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The Corporate Transparency Act – Disclosure Requirements and Guidance for Reporting Companies Based on FinCEN’s Final Rules

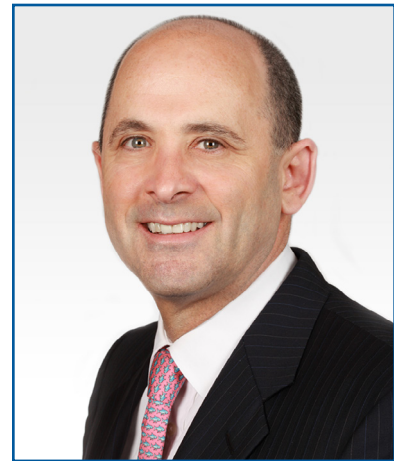
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Overview

The Corporate Transparency Act (the “CTA”) was enacted into law on January 1, 2021 pursuant to the National Defense Authorization Act for Fiscal Year 2021.¹ As mandated by the CTA, the Department of Treasury’s Financial Crimes Enforcement Network (“FinCEN”) issued a final rule (the “Final Rule”) implementing beneficial ownership information reporting in September 2022.² These regulations go into effect on January 1, 2024. Until that date beneficial ownership information will neither be required nor accepted.

The CTA and the rules promulgated thereunder are intended to combat money laundering, terrorism, drug trafficking and other illicit activities by enabling law enforcement and other regulators to have access to information about beneficial ownership of entities. Historically, the lack of transparency has enabled criminals, terrorists, and other illicit actors to remain anonymous while engaging in fraud, drug trafficking, corruption and other illicit activities through legal entities created in the United States.

FinCEN’s approach in the Final Rule is intended to close loopholes that allow corporate structuring to obscure the identities of owners or decision-makers, which FinCEN determined is crucial to unmasking anonymous shell companies. The result is that the definitions in the Final Rule relating to ownership and control and related determinations are broadly drafted to account for structures that companies may adopt and create sufficient transparency to prevent illicit actors from using shell and front companies to obfuscate their identities for criminal purposes. Accordingly, while many of the determinations are standard, there are also catchalls and broadly drafted provisions that may make it difficult or impossible to make the



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¹ The William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, H.R. 6395, 116th Cong. (2020) § 6403, is available [here](https://www.congress.gov/bill/116th-congress/house-bill/6395/text) (<https://www.congress.gov/bill/116th-congress/house-bill/6395/text>).

² The Final Rule is available [here](https://www.federalregister.gov/documents/2022/09/30/2022-21020/beneficial-ownership-information-reporting-requirements) (<https://www.federalregister.gov/documents/2022/09/30/2022-21020/beneficial-ownership-information-reporting-requirements>).

required determinations prospectively, and will require ongoing vigilance and analysis to ensure Reporting Companies make these determinations in a timely manner.

Reporting Companies and Reports

Who must report?

Corporations, limited liability companies, and other entities organized in the U.S. and non-U.S. corporations, limited liability companies or other entities registered to do business in the United States (“Reporting Companies”), in each case which are formed by filing with the secretary of state or similar office or under the laws of a foreign jurisdiction and registered to do business in any state or tribal jurisdiction.

What entities are exempt?

The Final Rule contains 23 categories of entities that are exempt from the definition of Reporting Companies, including the following:

- Companies with (i) more than 20 full time employees (not on a consolidated basis), (ii) annual gross U.S. receipts or sales of more than \$5 million (on a consolidated basis for certain affiliated entities) reported on an applicable IRS form, excluding receipts or sales outside of the U.S., and (iii) an operating presence in an office in the United States.
- Issuers of securities registered under Section 12 of the Securities Exchange Act of 1934 (“Exchange Act”) or that are required to file supplementary and periodic information under the Exchange Act.
- Companies operating in certain industries already subject to significant regulation, such as banks, investment companies and investment advisers registered with the Securities and Exchange Commission (the “SEC”), public accounting firms registered under the Sarbanes-Oxley Act of 2002, public utility companies, and 501(c) charitable organizations.
- Pooled investment vehicles, including (i) any fund that would be an investment company but for the exclusion in section 3(c)(1) or 3(c)(7) of the Investment Company Act³ and that is identified by its legal name in the applicable registered investment adviser’s Form ADV filed with the SEC or that will be so identified in the next annual updating amendment to such Form ADV and (ii) venture capital fund advisers that have made specified filings with the SEC.
- Subsidiaries of certain exempt entities that are wholly owned or directly or indirectly controlled by such entities. The Final Rule contains notable exclusions from the subsidiary exception, such as subsidiaries of pooled investment vehicles as described above.
- Inactive entities in existence on or before January 1, 2020 that (i) are not owned by a foreign person, (ii) have not had a change in ownership during the last 12 months, (iii) have not sent or received funds in excess of \$1,000 in the last 12 months, and (iv) do not hold any kind or type of assets.

