

THE CORPORATE TRANSPARENCY ACT IMPOSES NEW BENEFICIAL OWNERSHIP REPORTING OBLIGATIONS ON BUSINESS ENTITIES



“A beneficial owner is defined as an individual who directly or indirectly, through any contract, arrangement, understanding, relations or otherwise (i) exercises substantial control over an entity or (ii) owns or controls not less than 25% of the ownership interests of an entity.”

On January 1, 2021, Congress overrode President Trump’s veto of H.R. 6395, the National Defense Authorization Act of 2021 (NDAA). Title LXIV of the NDAA enacts the Corporate Transparency Act (CTA or the Act). CTA, among other things, requires every corporation, LLC, or similar entity that meets the definition of a “reporting company” to make a filing with the Department of Treasury’s Financial Crimes Enforcement Network (FinCEN) identifying its beneficial owner or owners. The Act also imposes severe penalties for a failure to comply with this new reporting obligation.

This article provides a summary of some of the key provisions of the Corporate Transparency Act. It should be noted that the Act does not define several important terms, nor does it provide details on the reporting process. Instead, the Act directs the Department of Treasury to promulgate implementing regulations within one year of enactment. Regulations and further guidance from FinCEN will need to be reviewed to fully understand the scope and impact of the Corporate Transparency Act on business entities.

WHY REQUIRE BENEFICIAL OWNER REPORTING?

The Act states that “malign actors” seek to conceal their ownership of corporations, LLCs, or similar entities in the United States to facilitate illicit activity including money laundering, financing of terrorism, tax fraud, and other acts of foreign corruption that harm national security interests. The Act further states that federal legislation providing for the collection of beneficial ownership information is needed to protect those interests and better enable efforts to counter those illicit activities.

WHAT IS A REPORTING COMPANY?

The Act imposes its reporting obligation on “reporting companies”. A reporting company is defined as a corporation, LLC, or other similar entity that is created by filing a document with the Secretary of State or a similar office under the law of a state or Indian Tribe, or formed under the law of a foreign country and registered to do business in the United States by the filing a document with the Secretary of State or a similar office under the laws of a state or Indian Tribe.

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WHAT ENTITIES ARE EXEMPT FROM REPORTING?

CTA includes more than 20 exemptions from the definition of a reporting company. Entities that are exempt include, but are not limited to, the following:

- ▶ An entity that (i) employs more than 20 people, (ii) filed a tax return reporting gross receipts in excess of \$5 million, and (iii) has a physical presence in the United States
- ▶ Entities already subject to close federal regulation or supervision, including public companies reporting under Sec. 12 or Sec. 5(d) of the Securities Exchange Act, investment companies, non-profit entities exempt from taxation under Sec. 501(c) of the Internal Revenue Code, financial institutions, insurance companies, public utilities, and broker-dealers
- ▶ Pooled investments
- ▶ An entity owned or controlled by an otherwise exempt entity
- ▶ Dormant entities as defined by the Act

WHAT INFORMATION MUST BE REPORTED?

The Act states that in accordance with regulations prescribed by the Secretary of the Treasury, a report shall identify each beneficial owner of the applicable reporting company and each applicant with respect to that reporting company by the following:

- ▶ Full legal name
- ▶ Date of birth
- ▶ Current residence or business address
- ▶ Unique identifying number from an acceptable document

An acceptable document includes a U.S. passport, a driver's license, or other state identification document, or an individual may request and use a FinCEN unique identifying number.

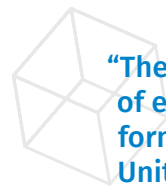
If an exempt entity has or will have a direct or indirect interest in a reporting company, the reporting company need only name the exempt entity and need not report the other information.

WHO IS A BENEFICIAL OWNER?

A beneficial owner is defined as an individual who directly or indirectly, through any contract, arrangement, understanding,

relations or otherwise (i) exercises substantial control over an entity or (ii) owns or controls not less than 25% of the ownership interests of an entity.

The Act excludes from the definition of beneficial owner (i) a minor child if the parent or guardian's information is reported; (ii) an individual acting as a nominee, intermediary, custodian, or agent of another individual; (iii) an individual acting solely as an employee whose control or economic benefits from the entity derives solely from the person's employment status; (iv) an individual whose only interest in the entity is through a right of inheritance; and (v) a creditor of an entity unless the creditor otherwise meets the definition of beneficial owner.



