



Ep. 30: What Will the Corporate Transparency Act Mean for Your Business?

October 1, 2021

Unless you are an exempt entity, the new Corporate Transparency Act will require you to disclose the beneficial owners of your company to the United States government. Businesses will not be required to do so, however, until the Department of Treasury issues regulations. What is required, who is exempt, and what will compliance look like for companies and the attorneys and accountants who form them?

Douglas Charnas: I'm **Douglas Charnas**, Member in McGlinchey's Washington DC office. I practice tax law. I'm joined by my partner, **Rudy Aguilar**, from our Baton Rouge office, who practices with our Business and Corporate Transactions group and has advised business entities on organizational, governance, and operational matters.

Rudy, you may recall that the Senate voted on New Year's Day to override the President's veto of the National Defense Authorization Act, making it law. The National Defense Authorization Act (NDAA) contains within it the Corporate Transparency Act. It looks like the Corporate Transparency Act, or CTA, is a game-changer in that it is going to require the disclosure of the beneficial owners of business entities to the Financial Crime Enforcement Network within the Department of Treasury, or FinCEN as it is commonly known, at the time a company is formed and at certain other times. This looks like one more layer of compliance burdens being placed on businesses. Why would Congress do this?

Rudy Aguilar: It is a game-changer, Doug. It's an anticrime measure. At the beginning of the CTA legislation, Congress discusses the purpose of the legislation. The primary driver is that Congress does not want, understandably so, U.S. entities to be used to hide the identity of the individuals engaged in criminal activities.

Douglas Charnas: To my knowledge, I have never represented a business entity that is engaged in criminal activity. Many of my clients have had disagreements with the Internal Revenue Service (IRS) over tax issues, but none of these have involved illegal activities. Nevertheless, if I understand the new law correctly, I not only will have to advise my clients on how to

make any required filing to notify FinCEN of the beneficial owners of the business entity, but I will have to provide FinCEN with a list of beneficial owners whenever I form a business entity on behalf of a client.

Rudy Aguilar:

You are right! There is a requirement to provide FinCEN with a list of the beneficial owners at the time a business entity is formed, and the entity will be required to notify FinCEN of any changes in ownership. But there are exceptions for certain types of entities that do not require filing with FinCEN.

Congress also wants FinCEN to know the identity of individuals forming entities. If you form an entity on behalf of a client, the CTA affects you directly. It requires the "Applicant," that is the person who forms the entity, to provide FinCEN with the same information about himself or herself as the information being provided for the beneficial owners.

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Douglas Charnas:

Well, I want to hear more about the exceptions, but if a client comes to me today and asks me to form a corporation or limited liability company for it, what am I supposed to do?

Rudy Aguilar:

The CTA instructs Treasury to issue regulations to provide guidance on how to comply. So at this point, no filings are required and won't be until Treasury issues regulations.

Douglas Charnas:

Okay, so until Treasury issues regulations on these reporting requirements, I can continue doing what I have always done.

Rudy Aguilar:

Yes, but your clients will need to know that once Treasury issues regulations, they will need to provide FinCEN with a list of their beneficial owners, unless an exception applies. I should also point out that it is only the reporting requirements that do not take effect until Treasury issues regulations. The CTA contains a provision that prohibits ownership certificates from being issued in a bearer form. What this means is that the ownership certificate, like a stock certificate, must include the name of the owner. It appears that this provision is currently in effect. It is not common to issue ownership certificates in bearer form anyway, but now you should not do this for any new or existing entities.

Additionally, I also want to point out that in some states, if you are providing services to or contracting with the state, often a state will require ownership disclosure of the owners of a company. For example, in Louisiana, if you do business with the state, there's an ownership disclosure form that must be filed with the Secretary of State listing every person, entity, or group that owns 5% or more of that particular company, and with respect to voting rights. Also, it may be true with federal contracting. For

example, under the Paycheck Protection Program (PPP), applicants had to list the substantial owners of an applicant for a PPP loan.

Douglas Charnas: Rudy, that's a really good point. Sometimes I got so caught up thinking about the CTA that I forget there are other reporting requirements already existing with respect to beneficial owners.

