

Shedding Light on the Corporate Transparency Act

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Corporate Transparency Act (“CTA”)

- Enacted by Congress in 2021
 - Part of 2021 National Defense Authorization Act
- Intended to assist law enforcement
 - Combat money laundering, fraud, foreign interference, terrorism, and other illegal activities



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CTA in a Nutshell

- Requires nearly all small businesses in the US to file reports with FinCEN beginning January 1, 2024
- Reports include information about the company and Beneficial Ownership Information (“BOI”) about each of the company’s “Beneficial Owners”
- Strict deadlines for initial and updated reports
- Criminal and civil penalties



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Statutes and Regulations

- CTA is codified at 31 USC § 5336, et seq.
- Treasury has produced a set of final regulations at 31 CFR 1010.380, et seq.
- Several proposed rules currently pending
 - Regulations dealing with government access to information and related safeguards
 - Deadline extension (from 30 days to 90 days) for initial reports for companies formed after January 1, 2024



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Other FinCEN Guidance

- Small Entity Compliance Guide
- Quick Reference Guides
- FAQs
 - Several dozen questions and answers
 - Issued at various times in 2023 and updated/added to periodically
 - Not formal rules/regulations
- <https://www.fincen.gov/boi/small-business-resources>



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Small Businesses – Burdens and Considerations

- Criticism of FinCEN outreach/education
- Tens of millions of collective hours, and billions in costs, each year to comply
- Update governance documents to assist with/require cooperation by owners, officers, etc.
- Dissolve or form entities before January 1, 2024
- Third party service providers
- Penalties and prosecution



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Concerns for CPAs

- AICPA has issued a Risk Alert regarding the CTA
- Potential areas of concern for CPAs
 - Failing to advise clients of CTA reporting requirements
 - Send client alerts/newsletter
 - Include disclaimer in engagement letters
 - Be careful of “off-the-cuff” advice
 - Unauthorized Practice of Law concerns
 - Technical/interpretive advice of CTA and its requirements could constitute practice of law
 - NCGS Sec. 84-1, et seq.
 - Check with your malpractice carrier



Definitions

- Reporting Company
 - A company that is required to report under the CTA
- Beneficial Owner
 - Individual who owns 25% of Reporting Company, or has “substantial control”
- “BOI” = Beneficial Ownership Information
- Company Applicant
 - Individual responsible for forming a Reporting Company



Initial Filing Deadlines

- For Reporting Companies formed before January 1, 2024:
 - Initial report must be filed on or before January 1, 2025
- For Reporting Companies formed on or after January 1, 2024:
 - Initial report must be filed within 30 calendar days after the earlier to occur of:
 - Date the company receives actual notice that its creation is effective, or
 - Date the secretary of state provides public notice of the creation of the company



Initial Filing Deadlines (cont'd)

- For an entity that loses its exempt status, within 30 days after that status is lost
- For a Reporting Entity that subsequently gains an exempt status, it must also file an updated report telling FinCEN of the exempt status – no deadline



Updated Filing Deadlines

- If there is any change with respect to the information that a Reporting Company previously reported, updated report must be filed within 30 days of the change
- NOTE: Not within 30 days of the date that the Reporting Company learns of the change, but within 30 days of the change itself



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Updated Filing Deadlines (cont'd)

- Changes that must be reported include:
 - Changes with respect to the Reporting Company itself (including changes to legal name, trade names, and business address)
 - Changes with respect to who is a Beneficial Owner – i.e., ownership changes, including by reason of death (clock starts when estate of decedent is “settled”)
 - Changes with respect to any Beneficial Owner’s previously reported information (including changes of residential address, new driver’s license)



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What is a Reporting Company?

- Domestic Reporting Companies
- Foreign Reporting Companies



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What is a Reporting Company?

- Domestic Reporting Companies:
 1. Corporations
 2. Limited Liability Companies
 3. Any other entity that is formed by filing a document with a secretary of state
- Does not include: sole proprietorships, trusts, general partnerships
 - Limited Liability Partnerships?



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What is a Reporting Company?

