

The Corporate Transparency Act: New Beneficial Ownership Reporting Requirements

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The Corporate Transparency Act (“CTA”) is a new U.S. federal law requiring most U.S. corporations, LLCs, and other entities, as well as similar non-U.S. entities registered to do business in the U.S., to report their beneficial ownership to the U.S. government.^[1] These requirements are detailed, burdensome, and involve the disclosure of personal information, and, therefore, compliance will impose a cost to reporting companies and result in the erosion of the traditional anonymity afforded to beneficial owners of entities not currently required to report.

Initially, Congress enacted the CTA on January 1, 2021, as part of the Anti-Money Laundering Act of 2020.^[2] Then, the Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”) finalized the CTA’s federal reporting requirements and published guidance on the CTA’s final regulations, known as the “Reporting Rule.”^[3] Under the CTA and the Reporting Rule, FinCEN is authorized to collect beneficial ownership information and disclose it to authorized government authorities, such as national security agencies, law enforcement, and financial institutions under certain conditions.

The CTA applies to companies formed or registered to do business on or after January 1, 2024, with those companies having 30 days from the confirmation date of their formation or registration to comply with the CTA. Companies existing before January 1, 2024, must comply with the CTA by no later than January 1, 2025.

The CTA is intended to prevent money laundering, tax fraud, and corrupt activity by requiring companies to file reports with FinCEN about the company itself, its beneficial owners, and its company applicants. It is important for all domestic and non-U.S. entities doing business in the U.S. to ensure compliance by the applicable effective and compliance dates and avoid liability and penalties for violations.

Introduction

Reporting Companies

The CTA applies to any domestic or non-U.S. “reporting company.” A domestic reporting company means any U.S. corporation, LLC, or other entity, such as a limited partnership or a business or statutory trust, that is created by the filing of a document with a secretary of state or any similar office under state or tribal law. A non-U.S. reporting company means a corporation, LLC, or other entity formed under non-U.S. law and registered to do business in any U.S. state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under U.S. state or tribal law. Notably, the definition of “reporting company” does not appear to apply to some U.S. entities, such as sole proprietorships, certain types of trusts, including common law trusts, and general partnerships, that are formed otherwise than by the filing of a document with a secretary of state or any similar office under U.S. state or tribal law.

Reporting companies are required to file reports with FinCEN containing detailed information about the company itself, its beneficial owners, and company applicants, if necessary.

Beneficial Owners Required to be Disclosed

"Beneficial owners" are individuals who, directly or indirectly: (1) exercise substantial control over a reporting company, or (2) own or control at least 25% of the ownership interests in a reporting company. Individuals are considered to exercise substantial control over a reporting company if they serve as a senior officer of or otherwise manage the reporting company (e.g., CEO, CFO, COO, or general counsel); have authority over the appointment or removal of senior officers or a majority of the board of the reporting company; or direct, determine, or have substantial influence over important decisions made by the reporting company (e.g., decisions concerning the nature, scope, and attributes of the reporting company's business, including the selection or termination of business lines, ventures, or geographic focus; entry into or termination or fulfillment of significant contracts; major corporate transactions and reorganizations; major expenditures or investments or incurrence of any significant debt; any equity issuances; operating budget approvals; compensation arrangements for senior officers; or amendment of substantial governance documents or significant policies or procedures). As a catch-all, an individual who exercises other methods of substantial control over a reporting company may also be considered a beneficial owner; for example, an individual may exercise substantial control in less conventional ways that apply to flexible governance structures found in series LLCs and decentralized autonomous organizations where different indicators of control may be more relevant but less commonly recognized. This catch-all provision operates to prevent the evasion or circumvention of FinCEN's requirements under the Reporting Rule.

Ownership interests are equity and other types of interests in a reporting company, such as capital or profit interests, partnership interests, convertible instruments, warrants or rights, or other options or privileges to acquire equity, capital, or other interests. Debt instruments may be considered ownership interests if they enable an individual to exercise the same rights as one of the equity or other interests listed above, including by conversion of the debt instrument.

An individual may be found to, directly or indirectly, own or control an ownership interest in a reporting company through any contract or other arrangement, including where another individual acts as such individual's nominee, intermediary, custodian, or agent. Joint ownership of an undivided interest in an ownership interest in a reporting company results in those assets being attributed to all of the joint owners. An individual may own or control ownership interests in a reporting company through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests in any intermediary entities, that separately or collectively own or control ownership interests in the reporting company.