I want to circle back to you mentioning that there are some exceptions to the general rule of providing FinCEN a list of all beneficial owners. I am hoping that an exception applies to some of the common situations I face. I have clients that engage in legitimate businesses, but have reasons why they do not want their identity known generally. For example, I have clients who own residential rental properties. To avoid the possibility of being confronted at their home by an upset tenant, my clients prefer not to disclose their identity as the owners of the business entity that owns the rental properties. Will they be able to continue to do this?

The list of beneficial owners filed with FinCEN is confidential and is only to be used for law enforcement/FinCEN purposes. There are severe penalties for unauthorized disclosures or misuse of this confidential information.

Rudy Aguilar: Generally, yes, but the type of entity you describe will be required to file a list of beneficial owners with FinCEN. And before I answer your question in more detail, I want to note that the list of beneficial owners filed with FinCEN is confidential and is only to be used for law enforcement/FinCEN purposes. There are severe penalties for unauthorized disclosures or misuse of this confidential information. So the CTA does not require, nor does it allow, disclosure of the beneficial owners to the public.

Douglas Charnas: Well that is certainly good to know.

Rudy Aguilar: Now, getting to your question about exceptions. The CTA imposes reporting requirements on what it refers to as "reporting companies." It generally defines a "reporting company" as a corporation, limited liability company, or other similar entity that is either formed under the laws of a state or an Indian Tribe, or is formed under the laws of a foreign country and registered to do business in the United States. While this definition of a "reporting company" is very broad, there are 24 exceptions. Among the 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 relevant sections of the Internal Revenue Code; and
- other companies that have certain reporting obligations to governmental entities (for example, insurance companies, banks, federal or state credit unions, investment companies, registered public accounting firms, and public utilities).

Douglas Charnas: Wow, that's a lot of exceptions. Will any apply to my landlord clients?

Rudy Aguilar: Well, one of the most important exceptions applies to active businesses. No reporting is required for 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.

No reporting is required for an entity that employs more than 20 full-time employees, or filed in the previous year Federal income tax returns demonstrating more than \$5 million in gross receipts or sales in the aggregate.

Douglas Charnas: That is going to exempt many businesses from reporting, but I have a lot of clients with less than 20 employees or less than \$5,000,000 in annual gross receipts. Rudy, it sounds like mom and pop businesses are going to be burdened with reporting while larger businesses, including publicly traded corporations, get a free pass.

Rudy Aguilar: Well, unfortunately, that is how the law reads. However, Treasury has the authority to exempt businesses with the consent of the Attorney General and Homeland Security if providing the beneficial information would not serve the public interest and would not be highly useful in national security and preventing or detecting criminal activity. Hopefully, Treasury regulations will provide some relief for small businesses.

Douglas Charnas: That active business exception raises another question in my mind. I have a client that owns several fast-food chain locations. Each location is owned by a separate limited liability company. Each of these separate LLCs is owned by one LLC that the client uses as her holding company. None of these locations has more than 20 employees or more than \$5,000,000 in annual gross receipts, but if you add up all the employees and gross receipts of these locations you exceed the 20 employee and \$5,000,000 thresholds for the active business exception. Can the client aggregate these locations to meet the [active] business exception?

Rudy Aguilar: Doug, that is an interesting question. The way the statute reads, it appears that you can aggregate the locations for the \$5,000,000 annual gross receipts test, but not the 20 employee test. This may be something that the Treasury regulations will address. Just as an aside, it's interesting to note that the CTA is not part of the Internal Revenue Code. So, the rules in the Internal Revenue Code that treat some entities as disregarded for income tax purposes do not apply. Having said that, Treasury may incorporate aspects of the disregarded entity rules into the reporting requirement regulations.

Douglas Charnas: Ok. Rudy, I want to run another situation by you that often comes up. I know that people use organizations described in Section 501(c)(4) of the Internal Revenue Code,

what are referred to as “Social Welfare Organizations,” to engage in lobbying or political activities. One reason for doing this is to keep the identity of the individuals behind the lobbying or political activities secret. I understand that the list of beneficial owners reported to FinCEN is confidential (although 501(c)(4) organizations may be required to disclose beneficial ownership under other provisions of law), but are these types of entities exempt from reporting under the CTA? I know you mentioned that churches, charities, and nonprofit entities are exempt. Would that include a Section 501(c)(4) organization?

Rudy Aguilar: Yes, Social Welfare Organizations are exempt, as well as Political Action Committees that are exempt from income tax under Section 527 of the Internal Revenue Code.