- Foreign Reporting Companies
 - Corporation, LLC, or other entity formed under the laws of a foreign country; AND
 - That is registered to do business in a US state by filing a document with a secretary of state

- Loophole?
 - Foreign companies that are not registered in any US state



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Reporting Company Exemptions

- 23 enumerated types of entities that may otherwise be Reporting Companies, but are specifically exempted



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Reporting Company Exemptions

- Heavily regulated industries, including:
 - Securities issuers that are registered under the Securities Exchange Act
 - Banks/Credit Unions
 - Registered Broker Dealers
 - Registered Investment Companies/Investment Advisors
 - Insurance Companies
 - Public Utilities
 - Accounting Firms registered with the PCAOB
 - Others



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Reporting Company Exemptions

- Tax-Exempt Entities
 - Have to be a 501(c)
 - Newly formed nonprofits must file BOI reports until they receive their Exemption Determination Letter from the IRS



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Reporting Company Exemptions

- Large Operating Companies:
 1. Has more than 20 full time employees in the US;
 - Borrows ACA definitions
 - Measuring date?
 2. Has an operating presence at a physical office in the US; AND
 3. Filed a Federal tax return for the previous year showing more than \$5,000,000 of gross receipts or sales
 - Affiliated groups: amount shown on consolidated return
 - Newly formed companies can never fall under exemption until tax return filed



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Reporting Company Exemptions

- Subsidiaries of other exempt entities:
 - An entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more other exempt entities
 - E.g., the wholly-owned subsidiaries of a Large Operating Company



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Reporting Company Exemptions

- Inactive Entities:

1. Was in existence on or before 1/1/2020;
2. Not engaged in active business;
3. Not owned by a foreign person (directly or indirectly, in whole or in part);
4. No change of ownership in the last 12 months;
5. Has not sent or received funds in excess of \$1,000 in last 12 months; AND
6. Holds no assets of any type (including interest in other entities)



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What Information Must Be Reported

- For all Reporting Companies:

- **Company Information**

- Full legal name
- All trade names and DBA's
- The US street address of the principal place of business
- Jurisdiction
- TIN or EIN



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What Information Must Be Reported

- For all Reporting Companies:
 - **Beneficial Owner Information** – for each of the company's Beneficial Owners (individuals):
 - Full legal name
 - Date of birth
 - Residential street address
 - A unique ID number from:
 - A non-expired US passport
 - A non-expired state ID
 - A non-expired driver's license, OR
 - A non-expired foreign passport
 - A scan/copy of the ID document



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What Information Must Be Reported

- For Reporting Companies formed on or after January 1, 2024, report must also include the following information for the **Company Applicant**:
 - Full legal name
 - Date of birth
 - Business street address
 - A unique ID number from:
 - A non-expired US passport
 - A non-expired state ID
 - A non-expired driver's license, OR
 - A non-expired foreign passport
 - A scan/copy of the ID document



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Who is a Company Applicant?

- Information on Company Applicants is only required to be reported for new companies formed after January 1, 2024
- Company Applicant is always an individual



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Who is a Company Applicant?

- Two potential Company Applicants:
 1. The person who directly files the document that creates a domestic reporting company (or that first registers a foreign reporting company in a US state); AND
 2. The person who is "primarily responsible for directing or controlling such filing"



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Who is a Company Applicant?

- Examples:
 - Attorney who prepares the formation document and directs his or her assistant or paralegal to actually file it on the Secretary of State's site is a Company Applicant, and so is the assistant/paralegal
 - If the attorney prepares the document and directs his or her client to sign it and file it directly, the attorney is likely still a Company Applicant (and so is the client who does the direct filing)



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Who is a Company Applicant?

- If business founder uses a third-party formation service (like LegalZoom), some employee of that service will be a Company Applicant
- Couriers?



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Who is a Beneficial Owner?

- Always an individual
- Vague and broad definition
 - In some cases, it will be relatively straightforward and clear-cut to determine Beneficial Owners; not so much with larger entities with complex structures



Who is a Beneficial Owner?