For a trust that holds ownership interests in a reporting company, if a trustee has the authority to dispose of the assets in the trust, or if a trust beneficiary is the sole recipient of the trust's principal and income or has the right to demand a distribution of substantially all of the assets in the trust, then the trustee and beneficiary in those instances will each be considered a beneficial owner. Additionally, a grantor or settlor of a trust who has the right to revoke the trust or withdraw the assets of the trust will also be considered a beneficial owner.

Where an individual is found to, directly or indirectly, own or control an ownership interest in a reporting company, the Reporting Rule provides guidance for determining whether the individual own or controls at least 25% of the ownership interests. For example, when making such a determination, all options and similar interests are to be deemed to be exercised.

Additionally, there are several exclusions to the definition of a beneficial owner that limit the number of individuals who are required to be reported to FinCEN. These exclusions include minor children if their parent or guardian's information is reported; individuals acting as nominees, intermediaries, custodians, or agents on behalf of another individual; individuals acting solely in their capacity as employees that are not considered senior officers; individuals whose only interest in a reporting company is a future interest through a right of inheritance; and certain creditors of a reporting company who otherwise satisfy the definition of a beneficial owner.

Company Applicants Required to be Disclosed

A “company applicant” is the individual who directly files the document that creates a reporting company or first qualifies a reporting company to do business in the U.S. If more than one individual is involved in the filing of the document, the individual who is primarily responsible for directing or controlling the filing is also a company applicant. This is a very broad definition. For example, when a reporting company hires a law firm and directs one of its attorneys to file entity formation documents, the person at the reporting company who is primarily responsible for overseeing the filing and the attorney who directly files the formation documents with a secretary of state would each be considered a company applicant and must be reported as such. However, the identification of company applicants may not be clear in all situations. For example, if an individual at a reporting company instructs outside counsel to form a company, the outside counsel instructs a more junior attorney at the same law firm to take care of the filing, and the junior attorney uses an outside business formation service provider to make the filing with a secretary of state, who should be deemed a company applicant? Under the Reporting Rule, it appears that the individual working at the business formation service provider who makes the filing with the secretary of state would be a company applicant, but whom of the other participants should be considered the second company applicant? The determination of whom should be considered primarily responsible for directing or controlling the filing, and thus be identified as the second company applicant, will likely depend on the specific facts of the filing.

Only reporting companies created or registered on or after the effective date of January 1, 2024, are required to report information about their company applicants. Reporting companies created or registered before January 1, 2024, are not required to report information about company applicants. Further, the Reporting Rule limits the number of company applicants to a maximum of two individuals.

Information Required to be Disclosed

Reporting companies are required to report to FinCEN their entity name as well as any alternative trade names or d/b/a names, their business address, their jurisdiction of formation, for non-US entities, their state or tribal jurisdiction of registration, and their IRS taxpayer identification number (e.g., the reporting company’s EIN or TIN). Second, reporting companies must report to FinCEN information about their beneficial owners and sometimes their company applicants. The identifying information required to be reported for beneficial owners and company applicants includes their full legal name, date of birth, residential address for beneficial owners and business address for company applicants, and a unique identifying number (e.g., from a U.S. passport, a U.S. state-issued identification such as a driver’s license, or a non-U.S. passport if the former are not available) with an image of the document. Upon request, FinCEN will issue a FinCEN Identifier to a reporting company at or after the filing of its initial report or to an individual applicant. The FinCEN Identifier can be included in subsequent filings so that the previously reported information does not need to be re-reported. Reporting companies and individuals who obtain a FinCEN Identifier must update or correct any of their information previously submitted to FinCEN. Updated or corrected FinCEN reports are to be filed within 30 days from when the change in information occurred or when the filing person became aware or had reason to know of the inaccuracy.

Reporting Timing Requirements

For companies created or registered to do business on or after January 1, 2024, reports must be filed with FinCEN within 30 days of receiving notice that the reporting company is formed or registered to do business. These reports include information about the reporting company itself, its beneficial owners, and its company applicants. For existing companies that were created or registered to do business before January 1, 2024, reports must be filed with FinCEN by January 1, 2025. These reports only require information about the reporting company itself and its beneficial owners. Reporting companies file reports with FinCEN at no charge through an electronic filing system on FinCEN’s website.

