

Small Business Contractors: Beware of Corporate Transparency Act's Potential Pitfalls

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Starting this year, certain companies are required to submit new reports related to their ownership and control that could highlight deficiencies in their small business contracting program eligibility. On September 30, 2023, the Financial Crimes Enforcement Network (FinCEN) issued a final rule, the Beneficial Ownership Information Reporting Rule, to implement the 2021 Corporate Transparency Act (CTA). Effective January 1, 2024, the final rule requires most U.S. businesses (and certain foreign businesses) to file Beneficial Ownership Information Reports (BOIRs) and company applicant information with the Federal Government. These reporting requirements are intended to help combat money laundering and prevent the abuse of shell companies and other opaque corporate structures. Because the rule has 23 exemptions that apply mostly to large, regulated companies, these reporting requirements will generally impact small businesses and will have significant implications for small business government contractors.

Disclosures May Invite Questions About Small Business Eligibility

With heightened disclosure requirements, small businesses should be particularly wary of how the CTA may intersect with the U.S. Small Business Administration (SBA) eligibility and affiliation rules for small business contracting programs. Although FinCEN is not currently accepting requests for access to beneficial ownership information, that may change in the future, and FinCEN plans to make this information available to multiple federal agencies by the end of this year.

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Under the CTA, Beneficial Owners are defined as individuals who either (1) "own or control not less than 25 percent of the ownership interests" of the reporting company; or (2) exercise "substantial control" over the reporting company. FinCEN advises that an individual exercises "substantial control" if the individual falls into any of the following four categories:

- (1) The individual is a senior officer;
- (2) The individual has authority to appoint or remove certain officers or a majority of directors of the reporting company;
- (3) The individual is an important decision-maker; or
- (4) The individual has ***any other form of substantial control*** over the reporting company.

Reporting an individual as having "substantial control" under the CTA definition may call into question a company's compliance with SBA regulations on affiliation or ownership and control requirements. Under these SBA regulations, "control" is the key determining factor for affiliation and set-aside contract eligibility, and reporting under the CTA could create, at a minimum, the appearance that two companies share the same "Beneficial Owners," even though they may not rise to similar levels under the SBA's regulations. For example, under the CTA, two small businesses may share an individual who exercises "substantial control" where an individual advisor maintains a senior officer title. Under the CTA, these two businesses would have the same reportable "Beneficial Owners" based on the senior officer title, which could raise questions as to affiliation under the SBA regulations based on "common management," even if the individual has limited authority over one or both companies. Similarly, where SBA programs (for example, the Service-Disabled Veteran-Owned Small Business (SDVOSB) program) require that the qualifying individual have complete control over the business, if a business is required under the CTA to identify other senior officers as "Beneficial Owners," that could suggest that the qualifying individual lacks complete control over the business. In short, the CTA's reporting requirements could involve disclosure of Beneficial Ownership information that may be in tension with the SBA's affiliation rules, even though much of the tension may owe to the different reporting regimes and definitional schemes within the CTA and the SBA regulations.

FinCEN's BOIR database is not publicly available, and thus, it is unlikely that a competitor will have access to the disclosed information. However, access to BOIRs by other federal agencies could lead to size determination proceedings or other investigations. An adverse size determination can result in the loss of contracts and the firm's small business program eligibility. BOIRs could also lead to investigations for misrepresentation and False Claims Act violations. Even a successful response proving full compliance or a lack of affiliation can, nonetheless, cause disruption and expense.

For all of these reasons, small business contractors should be cognizant of the CTA's reporting requirements and may need to consider them in fashioning corporate structures, operations, and leadership to mitigate areas of tension between the CTA and the SBA's regulations.

The CTA's Burden on Small Businesses and Consequences for Failing to Disclose

Noncompliance with the CTA's reporting requirements carries heavy penalties, which in turn necessitates a robust (and potentially costly) compliance program. Under the CTA, an individual or entity that "willfully" fails to file **or update** a BOIR, or provides false information on a BOIR, may face civil penalties of up to \$500 **per day** or criminal penalties, including imprisonment for up to two years and/or a fine of up to \$10,000. Reporting companies are under a continuous obligation to update their BOIRs whenever changes occur and could face civil or criminal penalties when they fail to correct information that becomes inaccurate or outdated. Some of these updates could involve seemingly trivial information. For example, an address change for any senior officer of a reporting company triggers an obligation to update the company's disclosure. Although the CTA requires a "willful" violation, noncompliance, whether due to mistake or oversight, can still invite civil or criminal inquiries.

The burden of compliance may become significant particularly for growing businesses. Because of the penalties associated with noncompliance, compliance is critical, but it carries a cost. CTA compliance costs are estimated to reach \$8,000 per company – a substantial financial burden, particularly on small businesses.[1] FinCEN, assuming that all reporting companies are small businesses, estimates that the total cost of filing BOIRs in 2024 would be approximately \$22.7 billion, with 126.3 million total "burden hours."

Overall, the CTA imposes immense compliance burdens disproportionately affecting small businesses. However, the consequences of noncompliance under the CTA are even greater. With that in mind, small businesses must ensure that they enact procedures to collect and file accurate personal identifying information and adequately monitor any changes in beneficial ownership information.

Wiley's Government Contracts and White Collar Defense & Government Investigations practices have unparalleled capabilities and experience in helping clients navigate an increasingly complex regulatory landscape and compliance with federal and state requirements. For more information about the CTA, SBA regulations, or any of these issues, please contact one of the authors listed on this alert.

¹ Mathew Erskine, *Year-End Update on The Corporate Transparency Act: The Access Rule, The Criticisms and The Costs of Implementation*, Forbes (Dec. 27, 2023), <https://www.forbes.com/sites/matthewerskine/2023/12/27/year-end-update-on-the-corporate-transparency-act-the-access-rule-the-criticisms-and-the-costs-of-implementation>.