

The Corporate Transparency Act December 2023 Update

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December 14, 2023

The Corporate Transparency Act (“CTA” or the “Act”) comes into effect on January 1, 2024. Enacted by Congress as part of the Anti-Money Laundering Act of 2020, the CTA requires certain entities, domestic and foreign, to report beneficial ownership to the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”).

The CTA’s reporting obligations will apply to “Reporting Companies” (discussed below) currently in existence, and to those formed after January 1, 2024. However, while FinCEN estimates that the CTA will affect over 32 million entities, it will largely impact only smaller and unregulated companies. For example, companies that meet the CTA’s definition of a “large operating company,” are publicly traded or regulated, or are a subsidiary of certain exempt entities are not required to submit beneficial ownership information to FinCEN. Accordingly, while all companies should take note of the CTA and the significant change in the law for corporate reporting obligations, an equally vast number of entities will likely find themselves exempt from these requirements.

With the CTA’s effective date fast approaching, companies should consider its potential impact to their compliance obligations and, if appropriate, implement appropriate policies and procedures for handling reporting.

What does the CTA Require?

The CTA will require Reporting Companies to file reports electronically with FinCEN identifying their beneficial owners, in addition to certain other information. For Reporting Companies formed prior to 2024, these reports require information about the Reporting Company and its beneficial owners. Reporting Companies formed prior to 2024 will have until January 1, 2025, to file an initial report.

For Reporting Companies formed on or after January 1, 2024, reports will require information about the Reporting Company and its beneficial owners, as well as its company applicants (i.e., individuals involved in the company’s formation filing). Reporting Companies formed after January 1, 2024, will have 30 days from formation to file their initial reports, although FinCEN recently issued a final rule extending this reporting period to 90 days for companies created or registered in 2024.

Who Must Report?

Reporting Companies are defined as legal entities that are formed through a filing in a state secretary of state’s office or similar office under the law of a state or Indian tribe. Reporting Companies can be domestic or foreign and include, but are not limited to, corporations, limited liability companies, certain partnerships and certain trusts. A foreign Reporting Company is an entity formed under foreign law that registers to do business in any state or Indian tribe. Certain entities outside of the CTA’s scope include sole proprietorships, most general partnerships, common law trusts, unincorporated associations, and foreign entities not registered to do business in a state or tribal jurisdiction. These entities are likely to have no reporting obligations under the CTA.

Exempt Entities

The CTA provides 23 exemptions for Reporting Companies that would otherwise be required to report beneficial ownership information under the Act. These exemptions are predominantly for large or heavily regulated companies, including:

- securities reporting issuers, banks, credit unions, depository institution holding companies, money services businesses, brokers-dealers, securities exchange or clearing agencies, pooled investment vehicles, regulated investment companies and investment advisors, insurance companies and state-licensed insurance providers, and accounting firms;
- “large operating companies” who have more than 20 full-time employees in the U.S., an operating presence at a physical office within the United States, and more than \$5 million in gross receipts or sales on their previous years’ U.S. tax returns;
- U.S. publicly traded companies;
- governmental authorities and tax-exempt entities; and
- inactive entities who have been in existence prior to January 1, 2020, are not engaged in active business, are not owned in any manner by a foreign person, have not had a change in ownership within the last 12 months, have not sent or received any amount greater than \$1,000 within the last 12 months, and have no assets or ownership interests in any entity in the United States or abroad.

The CTA also exempts subsidiaries of certain exempt entities if those exempt entities own or control the subsidiary.

What Must be Reported?

Reporting Companies are required to report to FinCEN:

- basic company information, including full legal name, trade names, business address, state of incorporation or business registration, and employer identification number;
- information of Beneficial Owners, including full legal name, date of birth, residential street address, unique ID number from individual’s identification document and issuing jurisdiction of acceptable ID document (e.g., driver’s license, passport, state-issued ID, etc.), and image of ID document from which unique ID number was obtained;
- information of Company Applicants, including full legal name, date of birth, business address, unique ID number from individual’s identification document and issuing jurisdiction of acceptable ID document, and image of ID document from which unique ID number was obtained. A “Company Applicant” is defined as the individual who directly files a document with the state secretary of state’s office to create the entity or register it to do business in the state, and the individual who is primarily responsible for directing or controlling the filing.

There is no cap on the number of beneficial owners a Reporting Company is required to report. In contrast, a Reporting Company cannot have more than two reportable company applicants. Additionally, the CTA only requires Reporting Companies formed on or after January 1, 2024, to report company applicants in their initial reports. There is no requirement to report company applicants for entities formed prior to January 1, 2024.

Who is a Beneficial Owner?

A beneficial owner is defined as any individual who, directly or indirectly, either exercises substantial control over a Reporting Company or owns or controls at least 25% of the ownership interests of such Reporting Company.