- Two broad categories of “Beneficial Owners”:
 1. Individual who, directly or indirectly, owns at least 25% of the “ownership interests” in the Reporting Company; OR
 2. Individual who, directly or indirectly, exercises “substantial control” over the Reporting Company



Beneficial Owner: “25% ownership” test

- “Ownership Interests” include:
 - Equity, stock or voting rights
 - Stock in a corporation
 - Capital or profits interests
 - Membership interests in an LLC
 - Convertible instruments
 - Includes warrants or rights to purchase/sell/subscribe to a share or interest in equity or stock, even if not characterized as a debt
 - Options or privileges for any of the above
 - Put, call, straddle rights
 - Catchall - “any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership”



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Beneficial Owner: “25% ownership” test

- How is the 25% threshold determined?
- “Simple” equation (ownership interest of the individual divided by the total outstanding ownership interests) with some specific rules



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Beneficial Owner: “25% ownership” test

- How is the 25% threshold determined?
- When options and similar interests have been issued to an individual, they are treated as having been exercised
 - On an individual-by-individual basis



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Beneficial Owner: “25% ownership” test

- How is the 25% threshold determined?
- For entities that issue capital/profits interests (e.g., LLC’s taxed as partnerships), an individual’s capital/profits interests as a percentage of total outstanding capital/profits interests



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Beneficial Owner: “25% ownership” test

- How is the 25% threshold determined?
- For stock in a corporation (and entities treated as corporations for fed. tax purposes)
 - the greater of:
 - Voting power of the stockholder as a percentage of total voting power outstanding (among all classes); OR
 - Value - combined value of the interests owned by the individual as a percentage of the value of all outstanding interests



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Beneficial Owner: “25% ownership” test

- How is the 25% threshold determined?
- Catchall - If ownership percentage cannot be calculated with reasonable certainty with the preceding special rules, any individual who owns or controls 25% or more of any class or type of ownership interest in the Reporting Company is a Beneficial Owner



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Beneficial Owner: “25% ownership” test

- Who is the owner of the ownership interest?
- Direct ownership of interest in Reporting Company
- Indirect ownership



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Beneficial Owner: “25% ownership” test

- Who is the owner of the ownership interest?
Indirect ownership:
 - Joint ownership with an undivided interest
 - Through third party who is holding the interest as a nominee/intermediary/custodian/agent
 - Person for whom the interest is being held is the Beneficiary Owner



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Beneficial Owner: “25% ownership” test

- Who is the owner of the ownership interest? Indirect ownership:
- Trusts - multiple individuals involved with a trust can be a Beneficial Owner:
 - Trustee or “other individual” with the authority to dispose of trust assets
 - Beneficiary - who meets either of the following criteria:
 - Is the sole income/principal beneficiary; or
 - Has the right to withdraw all or substantially all of the trust assets
 - Grantor who has the right to revoke the trust or “otherwise withdraw assets”



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Beneficial Owner: “25% ownership” test

- Who is the owner of the ownership interest? Indirect ownership:
 - Through ownership of intermediary entities
 - Ownership at each level of a parent-subsidary group needs to be examined and analyzed



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Beneficial Owner: Substantial Control Test

- Broad definitions and tests of what constitutes direct or indirect “substantial control” of a Reporting Company
- “Either/or” with 25% ownership test



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Beneficial Owner: Substantial Control Test

- An individual exercises “substantial control” if he or she:
 - Serves as a “senior officer” of the entity
 - President, CFO, general counsel, CEO, COO, or any other similar officer regardless of title



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Beneficial Owner: Substantial Control Test

- An individual exercises “substantial control” if he or she:
 - Has authority over the appointment or removal of a “senior officer” or of a majority of the board of directors (or similar body)



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Beneficial Owner: Substantial Control Test

- An individual exercises “substantial control” if he or she:
 - Directs, determines, or has substantial influence over important decisions made by the entity, including the following decisions regarding:
 - Nature/scope/attributes of the entity's business, including the sale, lease, mortgage, etc. of the entity's principal assets
 - Reorganization/dissolution/merger of the entity
 - Major expenditures/investments, issuance of equity, incurrence of significant debt, approval of operating budget
 - Selection/termination of business lines/ventures/geographic focus
 - Compensation of senior officers
 - Entry into/termination/performance of significant contracts
 - Amendments of governance documents



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Beneficial Owner: Substantial Control Test

- An individual exercises “substantial control” if he or she:
 - Catchall - “has any other form of substantial control over the reporting company”