FinCEN declined to include additional exemptions in the Final Rule, but noted it would consider suggestions for additional exemptions.

³ It should be noted that real estate funds relying on section 3(c)(5)(c) of the Investment Company Act will not be exempt.

When must reports be filed?

- Reporting Companies formed before January 1, 2024 will have until January 1, 2025 to file their initial reports.
- Reporting Companies formed on or after January 1, 2024 must file within 30 days of the earlier of receipt of notice of creation or registration from the secretary of state or similar office.
- Reporting Companies have to (i) report changes to information in their previously filed reports (including, but not limited to, transfers of beneficial ownership) within 30 days of when such changes occur and (ii) correct inaccurate information in previously filed reports within 30 days of when the Reporting Company became aware or has reason to know of the inaccurate information. If a Reporting Company became exempt, that will be required to be disclosed as a change to previously filed information.

What must be reported by a Reporting Company in the Initial Reports?

1. The following information regarding the Reporting Company:

- Full legal name;
- Any trade name or “doing business as” name;
- For a Reporting Company with a principal place of business in the U.S., the street address of such principal place of business, and in all other cases, the street address of the primary location in the U.S. where the Reporting Company conducts business;
- The state, tribal, or foreign jurisdiction of formation of the Reporting Company. A foreign Reporting Company should additionally include the U.S. state or tribal jurisdiction where such company first registers; and
- Taxpayer Identification Number (TIN) (including an Employer Identification Number (EIN)) of the Reporting Company, or where a foreign Reporting Company does not have a TIN, a tax identification number issued by a foreign jurisdiction and the name of such jurisdiction.

2. Regarding Company Applicant and each Beneficial Owner, a Reporting Company must report the following:

- Full legal name;
- Date of birth;
- For a Company Applicant who forms or registers an entity in the course of such Company Applicant’s business, the street address of such business. In any other case, the individual’s residential street address;
- A unique identifying number and the issuing jurisdiction from one of the following:
 - » a non-expired U.S. passport,
 - » a non-expired state, local government or Native American tribe identification document,
 - » a non-expired state driver’s license, or
 - » a non-expired a passport issued by a foreign government, if the individual does not have any of the forgoing documents; and
- An image of the document containing the unique identifying number.

Reporting Companies formed before January 1, 2024 are not required to report Company Applicant information.

Additionally, if an individual provides its four pieces of information to FinCEN directly, the individual may obtain a “FinCEN identifier” which can then be provided to FinCEN with the report in lieu of information about the individual.

Company Applicants and Beneficial Owners

Who is a Company Applicant?

A “Company Applicant” is the individual who directly files the document that creates the entity, or in the case of a foreign reporting company, the document that first registers the entity to do business in the United States and the individual who is primarily responsible for directing or controlling the filing of the relevant document by another.

Who is a Beneficial Owner?

A “Beneficial Owner” is an individual who, directly or indirectly either: (a) exercises substantial control over a Reporting Company, or (b) owns or controls at least 25 percent or more of the ownership interests of a Reporting Company.

Exemptions to the definition of Beneficial Owner are:

- i. A minor child, provided that the information of such child’s parent or guardian is reported properly;
- ii. An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
- iii. An individual acting solely as an employee of the applicable entity whose control is derived solely as a result of such individual’s employment status;
- iv. An individual whose only interest in the applicable entity is through a future right of inheritance; and
- v. A creditor of the applicable entity, unless the creditor otherwise meets the requirements of a Beneficial Owner.

When does an individual exercise substantial control over a Reporting Company?

