

## United States: Corporate Transparency Act – Three Months In

Tax News and Developments March 2024

### In brief

Recently, a district court in Alabama ruled that the Corporate Transparency Act violates the Constitution's limits on Congress's power and enjoined Treasury and FinCEN from enforcing the law against the plaintiffs in that case. Similar cases have been filed in other states, including Maine and Michigan. We discuss the law and its implementing regulations in the report below.

### Introduction

The US Corporate Transparency Act (CTA) went into effect 1 January 2024. Passed in January 2021, The CTA requires "Reporting Companies" to report information regarding their "Beneficial Owners" and "Company Applicants." More than 30 million entities are expected to report beneficial ownership information (BOI) to the Financial Crimes Enforcement Network (FinCEN) of the US Department of the Treasury ("Treasury"). FinCEN released the final regulations regarding BOI reporting requirements on 29 September 2022 and the final regulations on access to BOI by individuals and entities other than FinCEN on 22 December 2023, both of which were effective as of 1 January 2024.

On 1 March 2024, the US District Court for the Northern District of Alabama, Northeastern Division, entered a declaratory judgment, determining that the CTA violates the Constitution's limits on Congress's power and enjoining Treasury and FinCEN from enforcing the CTA against the specific plaintiffs: Isaac Winkles, reporting companies for which Isaac Winkles is the beneficial owner or applicant, the National Small Business Association, and members of the National Small Business Association.<sup>1</sup> The Court reasoned that the CTA was not sufficiently supported by the constitutional powers granted to Congress under the Commerce Clause, the Necessary and Proper Clause, or Congress's plenary power to conduct foreign affairs. FinCEN has stated that it will comply with the court's order for as long as it remains in effect. Pending appeal, the US government is not currently enforcing the CTA against the plaintiffs, who are not required to report beneficial ownership information under the CTA to FinCEN at this time. The filing requirements and deadlines for Reporting Companies not involved in the specific case remain unchanged.

### Reports Required

The CTA requires Reporting Companies to disclose specific information regarding their Beneficial Owners and Company Applicants to FinCEN.<sup>2</sup> In addition, the final regulations regarding BOI reporting requirements (the "Final Regulations") require specific information on the Reporting Company itself to be disclosed to FinCEN.<sup>3</sup>

<sup>1</sup> See *National Small Business United v. Yellen*, No. 5:22-cv-01448 (N.D. Ala.). There is at least one other lawsuit pending against US Treasury Department in the US District Courts in Maine and Michigan. See *Boyle v. Yellen*, No. 2:24-cv-00081 (D. Me.); *Small Bus. Ass'n of Mich. v. Yellen*, 1:24-cv-00314 (W.D. Mich.).

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

<sup>3</sup> 31 CFR 1010.380(b)(1)(i).

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

Form of BOI Reports

The Reporting Company must disclose specific information about itself, its Beneficial Owners, and its Company Applicant.<sup>4</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 BOI Reports

The CTA imposes a series of deadlines for submitting initial reports under the CTA with FinCEN:

Reporting Companies in existence prior to January 1, 2024	Reporting Companies formed (for domestic) or registered (for foreign) on or after January 1, 2024, but before January 1, 2025	Reporting Companies formed (for domestic) or registered (for foreign) on or after January 1, 2025
by January 1, 2025 <sup>5</sup>	within 90 days after formation or registration <sup>6</sup>	within 30 days of formation or registration
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>7</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>8</sup> A violation may result in a civil penalty of \$500 per day for each day that the violation continues or is not remedied, or a criminal fine of not more than \$10,000, imprisonment for not more than two years, or both.<sup>9</sup>

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. Consequently, a Reporting Company can have multiple Beneficial Owners, all of which need to be reported. To clarify the definition, the Final

<sup>4</sup> 31 USC §5336(b)(2) and 31 CFR 1010.380(b).

<sup>5</sup> 31 CFR 1010.380(a)(1)(iii).

<sup>6</sup> 31 CFR 1010.380(a)(1)(i) and (ii).

<sup>7</sup> 31 CFR 1010.380(a)(2).

<sup>8</sup> 31 USC §5336(h)(1).

<sup>9</sup> 31 USC §5336(h)(3).

Regulations provide guidance on how to interpret the terms "substantial control" and "ownership interest" for the purpose of identifying Beneficial Owners and contain certain exceptions to the term Beneficial Owner.

## Substantial Control

The Final 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:

- serving as a senior officer<sup>10</sup> of a reporting company;
- 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
- direction, determination, or substantial influence over important decisions<sup>11</sup> of a 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 specifically enumerated powers as well as any contract, arrangement, understanding, relationship, or otherwise.<sup>12</sup> For example, a trustee may control a Reporting Company by exercising control rights associated with the shares of, or financial arrangements in, a company directly or over one or more intermediary entities that separately or collectively exercise substantial control.

