

NEW CORPORATE COMPLIANCE ON THE HORIZON: THE CORPORATE TRANSPARENCY ACT

Effective January 1, 2024, the Corporate Transparency Act (CTA), 31 U.S. Code § 5336, will require most new and existing business entities to file a report with the federal government containing personal information about who created and who owns the company. Owners and principals will need to be identified by name, date of birth, and home address, and must submit a copy of a valid government-issued identification. Although there are exceptions, this new reporting obligation will likely affect your business.

The goal of the CTA is to create a comprehensive database of entities operating in the U.S. It is an expansion of anti-money laundering laws intended to combat a variety of criminal activities, including tax evasion and the financing of criminal and terrorist enterprises. The Financial Crimes Enforcement Network (FinCEN), a bureau of the U.S. Treasury, will be in charge of creating and maintaining the database.

Affected Companies

The CTA covers a broad range of domestic and foreign business entities. It defines the term “reporting company” as any entity that is a corporation, a limited liability company, or other similar entity that is (1) created by the filing of a document with a secretary of state or similar office, or (2) formed under the law of a foreign country and registered to do business in any U.S. state by the filing of a document with a secretary of state or similar office.

In practical terms, this means that unless your company qualifies for an exemption, it will have to file a report. Even small businesses with only one owner that are ignored for federal income tax purposes (e.g., a single-member disregarded LLC) must file.

Exemptions

The CTA lists 23 types of entities that are exempt from reporting, most of which are entities already subject to extensive regulation. Notable exemptions include:

- SEC-reporting companies;
- Regulated financial services companies, including banks, credit unions, registered securities broker-dealers, registered investment companies and investment advisers, venture capital fund advisers, and pooled investment vehicles that are operated or advised by the foregoing;
- Insurance companies;
- PCAOB-registered accounting firms;
- Tax-exempt entities;
- Subsidiaries of certain exempt entities; and
- Inactive entities existing before January 1, 2020, that are not engaged in active business, are not owned by a foreign person, have not had a change in ownership in the last 12 months, have not sent or received funds greater than \$1,000 in the last 12 months, and do not hold any assets.

There is also an exemption for large companies that meet certain employment and/or tax reporting criteria, viz., any entity that (1) employs more than 20 full-time employees in the U.S., (2) has an operating presence at a physical office in the U.S., and (3) demonstrated more than \$5 million in gross receipts or sales on their federal income tax return (excluding sales from sources outside the U.S.).

Timelines for Compliance

For entities formed before January 1, 2024, initial reports are due by January 1, 2025. For entities created on or after January 1, 2024, the initial report is due within 30 calendar days from the date of the company's creation. As of now, there are no time extensions.

Initial Filings and Updates

FinCEN is currently designing and building a virtual system called the Beneficial Ownership Secure System to collect and store CTA reports. This system is not yet available, and reports will not be accepted prior to January 1, 2024. Once it is operational, reports will require the following:

1. **Entity Information:** Reporting companies must provide the full legal name of the entity and any trade names or "doing business as" (d/b/a) names, a street address for company's principal place of business, the state of formation, and the federal taxpayer ID number.
2. **Beneficial Owners:** All beneficial owners must disclose their full legal name, date of birth, and current home address (a P.O. Box will not suffice), and submit a copy of a nonexpired government-issued document with a unique identifying number (e.g., a passport or driver's license). Alternatively, individuals and entities may apply for a FinCEN identifier, which can be included on subsequent filings in lieu of this information, and may be a convenient option for frequent filings.

The CTA defines a "beneficial owner" as any individual who, directly or indirectly, either exercises "substantial control" over the company or owns or controls at least 25% of the company's ownership interests. An individual exercises "substantial control" over a company if the individual (A) serves as a senior officer of the company; (B) has authority over the appointment or removal of any senior officer or a majority of the board; or (C) directs, determines, or has substantial influence over important decisions made by the reporting company. Thus, senior officers and other individuals with control over the company are "beneficial owners," even if they have no equity interest in the company. "Ownership interest" is also defined broadly to include any type of equity interests (e.g., profits interests, convertible instruments, warrants, options, puts, calls, and other entity interests).

