

What Does the Corporate Transparency Act Mean for Businesses and Incorporators?

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Unless you are an exempt entity, the Corporate Transparency Act will require you to disclose the beneficial owners of your company to the government. You will not be required to do so, however, until Treasury issues regulations providing the compliance requirements.

With a New Year's day vote, the Senate has overridden President Trump's veto of the National Defense Authorization Act. The House voted on Monday, December 29 to override the veto. Now, businesses and incorporators will be faced with the Corporate Transparency Act (CTA), which is contained within the National Defense Authorization Act and is designed to combat illegal activities conducted through anonymous shell companies by requiring the reporting of the identity of the "beneficial owners" of companies (subject to certain exceptions). Existing businesses with an operating physical presence in the United States, at least 20 employees, and at least \$5 million in annual revenue will be exempt from the reporting requirements under the CTA.

Under current law, an entity, such as a corporation or limited liability company, can be created and operated without disclosing the identity of the person(s) who actual controls the entity and financially benefits from its activities. This allows criminals to hide behind these so-called anonymous shell companies to conduct their criminal activities. This is especially true of companies that serve no business purpose other than to launder or hide money from illegal activities.

The CTA requires disclosing the "beneficial owners" to the Financial Crime Enforcement Network (FinCEN) at the time a company is formed. Companies also will be required to report to FinCEN any change in beneficial ownership information. This will allow FinCEN to create a data base for law enforcement purposes.

Maintaining privacy is a key component of the CTA. The information reported to FinCEN will not be available to the public. It is confidential information that is to be used only for law enforcement purposes. Severe penalties apply for unauthorized disclosures or misuse of this confidential information. An entity may consent to the disclosure of this confidential information to financial institutions for purposes of complying with their "Know-Your-Customer" regulatory requirements, along with appropriate privacy protection.

The specifics for reporting requirements under the CTA will be provided by Treasury regulations. Thus, the reporting requirements will take effect on the effective date of the Treasury regulations, which are to be issued no later than one year after enactment of the CTA.

The components of the CTA that most directly affect businesses are:

- **What must be reported and when?**
 - **Who must report?**
 - **What is the penalty for failing to properly report?**
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What must be reported?

Information must be reported for “beneficial owners.” With certain exceptions, a “beneficial owner” is:

- a natural person who exercise substantial control over a company;
- owns 25% or more of the equity interests of a company; or
- receive substantial economic benefits from the assets of a company.

At time of formation

At the time a “reporting company” (defined later) is formed, it must file a list of its beneficial owners with FinCEN. The list must include the same information that financial institutions are required to collect under FinCEN’s Customer Due Diligence rule. This is:

- the full legal name;
- date of birth;
- current residential or business address; and
- a current identifying number (e.g., driver’s license or passport number)

for each beneficial owner. The “applicant,” who generally is the person filing an application to form a “reporting company,” also is required to provide this information for himself or herself, even if he or she is not a beneficial owner. This means that lawyers, accountants, and others who form reporting companies for clients will be required to report their personal information. To protect themselves, applicants will want to “know-their-clients” before forming companies on their behalf.

Periodic reporting

If there is a change in any beneficial ownership information that was filed with FinCEN, the reporting company must file a report, no later than one year after the change occurred, that updates the information relating to the change. In addition, Treasury is authorized to require companies to file more frequent updates with FinCEN if it issues a rule requiring updates within a specified amount of time after a change in a company’s beneficial ownership information.

State notification requirement

States will be required to notify each applicant seeking to form a company in the state of its obligation to file a list of its beneficial owners with FinCEN.

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Who must report?

The type of entity required to report is referred to as a “reporting company. The term “reporting company” means a corporation, limited liability company, or other similar entity that is—

- created by the filing of a document with a 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 of a document with a secretary of state or a similar office under the laws of a state or Indian Tribe.

There are a number of companies excepted from the definition of “reporting company.” One of the most significant exceptions is the one for an active business. The term “reporting company” does not include an entity that—

- employs more than 20 employees on a full-time basis in the United States;
- filed in the previous year Federal income tax returns in the United States demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate, including the receipts or sales of—
 - other entities owned by the entity; and
 - other entities through which the entity operates; and
- has an operating presence at a physical office within the United States.

While this exception may not exclude small businesses, it will exclude many active businesses from the requirement to annually report beneficial owners to FinCEN. Among the other types of entities that are exempt from reporting are:

- public companies under the Securities Exchange Act of 1934;
- churches, charities, nonprofit entities, and any other entity that qualifies for tax-exempt status under sections 501(a), 527, or 4947(a)(1) of the Internal Revenue Code; and
- other companies that already have certain reporting obligations to governmental entities (e.g., insurance companies, banks, federal or state credit unions, investment companies under the Investment Company Act of 1940, registered public accounting firms, and public utilities).

Applicants seeking to form an entity that is exempt from filing beneficial ownership information with FinCEN will be required to file a written certification with FinCEN identifying the specific applicable exemption and provide the identifying information of the applicant. Existing entities that qualify for an exemption have 2 years from the date that the final regulations are issued by Treasury to file the required certification with FinCEN stating that it is exempt.

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What is the penalty for failing to properly report?

It is unlawful under the CTA to:

- knowingly file false beneficial ownership information to FinCEN; or
- willfully failing to provide complete or updated beneficial ownership information to FinCEN.

Violations are subject to a civil penalty of not more than \$10,000, or criminal penalties under title 18 of the U.S. Code, which can include fines and imprisonment for not more than 3 years. Fortunately, the CTA explicitly states that negligent violations are not penalized. Moreover, a waiver process is provided for violations that are due to reasonable cause and not due to willful neglect, which is modeled on the Internal Revenue Service waiver process for companies' SS-4 filings. Penalties are also provided for unauthorized disclosures or misuse of beneficial owner information.

The CTA contains a number of provisions relating to rulemaking, funding, requirements on federal contractors, studies, and reports.

As noted above, the CTA will not become effective until Treasury issues regulations, which may not happen until late this year. This will give the business community time to study the CTA, consult with their lawyers, and determine how best to comply.

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