

CORPORATE TRANSPARENCY ACT

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A. Enactment and Purpose. Congress, in rare bipartisan fashion, passed the Corporate Transparency Act (“CTA”) which became law via Senate override of a presidential veto on January 2, 2021, as a part of the National Defense Authorization Act.¹ Implementation and enforcement was assigned to the U.S. Treasury Department’s Financial Crimes Enforcement Network (also known as FinCEN). The purpose of the CTA is to address the perceived vulnerability in the U.S. relating to the ability to use U.S. entities to effectively conceal information on beneficial ownership of corporate entities formed in the United States to promote anti-money laundering/countering the financing of terrorism (AML/CFT) framework. The CTA’s preamble states that this “... lack of transparency creates opportunities for criminals, terrorists, and other illicit actors to remain anonymous while facilitating fraud, drug trafficking, corruption, tax evasion, organized crime, or other illicit activity through legal entities created in the United States.” These rules will require most corporations, limited liability companies, and other entities created in or registered to do business in the United States to report information to FinCEN about their beneficial owners, the persons who ultimately own or control the company. The information collected will be kept in a private database maintained by FinCEN with access limited to federal agencies, state agencies with a court order, and financial institutions with the consent of the company.

B. Scope of the Corporate Transparency Act. There are three basic definitional components of the reporting that will be required under the Corporate Transparency Act – what/who are: (1) a reporting company, (2) a beneficial owner of a reporting company, and (3) a

company applicant. FinCEN issued the first set of what will be three final regulations at the end of September, 2022.² These rules describe who must file a report of “Beneficial Ownership Information” (“BOI”), what information must be reported, and when a report is due. Specifically, reporting companies will be required to file reports with FinCEN that identify two categories of individuals: (1) the beneficial owners of the entity; and (2) the company applicants of the entity.

1. **Reporting Company.** A domestic “reporting company” is defined as any entity that is a corporation, a limited liability company, or is created by the filing of a document with a Secretary of State or similar office under the law of a state or Indian tribe. Typically these will include limited liability partnerships, limited liability limited partnerships, business trusts, and most limited partnerships. A foreign reporting company is a similar entity formed under the law of a foreign country which is registering to do business in any state or tribal jurisdiction in the United States.
2. **Exemptions.** There are numerous exemptions from the definition of a “reporting company.” Generally, the exempt entities are companies that are already subject to substantial federal or state regulation under which their beneficial ownership is already disclosed, such as entities that file reports with the SEC, governmental authorities, banks, credit unions, money services businesses, investment advisors, securities brokers and dealers, tax exempt entities, entities assisting tax exempt entities, insurance companies, state-licensed insurance producers, pooled investment vehicles, public utilities, inactive entities, subsidiaries of certain exempt

entities, accounting firms, and large operating companies.

- a. Inactive entities are only those non-foreign entities in existence on or before the date of enactment of the CTA, which are not engaged in active business, and effectively have no assets.
- b. Large operating companies are generally entities that: (1) employ more than 20 full time employees in the United States, (2) have an operating presence at a physical office within the United States, and (3) have filed a federal income tax or information return in the United States for the previous year demonstrating more than \$5 million in gross receipts or sales. This is a fairly significant exemption.
- c. Other types of legal entities, including certain trusts, are excluded from the definitions to the extent that they are not created by the filing of a document with a secretary of state or similar office.
- d. Significantly for the audience of this material, the reporting obligation falls on the reporting company. The CTA does not impose a filing obligation upon lawyers or CPAs or other advisors. On the other hand, reporting companies are almost certain to rely on their legal and accounting advisors for helping them with their reporting obligations. And, as will be commented on later, the penalties for non-compliance are rather severe.

C. What Information must be Disclosed?

1. Reporting Company. Each reporting company must provide: (1) the full legal name of the reporting company, (2) any trade name or “doing business as” name of the reporting com-

pany, (3) the business street address of the reporting company, (4) the state or Tribal jurisdiction of formation of the reporting company (or for a foreign reporting company, the state or Tribal jurisdiction where such company first registers), and (5) an IRS Tax identification number (TIN) of the reporting company; foreign reporting companies without a TIN will be required to provide a foreign tax identification number.

