

Corporate Transparency Act and its Impact on Your Business

Article

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On January 1, 2021, Congress passed the Corporate Transparency Act (the “**CTA**”), which requires all entities formed in or registered to do business in the United States to report beneficial ownership information to the Financial Crimes Enforcement Network (“**FinCEN**”), subject to some exceptions, by no later than January 1, 2022.

Although the CTA was intended to make it more difficult to operate anonymous shell companies for criminal or tax evasion purposes, the broad net it casts means that, for the first time in history, **there are now federal reporting requirements for small companies that will require the annual collection and reporting of ownership information.** The federal government will now have a database of beneficial ownership information for unregulated entities that is available to government authorities for law enforcement purposes.

The broad net that this law casts means that – for example – real estate companies (or individual investors) that form a new entity for each project, large companies that form a new entity for each corporate endeavor, or even mom and pop shops that form an entity to protect themselves from liability will **ALL** need to regularly collect and report each entity’s ownership information to FinCEN unless that particular entity (and not the company as a whole) falls into an exception. As you’ll see below, the exceptions generally exempt larger operating companies with \$5M revenue and 20 employees, but not small businesses or corporate structuring vehicles being set up by larger companies.

Applicability

The scope of the CTA is intentionally broad and requires corporations, limited liability companies, or similar entities formed under state law or registered to do business in the United States to meet the reporting requirements of the CTA. However, the CTA does have exemptions for publicly traded companies and heavily regulated companies that already provide ownership information to a government agency and specifically excludes: (a) a majority of financial services institutions, including those investment, accounting, and banking firms that report to government agencies (i.e. SEC, FDIC, etc.), (b) companies that employ more than 20 full-time employees or report revenues of more than \$5 million dollars annually, and have a physical presence in the United States, or (c)

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nonprofit organizations such as churches and charities.

Reporting Requirements

FinCEN will collect the name, address, date of birth, and identifying number (i.e. a nonexpired driver's license number, passport number, or personal ID card) for each of the entities' beneficial owners, which will need to be updated annually. FinCEN is required to create a registry and prescribe regulations by January 1, 2022. Qualifying entities will be required to (a) report at the time of formation, (b) if the qualifying entity was formed prior to the enactment of the CTA, then the qualifying entities will be required to submit reports no later than two years after the effective date of the regulations, or (c) if there are changes to the original CTA submissions, the qualifying entity must provide an updated report no later than one year after the date of the change.

It is not yet clear how each company will report under the CTA but there is speculation that each state will separately undertake the administration of the data collection required under the CTA.

Beneficial Owners

The new law requires reporting on beneficial owners, but who is a beneficial owner under the new law? The CTA definition is different than commonly used under other laws and regulations such as securities laws. Under the CTA, a beneficial owner is an individual who, directly or indirectly, through contract, arrangement, understanding, relationship, or otherwise exercises substantial control over the entity or owns or controls at least 25% of the ownership interests in the entity. A beneficial owner, however, does not include (a) a minor child, (b) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual, (c) an individual acting solely as an employee and whose economic benefits derive solely from their employment status, (d) an individual whose only interest is through a right of inheritance, and (e) a creditor of the entity, unless it exercises substantial control or has 25% of the interests in the entity.

Access

The CTA requires the Secretary of the Treasury to establish security protocols to protect the confidentiality of the information collected. Once the beneficial ownership information is collected, FinCEN is only permitted to disclose the information to government and financial institutions for law enforcement, national security, or intelligence purposes and it is prohibited from providing access to the information to the general public. Reports filed under the CTA will be secure and may not be disclosed under the Freedom of Information Act or similar laws.

Violations and Penalties

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Any false or fraudulent information, or failure to report or complete beneficial ownership information constitutes a violation of the CTA. Such violation may result in a civil penalty of up to \$500 for each day the violation continues and criminal fines up to \$10,000 and/or imprisonment for up to two years. Unauthorized disclosure of beneficial ownership information by a government employee or third-party recipient is also a violation subject to similar civil penalties and criminal fines up to \$250,000 and/or imprisonment for up to five years.

Impact

Companies will want to (a) begin to gather the beneficial ownership information that is available, (b) review governance documents to confirm there are no confidentiality clauses or other obligations that will conflict with the requirements under CTA, (c) consider revising governance documents to require owners to disclose the required information, and (d) work with management and advisors to implement a process for meeting the CTA requirements. We will continue to monitor the CTA regulations and are available to assist business owners in understanding what beneficial ownership information needs to be collected and how to properly report it under the CTA.

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