Updating the Information

After initial reports are submitted to FinCEN, reporting companies must update their reports within 30 days of any changes to their previously reported information or within 30 days of becoming aware or had reason to know that any previously reported information was inaccurate. But, updated reports are not required for changes to any information related to company applicants.

Penalties for Not Reporting

Any individual or entity who willfully provides, or attempts to provide, false beneficial ownership information to FinCEN or willfully fails to report complete or updated beneficial ownership information to FinCEN may be subject to both civil and criminal penalties. This means that reporting companies, beneficial owners, and company applicants, as well as other persons involved in the reporting process, may all be subject to potential liability. Violators may be subject to a penalty of \$500 per day for each day the violation continues with a maximum penalty of \$10,000 and may be subject to imprisonment for up to two years. Due to the severity of the penalties for failing to report or reporting inaccurate information to FinCEN, guidance from the Reporting Rule suggests overreporting information to FinCEN because the purpose of the CTA is to provide full beneficial ownership and other related information about reporting companies to FinCEN.

Exemptions, Exceptions, and Remaining Risks

The Reporting Rule provides 23 categories of entities that are exempt from the definition of a reporting company and are not required to file reports with FinCEN. Generally, these exemptions apply to entities that already disclose beneficial ownership information under other laws or regulations or entities for which money-laundering activities are not feasible. Under the Reporting Rule, the 23 categories of exempt entities are securities reporting issuers, governmental authorities, banks, credit unions, deposit institution holding companies, money services businesses, brokers or dealers in securities, securities exchanges or clearing agencies, other Exchange Act registered entities, investment companies or investment advisers, venture capital fund advisers, insurance companies, state licensed insurance producers, Commodity Exchange Act registered entities, accounting firms, public utilities, financial market utilities, pooled investment vehicles, tax-exempt entities, entities assisting a tax-exempt entity, large operating companies, subsidiaries of certain exempt entities, and inactive entities. Nevertheless, U.S. companies, including most small businesses, will not be exempt from the CTA's reporting requirements. Most U.S. companies will be required to file reports with FinCEN. Under the CTA, the Secretary of the Treasury is authorized to exempt additional entities.

The corporate exemptions cover "large operating companies," which are entities with more than 20 full-time U.S. employees, more than \$5 million reported on their previous year's federal income tax return, and a presence in the U.S. with a physical office, as well as publicly traded companies that issue registered securities and file under the Exchange Act. Registered entities that are subsidiaries of large non-U.S. companies but do not qualify for the large operating companies exemption because of a lack of adequate U.S. presence or insufficient gross receipts on their previous year's federal income tax return will be required to report to FinCEN unless they satisfy another exemption criterion. Also, the requirements for satisfying the inactive entity exemption will exclude from the exemption many inactive entities which common understanding would expect to be exempt. The inactive entity exemption requirements include that the entity have been in existence since 2020, has not sent or received more than \$1,000 in funds in the last year, is not owned, directly or indirectly, by a non-U.S. person, and holds no other assets, including any ownership interests in any corporation, LLC, or similar entity.

For a subsidiary to be considered exempt under the Reporting Rule, it must be controlled or wholly owned, directly or indirectly, by one or more entities that are themselves exempt from the Reporting Rule. The Reporting Rule indicates that subsidiaries that are only partially owned by exempt entities do not qualify for the subsidiary exemption and must be separately evaluated to determine if they qualify as a reporting company. Additionally, the subsidiary exemption does not apply to subsidiaries of money services businesses, pooled investment vehicles, or entities assisting a tax-exempt entity notwithstanding that these three types of entities are directly exempt under other specific exemptions. Exempt entities that no longer meet the criteria for any exemption will be required to file a report within 30 days after the date that the entity no longer meets such criteria.

Pooled investment vehicles formed under non-U.S. laws are deemed to be reporting companies, but, for purposes of their initial report to FinCEN, the reported information shall solely relate to an individual who exercises substantial control over that pooled investment vehicle.