An individual may exert substantial control by (i) serving as a senior officer (e.g., company’s president, CEO, COO, CFO or general counsel, or any officer who performs a similar function), (ii) having authority to appoint or remove certain officers or a majority of directors (or similar governing body) of the Reporting Company or (iii) having “substantial influence” over important matters at the company, regardless of their title or role.

Ownership interests in a company generally refer to any arrangement that establishes ownership rights in the Reporting Company, such as stock, capital or profit interests, convertible interests, options to buy or sell any of the above-named interests, or contracts, relationships or other understandings. Option interests must be treated as exercised for purposes of the analysis. Additionally, a beneficial owner may own or control such interest directly or indirectly, jointly with another person or through an agent, custodian, trust or intermediary entity.

The CTA identifies five instances where an individual who would otherwise be a beneficial owner under the Act qualifies for an exception. In these cases, the Reporting Company does not have to report the individual's information to FinCEN.

These exceptions are as follows:

- a minor child;
- a nominee, intermediary, custodian or agent;
- an employee (excluding senior officers);
- an inheritor, whose only interest in the company is a future interest through a right of inheritance; and
- a creditor.

How to Report

No filings are due prior to the Act's effective date. While FinCEN has published draft forms for filing by a Reporting Company for comment, they are not yet finalized. FinCEN is also in the process of setting up the beneficial owner reporting infrastructure, the Beneficial Ownership Secure System ("BOSS"), which has not yet been finalized.

If beneficial owners or company applicants do not want to provide their personal data to a Reporting Company, individuals have the option of applying directly to FinCEN for a "FinCEN identifier" (a "FinCEN ID"). The individual will need to provide directly to FinCEN all of the same data that he or she would need to submit to the Reporting Company, but then would only need to provide his or her FinCEN ID to the Reporting Company for inclusion on its reporting.

Individuals who receive FinCEN IDs have the burden of keeping their data updated with FinCEN, whereas a Reporting Company has the burden of keeping the individual's data current if the individual reports such data directly to the Reporting Company.

When to Report

For non-exempt Reporting Companies in existence as of January 1, 2024, they will have until January 1, 2025, to make their initial beneficial ownership report.

For non-exempt Reporting Companies formed on or after January 1, 2024, they will need to file their first beneficial ownership report within 30 calendar days after the date of formation. On November 29, 2023, FinCEN issued a final rule extending this deadline to 90 days for companies formed or registered in 2024. The time of formation is the earlier of (i) a company receiving actual notice of its registration from the state secretary of state or (ii) a company receiving notice of its registration becoming publicly available.

In addition to filing initial reports, Reporting Companies are also obligated to make reports within 30 days of a change to any data that FinCEN requires to be reported for the company and its beneficial owners.

Penalties for Noncompliance

Congress included steep penalties for non-compliance with the CTA's reporting requirements. Specifically, the CTA provides that willfully reporting or attempting to report false or fraudulent beneficial ownership, or willfully failing to make updates, shall be punishable with a civil penalty up to \$500 per day while such violation continues, with a possible criminal fine up to \$10,000 and up to two years in prison. If a reporting violation is found to be "willful," the CTA provides that responsible parties can include individuals that cause the failure, or are senior officers of the Reporting Company at the time of the failure. The CTA also enhances criminal penalties when a Reporting Company's failure to file is combined with other illegal activity.

Additionally, it is also unlawful to knowingly disclose or knowingly use beneficial ownership information obtained by the person for an unauthorized purposes. Violations are punishable with a mandatory civil penalty of \$500 per day while the violation continues, plus a possible criminal fine of up to \$250,000, five years in prison, or both.

How You Can Prepare

The CTA will alter the ways entities organize and govern themselves and it will impose substantial and continuing reporting obligations. In the weeks leading up to the CTA's implementation, entities should be developing internal policies and procedures to assess their reporting obligations, identify beneficial owners, and identify company applicants on a go-forward basis.

Reporting Companies may wish to consider adopting a CTA compliance policy. Such a policy can educate managers and senior officers on obligations under the CTA, address procedures for reporting to FinCEN and monitoring changes to a company's reporting status and beneficial ownership, and address the application of the CTA to potential future affiliates of the Reporting Company.

Reporting Companies may also wish to consider how the CTA may implicate its constituent documents and evaluate amending existing operating agreements to incorporate provisions addressing compliance with the CTA. Similarly, some entities may wish to consider their organizational structures and corporate governance in light of the obligation to collect and report personally identifiable information. Additionally, Reporting Companies should consider how the CTA will impact future material transactions, such as mergers and acquisitions.

How We Can Help

Vedder Price has attorneys knowledgeable in the CTA and who are experienced in a variety of practice areas, including finance and transactions, global transportation finance, real estate, and corporate governance. Our attorneys can provide assistance with assessing the CTA's applicability to your business and advising on reporting and compliance obligations.

If you have any questions about this article, please contact Joel R. Thielen at jthielen@vedderprice.com, Benjamin O. Williams at bwilliams@vedderprice.com or any other Vedder Price attorney with whom you have worked.

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