor exception applies to future interests associated with a right of inheritance. Once an individual has inherited the ownership interest, the individual owns it and may be reportable.
- An individual would qualify for the creditor exception based on the individual's entitlement to payment of a Reporting Company's indebtedness, even if there are loan covenants or other similar obligations associated with that indebtedness that are intended to secure repayment or enhance the likelihood of repayment.

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## Definition of Company Applicant

The Final Regulations define a "Company Applicant" for purposes of the reporting requirements as an individual who directly files a document to create (with respect to a domestic Reporting Company) or first register (with respect to a foreign Reporting Company) a Reporting Company with a secretary of state or similar office of a State, and also includes the individual who is primarily responsible for directing or controlling the individual to file the document.<sup>19</sup> The Final Regulations thus envision that a Reporting Company will have no more than two Company Applicants. One can easily envision lawyers and their staff (e.g., associate, paralegal, legal assistant), who regularly assist clients with the formation of entities, falling within the definition of Company Applicant. Unlike for a Reporting Company or its Beneficial Owners, a Company Applicant's information is not required to be updated.

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## Definition of Reporting Company

### Domestic Reporting Company

A Domestic Reporting Company is a corporation, LLC, or an entity that is "created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian Tribe."<sup>20</sup> Based on the provisions of the CTA and the Final Regulations, there is a strong argument that a structure that is not created by the filing of a document with a state, such as a common law trust created under the law of any of the fifty US states, is not a Reporting Company. However, the trustee, settlor, and beneficiary of a trust would nevertheless need to be included in the report to FinCEN by the Reporting Company if the trust has an "ownership interest" in the company.

The preamble to the Proposed Regulations states that the definition of a Domestic Reporting Company was done for clarity and ease of administration as FinCEN notes that it is FinCEN's understanding that all corporations and LLCs are created by the filing of a document with the secretary of state or similar office under the law of a state or Indian Tribe. The preamble also discusses how FinCEN considered defining "similar entity" narrowly to include entities that limit their owners' personal liability under state or Indian Tribe law, or even more broadly to include entities that are legally distinct from their natural person owners, but FinCEN found these approaches to be too burdensome and could possibly exclude entities that can obscure their true ownership or control structures. The preamble to the Final Regulations discusses some of these comments, however notes that FinCEN opted not to make a change to the definition in order to provide clarity. The Final Regulations do mention that FinCEN may issue guidance on these rules in the future.

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<sup>19</sup> 31 USC §5336(a)(2) and 31 CFR 1010.380(e).

<sup>20</sup> 31 USC §5336(a)(11) and 31 CFR 1010.380(c)(1)(i).



## Foreign Reporting Company

A Foreign Reporting Company is a corporation, LLC, or other entity formed under the law of a foreign country and registered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian Tribe.<sup>21</sup> This definition more clearly captures each entity that is registered to do business in the US and leaves open less room for interpretive differences.

## Exemptions to Reporting Obligations

While more than 30 million entities that FinCEN estimates exist in the US will become subject to the requirements in the Final Regulations, there will be some notable exceptions. Many of the exempt entities are already subject to substantial federal and/or state regulation or already have to provide their beneficial ownership information to a governmental authority.

The exemptions from the beneficial ownership reporting requirements generally encompass larger and more complex or regulated entities. FinCEN has highlighted that while some smaller entities may have similarly complex management and ownership structures, most such entities with conventional structures will be able to readily identify their beneficial owners.

FinCEN considered comments proposing additional exemptions but concluded that generally commenters did not provide enough information to support making those determinations at this time.<sup>22</sup>

## List of Exemptions to Reporting Company

The Final Regulations include all 23 statutory exemptions from the definition of Reporting Company:

- Banks
- Publicly traded companies
- Large operating companies (i) employing more than 20 full-time employees in the US, (ii) with gross receipts or sales over USD 5 million in the aggregate, and (iii) with an operating presence at a physical office in the US

The Final Regulations adopt the proposed exemption without change. For example, the aggregate amount includes receipts or sales of other entities owned by the entity and through which the entity operates. However, FinCEN declined to permit companies to consolidate employee headcount across affiliated entities. FinCEN expects that companies will regularly evaluate whether they qualify (or no longer qualify) for the exemption. Such evaluations should be as simple as possible, and as consistent as possible.

- IRC §501(c) organizations that are tax exempt under IRC §501(a), which include charitable organizations, social welfare organizations, business leagues and chambers of commerce (regardless of whether they have applied for exempt status on IRS Form 1023, 1024, or 1024-A); political organizations under IRC §527; and trusts under IRC §4947(a)(1) or (2), and entities assisting tax exempt entities

The final rule adopts the proposed exemption for **tax-exempt entities** as proposed and thus almost identical to the CTA language. For comparison, **common law trusts** are not excluded from the reporting as exempt entities; rather, they fall outside the definition of Reporting Company.

- Subsidiaries of an entity that is exempt from being a Reporting Company under the CTA if the ownership interests of the subsidiary are controlled or wholly owned, directly or indirectly, by one or more entities that are exempt from being a Reporting Company; however, if the exempt entity (such as a IRC §501(c) entity) is a minority owner of the subsidiary, the subsidiary will be a Reporting Company

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<sup>21</sup> 31 USC §5336(a)(11) and 31 CFR 1010.380(c)(1)(ii).