Further, while the Reporting Rule exempts registered investment advisers and subsidiaries of registered investment companies, the Reporting Rule will still have a significant effect on private investment funds and similar entities because it does not exempt private fund advisers, non-U.S. private advisers, or family offices. Moreover, feeder funds, alternative investment vehicles, some holding companies, certain kinds of pooled investment vehicles such as real estate vehicles, certain commodity pools and non-U.S. pooled investment vehicles, and even subsidiaries of exempt private funds of registered investment vehicles, may not qualify as exempt entities under the Reporting Rule, unless they qualify for an exemption by means of being operated or advised by a registered investment adviser or venture capital fund adviser and being listed on such adviser's Form ADV.

If an exempt entity has or will have a direct or indirect ownership interest in a reporting company, then such reporting company is required to only list the name of the exempt entity in the report submitted to FinCEN, which means that the exempt entity's beneficial owners need not be reported. Companies should be careful to ensure that they are exempt beyond a reasonable doubt to avoid violating the CTA and potentially suffering the penalties.

Privacy and Access to Reported Information

While information reported to FinCEN under the Reporting Rule will not be accessible by the general public and is not subject to the Freedom of Information Act, the CTA authorizes FinCEN under strict confidentiality, security, and access restrictions to disclose reported beneficial ownership information to statutorily defined groups including U.S. government agencies, certain non-U.S. agencies and authorized persons, and financial institutions that use the information for KYC purposes. If a reporting company provides its consent, then FinCEN may disclose reported information to financial institutions for KYC compliance purposes. U.S. government agencies with access to reported information from the FinCEN database include federal agencies engaged in national security, intelligence, and law enforcement activities; Department of Treasury officials and employees; and state, local, and tribal enforcement agencies in connection with certain investigations. To access reported information on the FinCEN database, federal agencies must provide FinCEN with a brief justification for their request, and state, local, and tribal agencies must provide FinCEN with court documentation authorizing their access. Under certain circumstances, FinCEN may disclose reported information in response to a request by a U.S. federal functional regulatory agency or similar regulatory agency if such agency is authorized by law, solely uses the information as authorized, and enters into an agreement with the Secretary of Treasury containing protocols and procedures for safeguarding the reported information. Consequently, thousands of people may have access to the reported information.

Non-U.S. law enforcement agencies and government authorities will not have direct access to reported information on the FinCEN database. Requests from non-U.S. entities must be submitted to a U.S. federal agency acting as an intermediary to retrieve any reported beneficial ownership information from the FinCEN database. However, such intermediary U.S. federal agency may only provide the requested information to the non-U.S. entity in connection with an investigation or prosecution by the non-U.S. entity's country where there is a treaty or similar agreement permitting the sharing of the reported information. So, disclosure of reported beneficial ownership to non-U.S. entities is much more strictly controlled and limited to a case-by-case basis.

Interpretation and Practice Pointers

Even though the CTA and the Reporting Rule provide a comprehensive framework for compliance, there are still several unanswered questions and potential interpretations of law needed. For example, when considering entities with huge organizational structure charts containing numerous subsidiaries and related companies, does FinCEN permit a single, combined report of information or are multiple reports for the several entities required? It seems whether a subsidiary must individually file its own report directly with FinCEN or whether the subsidiary is covered in a combined report by its parent company depends on the subsidiary's ownership. Even if the parent company of a group is exempt from being a reporting company, as not all subsidiaries of an exempt company are also exempt, each subsidiary will need to be individually evaluated to determine whether it also is exempt. Also, a U.S. subsidiary of a non-U.S. company that itself has little or no U.S. presence may also

be required to report, even if the U.S. subsidiary is controlled or wholly owned by the non-U.S. company. Similarly, related companies in a parent company's organizational structure must be considered individually on a case-by-case basis in light of their ownership to determine whether separate reports must be filed with FinCEN. Additionally, for entities, such as sole proprietorships, certain types of trusts, including common law trusts, and general partnerships, which are formed without filing with a secretary of state and thus do not meet the requirement under the definition of a reporting company that the entity be "created" by such a filing, such entities may register for a business license or similar permit with a U.S. state. While FinCEN believes that those registrations would not generally "create" the entity, the particularities of the specific U.S. state's registration or filing practices may be relevant in determining whether the entity should in fact be deemed "created" for purposes of FinCEN's definition of a reporting company.

Accordingly, there is no categorical rule provided by FinCEN for whether certain types of entities are considered reporting companies, and the circumstances surrounding the formation, filing, and operation of these types of entities should be considered on a case-by-case basis to prevent violations of the Reporting Rule. As previously mentioned, overreporting with FinCEN is suggested and preferred by the Reporting Rule to avoid the risk of noncompliance and any subsequent violations and penalties being incurred by a reporting company.