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 a corporate trustee is not an individual, one or more employees of the trust company who are responsible for the trust may need to be reported as individuals with *indirect* substantial control.

## Ownership Interest

### Definition of Ownership Interest

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. Further, the Final Regulations have 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 establish ownership."

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<sup>10</sup> 31 CFR 1010.380(f)(8) defines "senior officer" as "any individual holding the position or exercising the authority of a president, 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>11</sup> 31 CFR 1010.380(d)(1)(C) provided a non-exhaustive list of "important decisions," including: (1) 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; (2) the reorganization, dissolution, or merger of the reporting company; (3) major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the reporting company; (4) the selection or termination of business lines or ventures, or geographic focus, of the reporting company; (5) compensation schemes and incentive programs for senior officers; (6) the entry into or termination, or the fulfillment or non-fulfillment of significant contracts; and (7) 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>12</sup> 31 CFR 1010.380(d)(1)(ii).

<sup>13</sup> 31 CFR 1010.380(d)(2)(i). For example, an "ownership interest" includes transferable shares, convertible instruments, put, call, straddle, or other options.

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

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

## Ownership or Control of Ownership Interest

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.

Furthermore, an individual may own or control ownership interests in Reporting Companies via trust that holds the ownership interest, if the individual is 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.<sup>18</sup>

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

In all circumstances, an individual's total ownership interests are compared to the outstanding ownership interests of the Reporting Company. 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:
  - 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
  - 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>19</sup>

- Minor children are excluded from the scope of Beneficial Owners, provided that the information is reported with respect to a parent or legal guardian.

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

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

<sup>18</sup> In addition, it may be possible to take a position that beneficiaries of trusts with multiple beneficiaries could also be deemed to own or control ownership interests in Reporting Companies. However, there is also room to conclude that only the specific types of trust beneficiaries are considered Beneficial Owners.

<sup>19</sup> 31 CFR 1010.380(d)(3).

- 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>20</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>21</sup> According to FinCEN, generally sole proprietorships, certain types of trusts, and general partnerships are not created through such a filing and would not be a Reporting Company, even if they register for a business license or similar permit that would not create the entity. Therefore, there is a strong position that a holding vehicle that is not created by the filing of a document with a US State, such as a common law trust created under the law of any of the 50 US States, is not a Reporting Company. However, the trustee, settlor, and beneficiary of a trust will nevertheless need to be included in the FinCEN report by a Reporting Company if the trust has an "ownership interest" in the company. FinCEN may issue further guidance on these rules in the future.

### 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>22</sup> This definition clearly captures each entity that is registered to do business in the US and leaves open less room for interpretive differences.

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<sup>20</sup> 31 USC §5336(a)(2) and 31 CFR 1010.380(e).

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

<sup>22</sup> 31 USC §5336(a)(11) and 31 CFR 1010.380(c)(1)(ii).

## Exemptions to Reporting Obligations

While FinCEN estimates that more than 30 million entities that existed before 2024 are subject to the reporting requirements in the Final Regulations, there will be some notable exceptions with respect to both existing and future entities. 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.<sup>23</sup>

### List of Exemptions to Reporting Company

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

- Banks<sup>24</sup>
- Publicly traded companies (securities reporting issuers)
- Large operating companies (i) employing more than 20 full-time employees in the US, (ii) with gross receipts or sales over \$5 million in the aggregate, and (iii) with an operating presence at a physical office in the United States
  - The aggregate amount includes receipts or sales of other entities owned by the entity and through which the entity operates. However, in respect of the first requirement, companies may not 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 and as consistent as possible.
  - Furthermore, an entity is treated as having an *operating presence at a physical office within the United States* if the entity regularly conducts its business at a US physical location that the entity owns or leases and that is physically distinct from the place of business of any other unaffiliated entity.<sup>25</sup>
- State licensed insurance producers with an operating presence at a US physical office
- Insurance companies
  - 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.
- Tax-exempt entities<sup>26</sup> and entities assisting tax exempt entities<sup>27</sup>
  - For comparison, *common law trusts* are not excluded from the reporting as exempt entities; rather, they fall outside the definition of Reporting Company.
- 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

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<sup>23</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.

<sup>24</sup> 31 CFR 1010.380(c)(2)(iii) (as the term is defined in the Federal Deposit Insurance Act, the Investment Company Act of 1940 and the Investment Advisers Act of 1940).

<sup>25</sup> 31 CFR 1010.380(f)(6).

<sup>26</sup> 31 CFR 1010.380(c)(2)(xix) (defining the term to mean 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 with regard to a §501(c)(3) organization); political organizations under IRC §527; and trusts under IRC §4947(a)(1) or (2)).

<sup>27</sup> 31 CFR 1010.380(c)(2)(xx) (limiting the exemption to *US person* entities that are beneficially owned or controlled *exclusively* by one or more US citizens or lawful permanent residents).