An individual exercises substantial control over a Reporting Company if the individual:

- i. Serves as a senior officer of the Reporting Company;
- ii. Has authority over the appointment or removal of any senior officer or a majority of the board of directors of a Reporting Company or similar governing body;
- iii. Directs, determines, or has substantial influence over important decisions made by the Reporting Company, including decisions regarding (a) sale or transfer of material assets, (b) reorganization, dissolution or merger of the Reporting Company, (c) major financial transactions, approval of operating budget or material changes in operations or business of the Reporting Company, or compensation of senior officers, and (d) modification of governance documents; or
- iv. Has any other form of substantial control over a Reporting Company.

When does an individual directly or indirectly exercise substantial control?

An individual may directly or indirectly (including as a trustee of a trust or a similar arrangement) exercise substantial control over a Reporting Company through: (a) board representation, (b) ownership or control of a majority of the voting rights or power of a Reporting Company, (c) rights associated with a financing arrangement or interest in a company, (d) control over one or more intermediary entities with substantial control over a Reporting Company, (e) informal or formal financial or business relationships with intermediaries acting as nominees, or (f) any contract, arrangement, understanding, relationship or otherwise.

What constitutes an Ownership Interest?

The Final Rule provides that an “Ownership Interest” includes, but is not limited to (a) equity, (b) capital and profits interests, (c) instruments convertible into equity, (d) puts, calls and straddles, and (e) any other instrument, contract, arrangement or understanding, relationship, or mechanism used to establish ownership.

What constitutes ownership or control of an Ownership Interest?

An individual may directly or indirectly own or control an Ownership Interest in a Reporting Company through any contract, arrangement, understanding, relationship, or otherwise, including: (a) joint ownership of an undivided interest, (b) through another individual acting as a nominee, intermediary or custodian, (c) as a trustee, beneficiary or grantor depending on rights with respect to certain trusts, and (d) the ownership or control of an intermediary entity or entities that separately or collectively control the Ownership Interests of a Reporting Company.

Certification and Other Regulatory and Enforcement Matters

Certification

The Final Rule provides that any person who submits a report or application to FinCEN must certify that the report is accurate, true, correct and complete. FinCEN clarified in its discussion in the preamble to the Final Rule that (i) while an individual may file a report on behalf of a Reporting Company, the Reporting Company would ultimately be responsible for the filing and the certification and (ii) while a number of commentators noted that the CTA already had made it unlawful for a person to willfully provide false information and the certification could potentially expand a person’s liability even if the information was provided in good faith, FinCEN declined to make any change noting in its commentary to the Final Rule that it “does not expect that an inadvertent mistake by a Reporting Company acting in good faith after diligent inquiry would constitute a willfully false or fraudulent violation.” However, it is also clear from FinCEN’s commentary that the criminal and civil penalties will still apply to individuals for willful acts in connection with a Reporting Company’s obligations under the CTA.

Penalties

Civil penalties for violations of the CTA may be up to \$500 for each day that the violation continues, and criminal fines may be up to \$10,000 and/or imprisonment for up to two years. Civil penalties for the unauthorized disclosure or use of beneficial ownership information collected under the CTA may also be up to \$500 per day and may also result in more severe criminal penalties of up to \$250,000 and/or a maximum term of imprisonment of five years. In addition, if the unauthorized disclosure or use of beneficial ownership information collected under the CTA occurs in conjunction with the violation of another domestic law as part of a pattern of illegal activity involving more than \$100,000 during a 12-month period, the disclosing party may be fined up to \$500,000 and/or may be imprisoned for up to 10 years.

Safe Harbor

The CTA contains a safe harbor from civil or criminal liability for the submission of inaccurate information if the person submitting such information voluntarily and promptly submits a report containing corrected information no later than 90 days after the submission of the original information. The 90-day period applies even if the person is unaware of the inaccuracy. However, the Final Rule provides that if a corrected report is filed within 30 days after the date on which the individual becomes aware of or has reason to know of the inaccuracy, the CTA safe harbor will be satisfied.