<sup>22</sup> The CTA allows the Secretary of the Treasury, with the written concurrence of the Attorney General and the Secretary of Homeland Security, to exclude by regulation additional types of entities. FinCEN did not propose to exempt additional types of entities beyond those specified by the CTA.





- Entities registered pursuant to the Commodity Exchange Act, public utilities, financial market utilities
- Securities issuers, US credit unions, depository institution holding companies, money transmitting businesses, brokers or dealers in securities, securities exchange or clearing agencies, other entities registered pursuant to the Securities Exchange Act of 1934
- RICs and advisers, venture capital fund advisers
- Pooled investment vehicles

The Proposed Regulations contained a special rule for foreign pooled investment vehicles, which must report to FinCEN the Beneficial Owner information of the individual who exercises substantial control over the legal entity. The Final Regulations adopt the rule as proposed.

- Insurance companies

The final rule adopts the language of the Proposed Regulations on an exemption for insurance companies without change. FinCEN did not express an opinion on whether or to what extent certain **captive insurance** companies, which can vary significantly in structure and size, might be able to properly claim this exemption.

- State licensed insurance producers

The Final Regulation adopts the insurance-producer exemption as proposed but eliminate the limitation of physical offices thus now including "the place of residence of any individual" for purposes of determining "an operating presence at a physical office within the United States".

- Accounting firms registered under §102 of the Sarbanes-Oxley Act of 2002
- Certain inactive entities in existence before 1 January 2020 (unless owned by a "foreign person", directly or indirectly, wholly or partially).<sup>23</sup>

### Exempt Entity as Beneficial Owner of Reporting Company

Notwithstanding the above Reporting Company exemptions, if an exempt entity meets the Beneficial Owner requirements (i.e., it is a Beneficial Owner of a Reporting Company), it will be necessary for the Reporting Company to report as the Beneficial Owner either the names of the individuals who control **directly or indirectly** the exempt entity or the **exempt entity itself**.<sup>24</sup>

- The Final Regulations clarify that this special rule on reporting of the exempt entity itself "*may*" apply when an individual holds 25% or more of ownership interests in the Reporting Company through "one or more" exempt entities "exclusively".
  - In other words, the special rule applies even if the interests are held via **multiple** exempt entities.
  - In contrast, the rule does **not** apply if the individual holds the interests through **both** exempt and non-exempt entities – then the name of the individual has to be reported as the Beneficial Owner.
  - This special rule is optional, rather than mandatory, under the Final Regulations, which use "may" instead of "shall". Accordingly, the Reporting Company may still report the name of the individual (rather than the exempt entity) as the Beneficial Owner even when the interest is held via exclusively exempt entities.

### Exempt Entity Becoming Reporting Company and Vice Versa

The Proposed Regulations specified that if a Reporting Company subsequently becomes eligible for an exemption from the reporting requirement after the filing of its **initial** report, this change will be deemed a change requiring an updated report.

<sup>23</sup> 31 CFR §1010.380(c)(2)(xxiii). The definition of a US person and a foreign person used in the rulemaking is the US tax definition under 26 USC §7701(a)(30).

<sup>24</sup> 31 CFR 1010.380(b)(2)(i).



FinCEN considers the rule to be clear with respect to when an entity's CTA reporting obligation begins or ends relative to when such entity becomes or ceases to be exempt.

Comments indicated that previously exempt entities should have 90 days or longer to submit an initial report after the qualifying conditions for the exemption lapse. One commenter asserted that existing entities that are exempt as of the effective date but that cease to be exempt during the first year after the effective date because they no longer meet the exemption criteria should receive the benefit of the one-year filing period for existing entities. In addition, some commenters said it was unclear how the initial reporting rules would apply to.

For example, an entity that is exempt as of the effective date (1 January 2024) may cease to be exempt during the first year thereafter because it no longer meets exemption criteria. Such previously exempt entities will receive the benefit of the longer of the two applicable time frames: (i) the remaining days left in the one-year filing period or (ii) the 30 calendar-day period.

Therefore, if event causes an exempt entity in existence on the effective date no longer to meet any exemption criteria on the 350<sup>th</sup> day after the effective date, the entity would have 30 days in which to file its initial report. In contrast, if an entity no longer meets any exemption criteria on the 330<sup>th</sup> day, it would have 35 days to file its initial report.

### Further Monitoring, Guidance and FAQs on Exemptions

According to FinCEN, it is appropriate to interpret any ambiguities in the exemptions reasonably narrowly to the smallest possible set permitted by the CTA. In addition, FinCEN will:

- Monitor the application of each exemption
- Consider guidance or FAQs to respond to any additional particular factual circumstances that may arise
- Assess the need for further guidance, notices, or FAQs accordingly

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## Conclusion

The CTA represents a significant step forward for the United States for increasing transparency and reducing the risk that anonymous entities may be used for money laundering, tax evasion or the financing of terrorism. The United States, although belatedly, has joined the international community in creating a legal and regulatory framework for identifying the individuals behind a broad class of legal entities. The world community will be watching to see whether and how well the CTA achieves the policy goal of making money laundering and terrorist financing more difficult in the United States' financial system. According to FinCEN, the effective date of 1 January 2024 should allow for a substantial outreach effort to notify businesses about the CTA reporting requirement and give existing Reporting Companies time to understand the requirement prior to the one-year timeline.

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