Individuals may exercise control directly or indirectly, through board representation, ownership, rights associated with financing arrangements, or control over intermediary entities that separately or collectively exercise substantial control. Indirect ownership or control of a company or its ownership interests may include:

- Joint ownership with one or more other persons;
- Through another individual acting as a nominee, intermediary, custodian, or agent;
- As trustee, grantor/settlor, or beneficiary of a trust; and
- Through ownership or control of one or more intermediary entities that separately or collectively own or control ownership interests of the reporting company.

3. **Company Applicants:** Any companies created after January 1, 2024, must also identify the company applicants with the same information required for beneficial owners. Entities created prior to January 1, 2024, do not need to include information on company applicants.

The "company applicant" is the individual who files the document that creates the reporting company. It also includes the individual who is primarily responsible for directing or controlling the filing

if more than one individual is involved. In many cases, the company applicant will also be a beneficial owner of the company; however, they are often third parties such as attorneys and paralegals who file corporate formation documents on behalf of clients.

4. **Changes in Reported Information:** Reporting entities must report changes to any filing within 30 calendar days of the date of the change. The only exception to this is information about company applicants, which is not required.

Changes requiring an updated report include the following:

- Changes in who is a beneficial owner (e.g., due to transfers of ownership or sales of additional ownership interests);
- A reporting company becoming exempt from the reporting requirements;
- Transfers of ownership interests due to an owner's death;
- Transfers of ownership when a minor child reaches the age of majority; and
- Any changes to an identifying document previously submitted (e.g., changes in name, address, or identifying number).

In addition, if the reporting company becomes aware of mistakes or inaccuracies in a previously filed report, it must file a corrected report within 30 calendar days after the date on which the reporting company becomes aware or has reason to know of the inaccuracy.

This area of the CTA presents a high risk for accidental noncompliance. For example, unbeknownst to you, one of the managers of an LLC you are involved with moves to a new home and changes their address. This change must be reported to FinCEN within 30 days, and the CTA offers no exceptions for receiving information after the deadline. To ensure compliance, you should implement procedures in your business requiring that such changes be disclosed in time to make the required filings. You may even want to amend your entity's governing documents (e.g., operating agreements, bylaws, etc.) to mandate that every signer takes appropriate action to inform a person designated on behalf of the entity to report relevant changes.

Access to CTA Reports

The CTA authorizes FinCEN to disclose reported information to authorized government authorities. Reports will not be accessible to the public and are not subject to requests under the Freedom of Information Act; however, FinCEN may disclose information to financial institutions to assist in their anti-money laundering compliance activities if the reporting company consents.

Penalties for Noncompliance

The CTA imposes heavy penalties for willful noncompliance: \$500 a day for each day the violation continues, up to \$10,000, and up to 2 years in jail. Any assessment as to whether false information was willfully filed would depend on all of the facts and circumstances, but as a general matter, FinCEN does not expect an inadvertent mistake by a reporting company acting in good faith, after diligent inquiry, to constitute a willful violation.

What to Do

1. **Review Your Business Holdings and Corporate Structures:** Compile a list of all of your reporting entities, and review the corporate structure of each to identify the beneficial owners.

2. **Create a Beneficial Ownership Register:** Once you have identified the beneficial owners, create a beneficial ownership register. The register should include the name, address, date of birth, and copy of a current government-issued photo ID (e.g., a passport or driver's license) of each beneficial owner.
3. **Develop a Compliance Program:** Consider developing a compliance program to ensure that your business is in compliance with the CTA. The program should include policies and procedures for identifying and verifying beneficial owners, maintaining the beneficial ownership register, reporting beneficial ownership information to FinCEN, and safeguarding personal information.
4. **Stay Up to Date on Changes:** It's important to keep the register up to date and accurate, as inaccurate or incomplete information can result in fines or other penalties. Furthermore, the CTA is a new law, and you need to remain informed about any future changes or clarifications to the CTA and FinCEN regulations.
5. **Ask for Help:** Our office is here to help you understand if your company qualifies for an exemption, identify beneficial owners, create and maintain a beneficial ownership register, report beneficial ownership information, and keep you informed of any changes in the law.

The Corporate Transparency Act represents a significant change in U.S. corporate law, and you should start preparing for its implementation soon.

KEY DATES

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| January 1, 2024: | CTA becomes effective. |
| January 1, 2025: | Initial reports due for all entities formed before January 1, 2024. |
| 30 days after Formation: | Initial reports due for entities created on or after January 1, 2024. |