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Insights

## The Corporate Transparency Act: Understanding the Reporting Requirements

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Recently, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a final rule regarding reporting requirements imposed by the Corporate Transparency Act (CTA). This final rule obligates certain entities to file with FinCEN reports that identify two (2) type of individuals: (i) the entity's beneficial owners, and (ii) individuals who have filed an application with a Secretary of State or similar office under the law of a state or Indian tribe to create the entity or register it to do business.

The CTA was enacted as part of the National Defense Authorization Act by Congress in January 2021 for the purpose of protecting the U.S. financial system from being used for money laundering, financing of terrorism, corruption, tax fraud and other illicit activity conducted by corporate entities. In a continued effort to combat and prevent the U.S. financial system from being taken advantage of by those engaging in illicit activity, the CTA requires certain entities to file financial ownership information with FinCEN which will be kept in a private database. This recent final rule is the first of three (3) final rules to be issued.

### *Entities Required to Report*

The CTA reporting requirement is targeted at small businesses, both domestic and foreign, with a primary focus on shell companies and other entities with limited operations. Reporting company is broadly defined by the CTA as any corporation, limited liability company or other similar entity that filed an application with a Secretary of State or similar office or that is formed in a foreign country and has registered to do business in the United States by filing the appropriate registration documents with a Secretary of State or similar office.

Because the CTA focuses on shell companies and entities with limited operations, there are 23 types of entities excluded from the reporting requirement, many of which are already subject to significant government oversight and/or are already required to report beneficial ownership to a governmental authority, including the following key exemptions:



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- Tax-exempt entities;
- Companies that file reports with the Securities and Exchange Commission;
- Banks and credit unions;
- Broker-dealers;
- U.S. governmental authorities;
- Insurance companies;
- Accounting firms;
- Investment companies or investment advisors registered with the Securities and Exchange Commission;
- Subsidiaries whose ownership interests are either controlled or wholly owned, directly or indirectly, by an exempt entity;
- Large operating companies that (i) employ more than 20 full-time employees in the U.S., (ii) have an operating presence at a physical office in the U.S., and (iii) filed federal income tax return in the U.S. for the previous year demonstrating more than \$5,000,000.00 in gross receipts or sales in the aggregate;
- Inactive entities that were formed on or before January 1, 2020 and meet other requirements; and
- Foreign pooled investment vehicles operated or advised by a qualifying bank, credit union, bank holding company, broker or dealer, investment company or investment advisor, or insurance company, or public accounting firm.

### *Beneficial Owners*

Individuals qualifying as beneficial owners of a reporting company are those who either, directly or indirectly, (i) exercise substantial control over a reporting company or (ii) own or control at least 25% of the ownership interest in a reporting company. Exceptions to the definition of beneficial owner include minor children (so long as the beneficial ownership interest of a parent or legal guardian is reported), nominees, employees whose substantial control or economic benefits result solely from their employment status, future inheritors, and creditors whose exclusive interest in the reporting company is as a creditor.

- **Substantial Control**

The final rule sets out the following criteria to determine whether an individual has “substantial control” over a reporting company:

1. services as a senior officer;
2. authority over appointment or removal of any senior officer or a majority of the board or similar body;

3. whether the person directs, determines, or has substantial influence over important decisions and matters affecting the reporting company; or
4. whether the person exercises any other form of substantial control over the reporting company.
5. Ownership Interest Percentage

An ownership interest is broadly defined to encompass equity interests, capital or profit interests, and convertible interests, as well as a catchall category for any other mechanism used to establish ownership. An individual's ownership interest percentage is determined by the type of entity the reporting company is treated as for federal income tax purposes.

For reporting companies that issue capital or profit interests (*i.e.* entities treated as partnerships for federal income tax purposes), an individual's ownership interest is the individual's capital and profit interests, calculated as a percentage of the entity's total outstanding capital and profit interests of the entity. On the other hand, for entities taxed as corporations, as well as other entities that issues shares of stock, the applicable percentage is the greater of (1) the total combined voting power of all of classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote, or (2) the total combined value of the ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests.

#### *Applicants*

An applicant is any individual who directly files the document that creates a domestic entity or registers a foreign entity to do business with a Secretary of State or similar office, as well as the individual who is primarily responsible for directing or controlling such filing.

#### *Information Required to be Reported*

Initial reports filed by reporting companies must include the following information:

- Reporting Company's Information:
  - Full legal name of the entity;
  - Trade name or "doing business as" name, if applicable;
  - Address of principal place of business, if located in the U.S., or if located outside the U.S., then the primary location in the U.S. where the reporting company does business;
  - Jurisdiction of formation; and
  - Internal Revenue Service Taxpayer Identification Number (TIN), or in the case of foreign reporting companies who have not been issued a TIN, a tax identification number issued by a foreign jurisdiction and the name of the jurisdiction.
- Beneficial Owner and Applicant Information:

- Full legal name of the individual;
- Date of birth of the individual;
- Business address if the applicant is in the business of forming or registering an entities, or, if not, the applicant's residential address;
- Unique identifying number and the jurisdiction issuing such number from (i) non-expired passport issued to the individual by the U.S. government or a foreign government, (ii) non-expired driver's license issued to the individual by a State, or (iii) non-expired identification document issued by a State, local government, or Indian tribe for the purpose of identifying such individual; and
- Image of the document from which the unique identifying number was obtained.
- Certification

Each reporting company must certify with FinCEN that the report is "true, correct, and complete." The responsibility for reporting the information falls on the reporting company. FinCEN's rationale is that by require reporting companies to certify this information, they will take appropriate care to verify the information they receive from their beneficial owners and applicants before they report it to FinCEN.

#### *Effective Date and Filing Deadlines*

The effective date of this final rule is January 1, 2024. Entities formed before January 1, 2024, will not be required to report applicant information. Any reporting company either formed in the U.S. or registered to do business in the U.S. on or after January 1, 2024 will need to file their initial report with FinCEN within 30 days of their formation or registration. Reporting companies existing prior to January 1, 2024 will have until January 1, 2025 to file their initial report.

Any change to previously reported information, including the correction of inaccurate information, must be updated with FinCEN within 30 days of such change occurring or the awareness of the inaccuracy by the reporting company.

*Upcoming from FinCEN* FinCEN will be creating the reporting forms that will be published for public comment. Additionally, FinCEN will be issuing two (2) supplementary final rules regarding who will have access to the database, including how FinCEN intends to keep the information secure, as well as, revisions to the customer due diligence rule, primarily relating to financial institutions.

*Disclaimer: This summary is provided for educational and information purposes only and is not legal advice. Any specific questions about these topics should be directed to Attorneys [Kayla Perry](#) or [Scott A. Stokes](#).*

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