- RICs and advisers, venture capital fund advisers
- Pooled investment vehicles
  - Foreign pooled investment vehicles must report to FinCEN the BOI of the individual who exercises substantial control over the legal entity.
- 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 an IRC §501(c) entity) is a minority owner of the subsidiary, the subsidiary will be a Reporting Company.
- Certain inactive entities in existence before January 1, 2020 (unless owned by a “foreign person”, directly or indirectly, wholly or partially).<sup>28</sup>

### Exempt Entity as Beneficial Owner of Reporting Company

If an exempt entity itself is a Beneficial Owner of a Reporting Company, the Reporting Company *may* report the exempt entity rather than those individuals who would otherwise be reportable “exclusively by virtue of the individual's ownership interest” in the exempt entity.<sup>29</sup> However, the Reporting Company must also report as beneficial owners any individuals who control the Reporting Company under the substantial control prong of the beneficial ownership test (e.g., the officers, managers, etc. of the Reporting Company). These people may happen to also be true owners of the exempt entity or could be third parties.

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. Accordingly, the Reporting Company may still report the name of the individual who has ownership interest in the exempt entity (rather than the exempt entity itself) as the Beneficial Owner even when the interest is held exclusively via the exempt entity that has a direct or indirect ownership interest in the Reporting Company.

### Exempt Entity Becoming Reporting Company and Vice Versa

If after the filing of its *initial* report a Reporting Company becomes eligible for an exemption from the BOI reporting requirement, this will be deemed a change requiring an updated report. 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. For example, an entity that is exempt as of the effective date 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.<sup>30</sup>

### 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 (i) monitor the application of each exemption, (ii) consider guidance or FAQs to respond to any additional particular factual circumstances that may arise, and (iii) assess the need for further guidance, notices, or FAQs accordingly.

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<sup>28</sup> 31 CFR 1010.380(c)(2)(xxiii). The definition of a US person (and thus a foreign person) for purposes of the CTA is the US tax definition under 26 USC §7701(a)(30), including the special rule on US lawful permanent residents who commence to be treated as a resident of a foreign country under an income tax treaty between the United States and the foreign country.

<sup>29</sup> 31 CFR 1010.380(b)(2)(i).

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

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## Access to BOI

### Final Regulations

On December 22, 2023, FinCEN issued final regulations on access to the beneficial ownership information by individuals and entities other than FinCEN. These final regulations provide that FinCEN may disclose CTA information upon receipt of request from the following:

- a Federal agency engaged in national security, intelligence, or law enforcement activity if the information is used to carry out such activities
- a State, local, or Tribal law enforcement agency to be used in a criminal or civil investigation if a court has authorized the agency to seek the information
- a Federal agency on behalf of a law enforcement agency, prosecutor, or judge of another country, or on behalf of a foreign central authority or foreign competent authority (or like designation) under an applicable international treaty, agreement, or convention
  - the BOI must be for assistance in law enforcement investigation or prosecution, or for national security or intelligence activity, that is authorized under laws of foreign country and a request must be made pursuant to an international treaty or convention or when no such treaty, agreement, or convention is available, as an official request by a law enforcement, judicial, or prosecutorial authority of a trusted foreign country
- a financial institution subject to customer due diligence requirements if the information is to be used in facilitating such compliance.

FinCEN will disclose BOI at the request by a Federal functional regulator or other appropriate regulatory agency such BOI disclosed to a financial institution if agency is legally authorized to assess, supervise, enforce, or otherwise determine the compliance of such institution with customer due diligence rules, will only use such information for said supervision, or authorized investigation or activity, and has entered into a safekeeping agreement with FinCEN.

FinCEN will make BOI accessible for inspection or disclosure to officers and employees of the US Department of the Treasury whose official duties the Treasury Secretary determines require such inspection or disclosure. Further, officers and employees of the Department of the Treasury may obtain BOI for tax administration.

Requests for BOI information may be rejected by FinCEN if not made on the proper form required by FinCEN. FinCEN has sole discretion to reject requests for BOI if it finds that the request has failed to meet any of the requirements by the CTA regulations, the information is being requested for an unlawful purpose, or other good cause exists. FinCEN also has authority to issue permanent or temporary bans from a party receiving BOI information.

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## Filing of BOI

The BOI Reports are able to be filed directly on the FinCEN website.<sup>31</sup> The FinCEN webpage allows Reporting Companies to file and create their unique identifying number directly on the website. Filers have the option to submit an online PDF or directly input their information on the website if they prefer to do so.

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<sup>31</sup> See <https://www.fincen.gov/boi>



## 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 has joined the international community in creating a legal and regulatory framework for identifying the individuals behind a broad class of legal entities. According to FinCEN, the effective date allows for a substantial outreach effort to notify existing Reporting Companies and to give them time to understand and comply with the BOI reporting requirements by the filing deadline by the end of 2024.

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