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Insights

Is Your Business Ready? Preparing for and Complying with the Corporate Transparency Act

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Starting January 1, 2024, most small privately held businesses will be required, pursuant to the Corporate Transparency Act ("CTA"), to report information to the federal government about their owners and individuals that exercise control over the company and to disclose those involved in forming or registering the company to do business in the United States. Congress enacted the CTA to better regulate and combat various financial crimes associated with money laundering, terrorism, human and drug trafficking, and other criminal enterprises that misuse corporate structures to carry out unlawful activities. The federal government has not previously required private business to disclose and report this information about their owners for these purposes. Most small businesses doing business in the United States will have to be ready to address this new requirement.

This Alert breaks down the CTA into key questions to consider. Our answers apply the CTA itself and the final rules adopted by the Department of the Treasury and reflect the related guidance published by the United States Department of Treasury's Financial Crimes Enforcement Network ("FinCEN") as of the date of this Alert.

Who is subject to the CTA and who is not?

A company that meets the definition of a "reporting company" under the CTA must comply with the CTA. The term "reporting company" means a corporation, limited liability company, or other similar entity that is created or registered to do business in the United States by the filing of a document with a secretary of state or similar office under the law of a State or Indian Tribe. Congress authorized the Secretary of the Treasury to adopt rules and regulations to implement the CTA. The term "similar entity" was clarified during the rulemaking process to include any entity created or registered to do business in the United States through a filing with a secretary of state in a U.S. jurisdiction. (A limited partnership, for example, is an entity type that is not listed but will be considered a reporting company under the CTA.)

Some businesses are explicitly exempt from the reporting requirements of the CTA. The term "reporting company" excludes any entity that operates in a physical office in the United States employs more than 20 employees on a full-time basis in the United States and filed in the previous year federal income tax returns reflecting more than $5,000,000 in gross receipts or sales. This exemption broadly excludes what might be considered "big" businesses. (Note that both the employee and dollar thresholds must be met to satisfy this exemption.)

Additionally, the CTA does not apply to entities that are normally already subject to government oversight through various regulatory structures, such as public companies, various financial institutions, insurance companies, and non-profit entities.

What must be reported?

A reporting company must submit a report to FinCEN that identifies each “beneficial owner” and “applicant” of the reporting company.

The term “beneficial owner” means an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise exercises “substantial control” over the entity or who owns or controls not less than 25 percent of the ownership interests of the entity. This term excludes certain individuals, such as a minor child and an individual whose only interest in a reporting company is a future interest through a right of inheritance.

An individual has “substantial control” over an entity if he or she serves as a senior officer of the reporting company, has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body), or directs, determines, or has substantial influence over important decisions made by the reporting company. This concept overall can ensnare a wide swath of individuals even if they do not have any ownership in the entity.

The scope of “important decisions” remains open-ended, as the guidance provided by FinCEN acknowledges that the examples given are non-exclusive. However, the list of important decisions includes many key aspects of an entity’s life and business: the nature and scope of the entity’s business, major transactions involving the entity, major expenditures, compensation packages for senior officers, and amendments to substantial governance documents, such as articles of incorporation and bylaws or similar governance documents.

For each reporting company, the reporting company must provide the following information:

- Full legal name of the reporting company.
- Any trade name or “doing business as” (d/b/a) name.
- Current address.
- Jurisdiction of formation or registration.
- Federal taxpayer ID number.

For each beneficial owner, the reporting company must provide the following information:

- Name.
- Date of birth.
- Current residential or business address.
- A unique identifying number from an acceptable, nonexpired identification document (such as a state driver's license or a U.S. or foreign passport) or an identifying number issued by FinCEN.

A reporting company, when or after submitting its initial report, can request a unique “FinCEN identifier” from FinCEN, which it can subsequently use in lieu of providing the corresponding information required by the CTA. Similarly, an individual can also obtain a FinCEN identifier that can be used in lieu of providing the required information. Individuals and reporting companies are obligated to update and correct the information provided to FinCEN in the application for the FinCEN identifier.

The term “applicant” means any individual who files an application to form or register a company to do business in the United States. If more than one individual is involved in a filing, both the individual who directly

files the document to create or register the reporting company and the individual who is primarily responsible for directing or controlling such filing must be disclosed as the applicants.