2. Beneficial Owners. A “beneficial owner” **includes any individual who, directly or indirectly, either (1) exercises substantial control over a reporting company, or (2) owns or controls at least 25 percent of the ownership interests of a reporting company. The rule defines the terms “substantial control” and “ownership interest.”**

- a. Substantial Control. The rule sets forth three (3) specific indicators of “substantial control”: (i) service as a senior officer 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 directors (or similar body) of a reporting company; and (iii) direction, determination, or decision of, or substantial influence over, important matters affecting a reporting company. Also included was the retention of a catch-all provision in from proposed rule also included a to ensure consideration of any other forms that substantial control might take beyond the criteria specifically listed. This list is intended to capture anyone who is able to make important decisions on behalf of the entity. In its own words, FinCEN’s approach is designed to close loopholes that allow corporate structuring that obscures owners or decision-makers,

stating that this is crucial to unmasking anonymous shell companies.

- b. Ownership Interest. A beneficial owner to includes “an individual who . . . owns or controls not less than 25 percent of the ownership interests of the entity.” This includes both equity in the reporting company and other types of interests, such as capital or profit interests (including partnership interests) or convertible instruments, warrants or rights, or other options or privileges to acquire equity, capital, or other interests in a reporting company. Debt instruments would be included if they enable the holder to exercise the same rights as one of the specified types of equity or other interests, including if they enable the holder to convert the instrument into one of the specified types of equity or other interests.

- i. Trusts. The final rule identifies the trustee as an individual who will be deemed to control trust assets for the purpose of determining which individuals own or control 25 percent of the ownership interests of the reporting company. In addition to trustees, the final rule specifies that other individuals with authority to control or dispose of trust assets are considered to own or control the ownership interests in a reporting company that are held in trust. These include: the beneficiary if: they are the sole permissible recipient of income and principal from the trust, they have the right to demand a distribution of or withdraw substantially all of the assets in the trust. In addition, trust assets will be considered as owned or controlled by a grantor or settlor who has the right

to revoke the trust or withdraw its assets. Consequently, it is possible that the ownership interests held in trust could be considered simultaneously as owned or controlled by multiple parties in a trust arrangement

- c. Exemptions. In keeping with the CTA, the rule exempts five (5) types of individuals from the definition of “beneficial owner.” These exemptions are: a minor child, provided that a parent or guardian’s information is reported; an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual; an individual acting solely as an employee of a reporting company in specified circumstances; an individual whose only interest in a reporting company is a future interest through a right of inheritance; and a creditor of a reporting company.
3. Company Applicants. A “beneficial owner” also specifically includes Company Applicants. The rule defines a “company applicant” to be only two (2) persons:
- a. the individual who directly files the document that creates the entity, or in the case of a foreign reporting company, the document that first registers the entity to do business in the United States, and
- b. the individual who is primarily responsible for directing or controlling the filing of the relevant document by another.

The rule, however, does not require reporting companies existing or registered on January 1,

2024 (the effective date of the rule) to identify and report on their company applicants. In addition, reporting companies formed or registered after the effective date also do not need to update company applicant information after the initial filing.

4. Beneficial Ownership Information Reports. The rule requires a reporting company to file a Beneficial Ownership Information Report (“BOI”) that identifies itself (per the above in Section); and reports four (4) pieces of information about each of its beneficial owners: name, birthdate, address, and a unique identifying number and issuing jurisdiction from an acceptable identification document (and the image of such document). Additionally, the rule requires that reporting companies created after January 1, 2024, also provide the four pieces of information and document image for company applicants.

- a. For each individual who is a beneficial owner or company applicant, a unique identifying number must be reported from one of four types of acceptable identification documents: a nonexpired U.S. passport; a nonexpired state, local, or Tribal identification document; a nonexpired State-issued driver’s license; or, if an individual lacks one of those other documents, a nonexpired foreign passport. Significantly, an image of the identification document from which the unique identifying number was obtained is also required to be filed.
- b. If an individual has a “FinCEN identifier,” (see below), that number can then be provided to FinCEN on a BOI report in lieu of the required information about the individual.

5. FinCEN identifier. To potentially aid in reporting an individual’s information in connection with the foregoing requirements, particularly those with multiple reporting instances, such individuals can obtain a “FinCEN identifier.”