Douglas Charnas: Rudy, I assume there are penalties for failing to comply.

Rudy Aguilar: You assume correctly. Civil and criminal penalties can apply for failing to comply, including fines of up to \$10,000 and up to two years in prison for willful violations. But the CTA explicitly states that negligent violations are not penalized. Also, a waiver process will be provided for violations that are due to reasonable cause and not due to willful neglect.

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Douglas Charnas: You know, as I think about the penalties and tax-exempt entities not having to report, an interesting issue arises. Except for Section 501(c)(3) organizations, which are charities, other types of tax-exempt organizations are not required to receive a determination letter from the IRS stating that they are tax-exempt. They can self-certify if they meet the legal requirements for being tax-exempt. But now that penalties can be imposed for failing to report under the CTA, it may be prudent for tax-exempt entities to receive a determination letter from the IRS so that they have evidence of the fact that they are tax-exempt, and therefore, exempt from reporting under the CTA. Something to think about.

Rudy, I know we are running short on time, but there are two other questions that maybe you could answer quickly. First, who is a beneficial owner, and second, what type of information must be provided?

Rudy Aguilar: A “beneficial owner” is:

- a natural person who exercises 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.

The information that must be provided is:

- the individual's full legal name;
- date of birth;
- current residential or business address; and
- a current identifying number, such as a driver's license or passport number or a FinCEN identifier.

Also, as I mentioned earlier, the individual forming an entity is required to provide this information for himself or herself, even if he or she is not a beneficial owner. So if you are forming a company for a client, you may want to do some due diligence to protect yourself from forming a company that will be used for criminal activities. Or maybe, you don't form it, you have your client form it directly.

It sounds like some of my smaller clients will be required to file a list of their beneficial owners, unless the Treasury regulations provide relief for these smaller businesses. My other clients that have active U.S. businesses with more than 20 employees and \$5,000,000 in annual revenue or are nonprofit organizations will not be required to report their beneficial owners.

Douglas Charnas:

Rudy, after speaking with you, I am not as concerned about the CTA as I was before we spoke. It sounds like some of my smaller clients will be required to file a list of their beneficial owners, unless the Treasury regulations provide relief for these smaller businesses. My other clients that have active U.S. businesses with more than 20 employees and \$5,000,000 in annual revenue or are nonprofit organizations will not be required to report their beneficial owners.

Rudy, I know I said I had two final questions, but I just remembered I want to ask you about the Advance Notice of Proposed Rulemaking issued by FinCEN on April 5th. My understanding is that this advance notice does not provide any guidance, but rather solicits comments from the general public on certain of issues.

Rudy Aguilar:

That's right, Doug. FinCEN is soliciting comments on a number of issues. For example:

- Should the definition of "beneficial owner" be clarified?
- Reporting companies include corporations, limited liability companies, "or other similar entities." How should FinCEN interpret "other similar entities?"
- Is clarification needed on who is an "applicant?" (Remember, an applicant is the person who forms a reporting company.)
- How should a reporting company confirm the accuracy of the beneficial ownership information?
- And what burdens are reported with these reporting requirements?

Douglas Charnas:

Sounds like FinCEN has its work cut out for it. Any idea when we can expect to see these proposed regulations?

Rudy Aguilar:

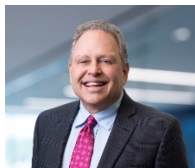
The CTA requires FinCEN to promulgate regulations prescribing procedures and standards for governing beneficial ownership reporting and the FinCEN identifier by January 1, 2022. If this means that final regulations have to be promulgated by January 1, 2022, then we should be seeing proposed regulations very shortly. Regulations addressing other issues can be promulgated later.

Douglas Charnas:

Rudy, I appreciate Congress's desire to curb criminal activity with more information reporting requirements, but it needs to balance the usefulness of the information collected against the burden imposed on the business community. I am encouraged by FinCEN's solicitation of comments on the burdens being imposed, and hope that it will reach a reasonable balance.

Although the reporting requirements under the CTA will not take effect until FinCEN finalizes its regulations, businesses should consider now whether they will be required to report, and, if so, be prepared for reporting. Rudy, I, and other McGlinchey lawyers are here to help businesses comply with these new reporting requirements. Thank you for joining us today.

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