Restricted Access to Data

The CTA contains numerous provisions regarding FinCEN's data protection procedures. FinCEN must store the information submitted to it in a private database which will not be accessible to the public. Under the CTA, the collected information may only be released pursuant to a request, through appropriate protocols, including by:

- A federal agency engaged in, and in furtherance of, national security, intelligence or law enforcement activity;
- A state, local, or tribal law enforcement agency with court authorization in connection with an investigation;
- A federal agency making the request on behalf of a foreign law enforcement agency, and such request is made under a treaty or by appropriate authorities in a trusted foreign country;
- A financial institution subject to, and in compliance with, customer due diligence requirements under applicable law, with the consent of the relevant customer, such as anti-money laundering (AML) and know-your-customer (KYC) requirements;
- A federal regulatory agency or other appropriate regulatory agency authorized to assess the compliance of a financial institution with customer due diligence requirements; and
- Officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure, including for tax administration.

Pursuant to the CTA, FinCEN issued a proposed rule on December 16, 2022 that is intended to implement the strict protocols on security and confidentiality required by the CTA to protect sensitive personally identifiable information reported to FinCEN.⁴ The proposed rule explains the circumstances under which authorized recipients would have access to beneficial ownership information and outlines data protection protocols and oversight mechanisms applicable to each authorized recipient category. On March 15, 2022, a bipartisan group of U.S. senators expressed concerns that the proposed access and safeguard “rule strays from congressional intent and erects unnecessary and costly barriers to accessing beneficial ownership information (BOI) that risk undermining the utility of the beneficial ownership directory.” The senators’ concerns were that (i) the access and use process was too restrictive, and (ii) the rule needs to implement the congressional mandate that FinCEN has an effective process in place to verify that the collected Beneficial Owner information is complete and accurate.⁵

⁴ The FinCEN Notice of Proposed Rulemaking Regarding Access to Beneficial Ownership Information and Related Safeguards is available [here](https://www.federalregister.gov/documents/2022/12/16/2022-27031/beneficial-ownership-information-access-and-safeguards-and-use-of-fincen-identifiers-for-entities) (<https://www.federalregister.gov/documents/2022/12/16/2022-27031/beneficial-ownership-information-access-and-safeguards-and-use-of-fincen-identifiers-for-entities>).

⁵ The senators’ comments are available [here](https://www.whitehouse.senate.gov/news/release/whitehouse-grassley-wyden-rubio-warren-push-fincen-to-improve-implementation-of-corporate-transparency-act) (<https://www.whitehouse.senate.gov/news/release/whitehouse-grassley-wyden-rubio-warren-push-fincen-to-improve-implementation-of-corporate-transparency-act>).

Takeaways

The commentary in the Final Rule explains that the CTA and regulations promulgated thereunder are, among other things, intended to address the broader goal of transparency of beneficial ownership for regulatory and law enforcement purposes, while minimizing the burden on the regulated community. Accordingly, the definitions relating to ownership and control are broadly drafted to account for structures that companies may adopt and ensure that there is sufficient transparency to achieve the goals of the CTA to prevent illicit actors from using shell and front companies to obfuscate their identities for criminal purposes. However, while the mechanisms utilized to close loopholes may, as suggested in the commentary to the Final Rule, prevent “sophisticated bad actors from structuring their relationships to exercise substantial control of reporting companies without the formalities typically associated with such control in ordinary companies,” these mechanisms may also require disclosure where in a crisis or other future situation, an individual has substantial influence over important decisions but is not reflected or contemplated in any organization or governance documents or other written agreements. Accordingly, in analyzing who is a Beneficial Owner, it is important to note when reviewing the applicable definitions of “Beneficial Owner,” “substantial control,” “Ownership Interest” and related concepts, that this is not a one-time determination, but a fluid process in which judgments and determinations may be triggered by subsequent events.

On March 24, 2023 FinCEN published the following “Beneficial Ownership Information Reporting Frequently Asked Questions” (the “FAQs”).⁶ In the introduction to the FAQs FinCEN made it clear that the FAQs are explanatory and do not supplement or modify the obligations set forth in the applicable statutes or regulations. In addition, FinCEN indicated it expects to publish further guidance in the future.

Disclosure and Enforcement Action

Sills Cummis & Gross P.C. has extensive experience advising individuals in connection with issues similar to those likely to arise under the CTA, such as disclosing information, responding to governmental inquiries and subpoenas, and conducting internal investigations.

⁶ The FinCen FAQs are available [here](https://www.fincen.gov/boi-faqs) (<https://www.fincen.gov/boi-faqs>).