

THE CORPORATE TRANSPARENCY ACT: WHAT YOU SHOULD KNOW

On January 1, 2021, Congress enacted the Corporate Transparency Act (“CTA”), which imposes significant new reporting requirements on both domestic and foreign business entities and effectively creates a beneficiary ownership registry at the federal level. Managers, directors, and officers should become familiar with the new requirements, as the CTA imposes substantial penalties for willfully providing false information or failing to report/update beneficial ownership information. Violating the CTA reporting requirements can result in civil penalties of up to \$500 per day the violation continues, and criminal penalties of imprisonment of up to two years and fines of up to \$10,000.

This article first discusses the new reporting obligations under the CTA, including the key definitions and parameters, at a high level. It then provides five key points that are relevant to businesses and their owners.

Overview

Congress’s stated purpose in enacting the CTA is to prevent the use of anonymously formed entities to facilitate tax evasion, securities fraud, money laundering, and other crimes. According to the preamble, each year more than 2,000,000 domestic corporations and LLCs are formed, the majority in states that lack disclosure or reporting requirements similar to those provided under the CTA.

Key Definitions; Parameters

Very simply, the CTA will require most types of business entities, namely corporations, LLCs, and other similar entities that fall within the definition of “reporting companies,” to report certain identifying information regarding their “beneficial owners” and “applicants” to FinCEN.¹

The CTA’s reach is broad; at its starting point, a “reporting company” is intended to include a corporation, LLC, or similar entity that is:

- formed by the filing of a document with a secretary of state or a similar office under the law of a U.S. 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 law of a U.S. state or Indian Tribe.

Under the CTA, an “applicant” is defined as any person who files such documentation to form the reporting company or registers a reporting company to do business. A “beneficial owner” refers to “an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise exercises substantial control over the entity or (ii) owns or controls not less than 25% of the ownership interests of the entity.



Requirements

In the mandated report to FinCEN, a reporting company must provide for each beneficial owner and applicant the following :

- Full legal name;
- Date of birth;
- Current residential address or business street address; and
- Unique identifying number from (i) a non-expired U.S. passport; (ii) non-expired state or federal identification document, (iii) a non-expired state-issued driver's license; or (iv) if the beneficial owner does not have any of the aforementioned documents, a nonexpired foreign passport.

The information reportable under CTA is not accessible to the public. While the CTA permits the sharing of information with certain other government organization under limited circumstances, it is not a public ownership registry.

5 Takeaways

Here are five points worth noting:

First, the definition of “reporting company” is broad and picks up many small (“main street”) businesses. There are numerous exceptions to this definition that are intended to narrow its scope. While a comprehensive discussion of the exceptions is beyond the scope of this article, it is worth noting the following two exceptions:

- An entity that (i) filed a U.S. federal income tax return in the previous year demonstrating annual gross receipts or sales of more than \$5,000,000; (ii) has more than 20 full-time employees; and (iii) has a physical operating presence in the United States. start-ups and many small businesses that do not meet all three of the above criteria will be subject to reporting under CTA.
- Most tax-exempt organizations under sections 501, 501A, 527, and 4947 of the Internal Revenue Code (e.g., split interest trusts and private foundations).

Second, the CTA represents a significant departure from previous federal reporting requirements. Until now, each state determined the information required with respect to business formations and foreign registration filings made in that state, with many states requiring little or no identifying information. Consequently, the CTA imposes substantial new reporting obligations on small businesses, new business formations, and the regulation of foreign business in the United States.

Third, the CTA's requirements are not yet effective. Under the CTA, the Secretary of the Treasury must issue regulations to interpret and implement its provisions by January 1, 2022, at which time (or earlier date as prescribed in the regulations), the CTA becomes effective.

Fourth, until the regulations are issued, there are many questions and concerns that remain open with the potential to impact not only the startup and business communities, but also other areas, such as estate planning. For example, while it is clear that the revocable and irrevocable trusts used in the wealth transfer, asset protection, and estate planning context are not “reporting companies,” it remains to be seen which entities will constitute a “similar entity” to a corporation or LLC, and will thus be subject to reporting (e.g., limited partnerships).

Finally, under the CTA, the reporting company (rather than the beneficial owner or applicant) has the obligation to report to FinCEN, notwithstanding the fact that, in practice, the entity may not have the ability to acquire (or require such persons to provide) the necessary information. Therefore, companies should consider, among other measures, amending the organizational and other governing documents to address this issue. Such amendments could include:

- A limitation on or carve-out to confidentiality clauses;
- including an express obligation on shareholders, members, other interest holders, controlling individuals, etc. to provide the company with the necessary information to submit to FinCEN (and a continuing duty to update such information); and
- A mechanism of enforcement if such individuals fail to provide the appropriate information, which might include penalties, financial or otherwise (e.g., forfeiture of interest if permissible under applicable law).

More information will be forthcoming when the regulations are proposed and then finalized, hopefully putting some clarity on the extent of the reporting requirements. If you have further questions about the CTA and potential impact on your company or organization, please contact PLDO Senior Counsel Jason P. Jones in our Boca Raton, Florida office at 561-362-5020 or email jjones@pldolaw.com.

¹ U.S. Department of Treasury's Financial Crimes Enforcement Network



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