“The owners, managers, and legal advisors of existing entities, and those who plan on forming a new entity or registering a non-United States entity, should carefully review the Corporate Transparency Act to determine if their entity meets the definition of a reporting company.”

WHAT IS AN APPLICANT?

An applicant is defined as an individual who files an application to form a corporation, LLC, or similar entity or registers or files an application to register a non-United States entity in the United States.

WHEN MUST THE REPORT BE FILED?

The Act states that in accordance with regulations prescribed by the Secretary of the Treasury, reports must be submitted to FinCEN as follows:

- ▶ After the effective date of the implementing regulations, newly formed or registered entities will be required to report at the time of formation or registration.
- ▶ Existing entities have to report this information within two years of the effective date of the regulations.
- ▶ A reporting company is also required, in a timely manner and not later than one year after a change with respect to the information, to submit a report to FinCEN updating the information.

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WHO HAS ACCESS TO THE INFORMATION?

FinCEN will keep the reported information in a database that will not be accessible to the public. The information will be retained for no less than five years after the date the reporting entity terminates.

FinCEN is permitted to disclose the information, upon request, to:

- ▶ A federal law enforcement agency engaged in national security, intelligence, or law enforcement activity
- ▶ A federal agency requesting information on behalf of a law enforcement agency, prosecutor, or judge of a foreign country
- ▶ A state, local, and Tribal law enforcement agency pursuant to a court order
- ▶ Financial institutions, with the reporting company's consent, for customer due diligence purposes
- ▶ A federal functional regulator or other appropriate regulatory agency authorized to determine the compliance of financial institutions with customer due diligence laws

WHAT ARE THE PENALTIES FOR VIOLATIONS?

It is unlawful for any person to willfully fail to report complete or updated beneficial ownership information to FinCEN or willfully provide false or fraudulent information. Violators are subject to a civil penalty of up to \$500 for each day the violation continues, and criminal fines of up to \$10,000, imprisonment for up to two years, or both. CTA also imposes penalties for the unauthorized disclosure of information.

Other Notable Provisions

- ▶ The requirements of the Corporate Transparency Act take effect as of the effective date of the regulations prescribed by the Secretary of Treasury, which must be promulgated not later than one year after the date of enactment of the NDAA.
- ▶ States are required periodically, including at the time of formation or registration or when assessing an annual fee, to notify filers of the CTA's requirements and provide access to the forms.
- ▶ The Act prohibits a corporation, LLC, or similar entity from issuing a certificate in bearer form evidencing either a whole or fractional interest in the entity.

WHAT SHOULD ENTITY OFFICIALS AND COUNSEL DO NOW?

The owners, managers, and legal advisors of existing entities, and those who plan on forming a new entity or registering a non-United States entity, should carefully review the Corporate Transparency Act to determine if their entity meets the definition of a reporting company. They should also review the regulations and guidance that is coming from FinCEN. If their entity is required to report they may wish to begin taking the necessary steps to comply with their beneficial owner reporting obligation.

What should Secretaries of State and State Officials Do Now?

- ▶ Treasury, in promulgating their regulations, is directed to, to the greatest extent possible (1) establish partnerships with the state agencies, and (2) collect the beneficial ownership information through existing state processes and procedures
- ▶ States shall cooperate with and provide information requested by FinCEN for the purposes of maintaining the database
- ▶ SOS offices shall periodically, including at the time of formation or registration, assessment of an annual fee or renewal of any license to do business in the US, notify filers of their requirements as reporting companies, including the requirements to file and update reports, and provide the filers with a copy of the reporting company form created by the Sec'y of Treasury or an internet link to that form.
- ▶ SOS offices shall update the websites, forms relating to incorporation, and physical premises of the office, to notify filers of their requirements as reporting companies, including providing an internet link to the reporting company form.
- ▶ The SOS notifications to filers shall explicitly state that they are on behalf of the Treasury Department for the purpose of preventing money laundering, the financing of terrorism, proliferation financing, serious tax fraud and other financial crimes by requiring nonpublic registration of business entities formed or registered to do business in the US.