How Will FinCEN Receive and Store the Reported Information? Who will have Access to the Reported Information?

FinCEN is in the process of developing a secure database called the "Beneficial Ownership Secure System" (BOSS) to receive, store, and maintain beneficial ownership reports electronically. Beneficial owner information that will be reported to FinCEN will not be public information. Rather, the reported information must be kept confidential in a secure, private database.

However, federal, state, and some foreign law enforcement and other agencies engaged in criminal investigations, national security and intelligence may access, upon request from the Department of Treasury, the information reported to FinCEN. The Department of Treasury is required to develop protocols and procedures for federal agencies and state, local and tribal law enforcement agencies to request and receive beneficial ownership information from FinCEN. For state, local, and Tribal law enforcement agencies, a court of competent jurisdiction must authorize the agency to seek the information as part of a criminal or civil investigation. For a law enforcement agency of a foreign jurisdiction, a federal agency would need to submit a request on behalf of the foreign country under international law. With the consent of the reporting company, FinCEN may also disclose information to financial institutions in connection with their required customer due diligence and to their regulators as part of assessing compliance with those requirements.

What does the CTA mean for you and your business?

As an initial matter, all business entities should determine if they are a "reporting company" under the CTA or are exempt from its reporting obligations. The complexities and lack of specificity in many of the concepts of the CTA raise uncertainty and questions for many businesses regarding their status under the CTA. Consultation with an attorney that has a good understanding of the CTA and its applicable rules and guidance is imperative.

An entity that is subject to the CTA will need to gear up for the reporting requirements starting January 1, 2024. A reporting company created or registered *before* January 1, 2024 will have until January 1, 2025 to file its initial beneficial ownership reports with FinCEN but will not be required to disclose the identity of the company's applicant.

A reporting company created or registered *on or after* January 1, 2024 will be required to file the initial beneficial ownership reports within 30 days of formation or registration. (We note that some efforts are underway to increase this timeframe.)

If there is any change with respect to information that has been previously submitted to FinCEN, a reporting company must update that information within 30 calendar days of when the change occurred. Reporting companies will want to develop a process to ensure that they track and receive timely updates when information changes, including information relating to the beneficial owners whose information has been reported and those who become beneficial owners in the future.

A reporting company or individual that violates the CTA will be subject to civil penalties of not more than $500 per day, capped at $10,000 in the aggregate, or imprisonment of not more than two years, or both.

Additionally, a reporting company should consider the timing of their business decisions, how the CTA may affect their operations and, if the entity and its owners want to avoid filing the required information, what restructuring might be available to meet the exemptions under the CTA. For example:

- A reporting company that engages in acquisitions may want to consider including a provision in a purchase agreement to certify that a target business and its owners have complied with the CTA and modify their due diligence process to verify this information.
- A reporting company may want to restructure its internal organization and the ownership of affiliated entities by forming a holding company that would be exempt from the CTA reporting requirements. This could lead to an exemption for their controlled or wholly owned subsidiaries. Planning for this action will need to consider the timing of the CTA's reporting obligations.
- A reporting company may also want to consider amending its internal governance documentation to require its beneficial owners to periodically confirm their information and provide timely updates to the reported information. A reporting company should also consider obtaining covenants from each owner and the reporting company to comply with the CTA and provide indemnification from liability for the company's or any such owner's failure to comply.
- A reporting company will also want to review its governing documentation to determine who qualifies as a beneficial owner and decide if certain provisions unintentionally cause individuals to qualify as a beneficial owner. For example, if a reporting company requires that certain corporate activities, such as large expenditures or disposition of company assets, be unanimously approved by the owners, each owner – even if holding a small percentage of the company well below the 25% threshold for beneficial ownership – may be considered to hold substantial control over an important decision. If so, the reporting company would be required to disclose these minority holders as beneficial owners.

Conclusion

The CTA broadly applies (subject to some exemptions from coverage) to any private company that forms or registers to do business in the United States and may require filing specific information about its owners and those who form the company. A more in-depth analysis will be necessary on a case-by-case basis to confirm whether a particular company is a reporting company for purposes of the CTA and to determine who would be considered a company's "beneficial owner" and "applicant." If you have any questions regarding the CTA or obligations to comply with the reporting requirements, please contact **Robert A. Greising** or **Travis D. Lovett** or any member of our **Business, Acquisitions and Securities Practice**.

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