- a. A “FinCEN identifier” is a unique number issued by FinCEN to individuals and reporting companies (though the latter is currently under further review. An individual may submit an application for a FinCEN identifier that contains all of the information that otherwise has to be set forth in the initial report about that individual. An individual who has obtained a FinCEN identifier may provide it to the reporting company and the reporting company can include the FinCEN identifier in lieu of the information otherwise required.
- b. If there is any change with respect to required information previously submitted to FinCEN in the application for the FinCEN identifier, the individual or reporting company must file an updated application reflecting the change within 30 calendar days after the date on which the change occurs. If the application was inaccurate when filed and remains inaccurate, the individual or reporting company must file a corrected application within 30 calendar days after the date on which the individual or reporting company becomes aware or has reason to know of the inaccuracy.

D. Effective dates.

1. Effective Date. The effective date for the rule is January 1, 2024.

- a. Reporting companies created or registered before January 1, 2024 will have one (1) year (i.e., until January 1, 2025) to file their initial BOI reports.
- b. Reporting companies created or registered after January 1, 2024, will have only 30 days after receiving notice of their creation or registration to file their initial BOI reports.
- c. Reporting companies also have 30 days to report changes to the information in their previously filed BOI reports; and must correct inaccurate information in previously filed BOI reports within 30 days of when the reporting company becomes aware or has reason to know of the inaccuracy of information in earlier reports.

E. Penalties.

1. Any party that unlawfully discloses any beneficial ownership information will be liable for fines of up to \$500 per day and up to \$250,000 in the aggregate, and up to 10 years in prison. In addition, any party that intentionally fails to comply with the reporting requirements of the CTA may be liable for fines of no more than \$500 for each day that there is a willful failure to report complete beneficial ownership information. Such parties may be subject to aggregate fines of up to \$10,000 or a prison term of up to two years.
2. The CTA contains a safe harbor from civil or criminal liability for the submission of inaccurate information if a report containing corrected information is submitted “voluntarily and promptly” (and no later than 90 days after the submission of the original inaccurate report).

F. Future Rulemaking and Implementation.

1. The BOI reporting rule discussed above is the first of three (3) rulemakings planned to implement the CTA. FinCEN will engage in additional rulemakings to: (1) establish rules for who may access BOI, for what purposes, and what safeguards will be required to ensure that the information is secured and protected; and (2) revise FinCEN’s customer due diligence rule following the promulgation of the BOI reporting final rule.
2. FinCEN will also continue to develop the infrastructure to administer these requirements in accordance with the strict security and confidentiality requirements of the CTA, including the information technology system that will be used to store beneficial ownership information: the “Beneficial Ownership Secure System” (BOSS).

G. Observations.

There is little doubt that the CTA’s new disclosure rules represent a significant change in reporting and disclosure of ownership and control of smaller non-publicly reporting entities. There will be the usual adjustments to comply with the new changes for a population of reporting companies not used to this sort of compliance.

1. Substantively, it appears that the most significant interpretive issue for reporting compliance is going to be the evaluation of “substantial control” over a reporting company. For many reporting companies, it would be likely that when in doubt over an issue like this determination, over-inclusiveness is preferable to under reporting.

2. Procedurally, the need to provide an image of the identification document from which the unique identifying number is in most cases, a copy of a photo ID document (driver's license, passport, etc.) will be more burdensome than small companies and their advisors are used to dealing with for other reporting obligations.
3. In addition, once fully implemented (Jan 2024 for new entities; with grace to Jan 2025 for existing entities), the thirty (30) day reporting window from date of creation or change for filing a BOI will become a part of entity formation and restructuring work in a manner not unlike S corporation elections (usually 75 days). However, a thirty (30) day reporting deadline is unusually fast in the world of small business.
4. Professional services firms, such as smaller law and accounting firms, will in most cases be reporting companies in their own right, required to file a BOI and amendments for applicable changes in ownership.

Consequently, after initial compliance, and being cognizant of promptly reporting any further changes in BOI reporting that might subsequently occur with changes in beneficial ownership or control, there will not be all that much change from present. For instance, in Virginia, very little public information is required to be reported for limited liability companies, allowing for significant privacy. The CTA does not alter that circumstance for information available for the public, rather only with respect to information provided to and available for governmental authorities.

It is important to remember that these rules do NOT require PUBLIC reporting of beneficial owner information. It only requires confidential reporting to FinCEN, for governmental use in law enforcement.

Endnotes

1. P.L. 116-283, William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021.
2. 31 C.F.R. Part 1010