Other parts of the CTA that have not been fully interpreted by relevant governmental authorities, leaving open questions to consider, include whether a joint venture ownership with only one venturer being exempt qualifies the joint ownership as exempt. Arguably, joint ownership of an undivided interest where only one of the owners is exempt would nonetheless require that a report be filed with FinCEN because the assets are attributed to all of the joint owners and not all of the joint owners are exempt, but the question remains as to whether reporting is necessary or simply the most conservative approach. This analysis further takes into consideration a control vs. ownership test by which a joint owner who is said to exercise substantial control over a potential reporting company possesses a different level of authority and perhaps a different measure of reporting requirements than a joint owner who is said to have an ownership interest in, but not exercise substantial control over, the potential reporting company, but this differentiation is not identified or clearly defined by the CTA and the Reporting Rule.

Due to the potential for liability upon failing to report or inaccurately reporting beneficial ownership information to FinCEN, reporting companies are also left with the question of how many senior officers should be appointed or remain appointed at the reporting company. With the Reporting Rule requirements, some individuals may no longer wish to remain in senior officer positions or maintain a status that holds them subject to liability for FinCEN reporting violations. Additionally, company management is responsible for determining the company's status as a reporting company and compiling the necessary information for reporting to FinCEN, which may leave many companies' senior personnel reconsidering their positions in the company and how to best proceed. Moreover, companies who must newly report their beneficial owners may be concerned with what the reporting requirements mean for their company and whether they will affect the company's operations because the information was previously private.

To best prepare for the implementation of the CTA and the Reporting Rule, domestic and non-U.S. entities, particularly small businesses, should determine whether their company is going to be considered a reporting company. If so, a reporting company should then determine when their first filed report will be due to FinCEN based upon the company's formation or registration date, i.e., for companies created or registered to do business on or after January 1, 2024, reports must be filed within 30 days of receiving notice that the reporting company is formed or registered to do business, and for existing companies by January 1, 2025. For larger umbrella and parent companies, senior officers and company management should consider all of the entities in their structures that will be required to file with FinCEN and gather any necessary information and documentation on all beneficial owners and potential company applicants.

All reporting companies should prepare for their applicable CTA effective date by familiarizing themselves with the CTA's reporting requirements and by developing internal processes for identifying the reporting company's beneficial owners and, if applicable, company applicants and for collecting the information required to be reported for such individuals. Additionally, reporting companies should create a system by which they are reminded and notified any time an updated report is due to be filed with FinCEN. Reporting companies should also

identify any individuals who are beneficial owners and who plan to file their personal information directly with FinCEN in order to obtain a FinCEN Identifier so that the reporting company may file a complete and accurate report with FinCEN including any such FinCEN Identifier. Moreover, reporting companies should consider obtaining consents from all parties about whom the reporting company will disclose information to FinCEN that such disclosure by the reporting company is permitted.

Depending on the circumstances, reporting companies may also wish to impose CTA compliance obligations on their beneficial owners. For example, reporting companies may wish to obtain from all beneficial owners, including shareholders, members, and partners: (1) written representations stating that those individuals are in compliance with the CTA's reporting requirements or are exempt from the CTA and (2) agreements that those individuals will continue to comply with the CTA's reporting requirements, including by providing the reporting company with all updated information required to be reported, or will continue to be exempt from the CTA. Lastly, reporting companies may wish to obtain indemnification or similar agreements from all beneficial owners, including shareholders, members, and partners, for their actions or omissions that result in any failure by the reporting company to comply with the CTA, either by failing to report or by reporting or failing to timely correct inaccurate information that was previously reported to FinCEN.

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[1] See Corporate Transparency Act, Title LXIV, William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283 (Jan. 1, 2021) ("NDAA"); Beneficial Ownership Information Reporting Requirements, 31 U.S.C. 5336 (2021).

[2] See Anti-Money Laundering Act, Div. F, NDAA.

[3] See Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,498 (Sept. 30, 2022) (to be codified at 31 C.F.R. pt. 1010); see generally, Beneficial Ownership Information Reporting, FinCEN (last visited June 30, 2023), <https://www.fincen.gov/boi>.

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