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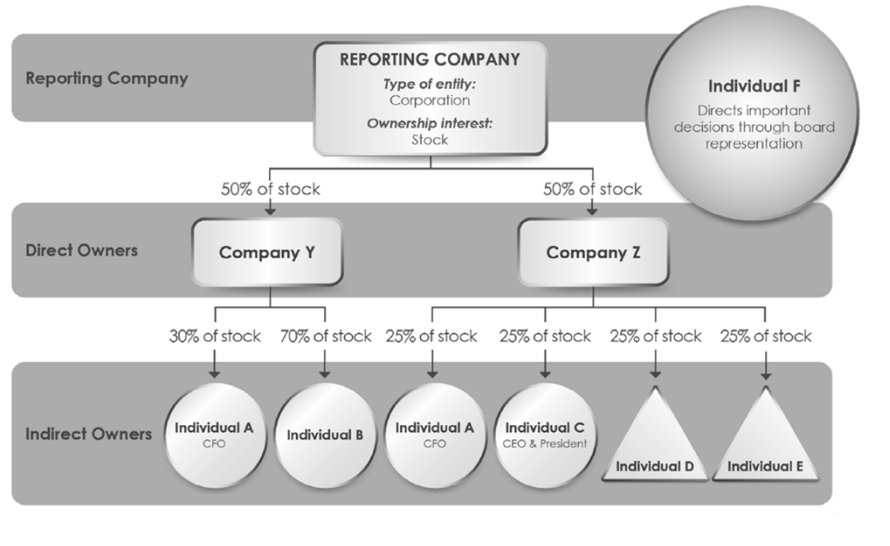
Beneficial Owner: Substantial Control Test

- How can an individual wield “substantial control?”
- Through any of the following (including as trustee of a trust):
 - Board representation
 - Ownership/control of a majority of voting power/voting rights
 - Rights associated with a financing arrangement/instrument
 - Control over intermediary entities
 - Arrangements or financial/business relationships with other individuals/entities - whether formal or informal
 - **Catchall** - “any other contract, arrangement, understanding, relationship, or otherwise”



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Beneficial Ownership Determination



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Beneficial Owner: Exceptions

- Express exceptions to Beneficial Owner status:
 - Minor child - so long as the parent/guardian's information is reported by the Reporting Company
 - An individual acting as nominee/intermediary/custodian/agent for another
 - Pure employees - someone whose control over or economic benefits from the Reporting Company arise solely as a result of an employment relationship (but expressly excluding "senior officers")
 - An individual whose sole interest is a future interest by inheritance
 - Creditors of the Reporting Company



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FinCEN Identifier

- Reporting Companies must solicit and report to FinCEN sensitive personal information about each Company Applicant and Beneficial Owner
 - Single individual may be a Company Applicant and/or Beneficial Owner for many different Reporting Companies
 - Each time any reportable information about a Company Applicant or Beneficial Owner changes, each associated Reporting Company is required to update its BOI report to reflect the change



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FinCEN Identifier

- Privacy concerns for individuals and professionals
 - Lawyers helping form new companies on a regular basis
- Reporting Company may not know each time a BO moves or changes other information



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FinCEN Identifier

- FinCEN Identifier as partial solution
- To receive a FinCEN ID, an individual provides requisite information (name, address, birthday, DL number, etc.) directly to FinCEN once
 - FinCEN will then issue the individual unique ID number



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FinCEN Identifier

- Each Reporting Company can then report the ID number for the individual in lieu of all the other information normally required
- If any information about the individual changes, it is up to him or her to take steps to update with FinCEN
 - Shifts responsibility - any reporting company that has previously submitted the FinCEN ID of a beneficial owner whose information changes shouldn't have to do anything



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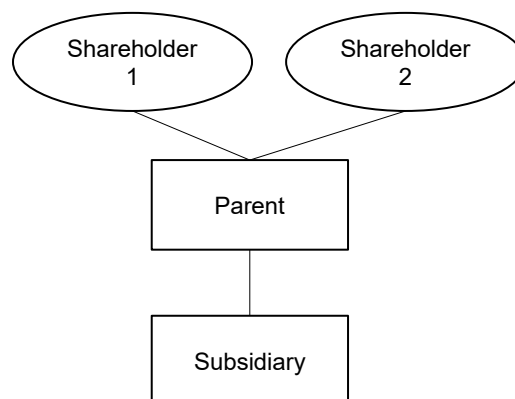
FinCEN Identifier

- Entities can also obtain FinCEN identifiers
 - A Reporting Company (Entity 1) can report another entity's (Entity 2) FinCEN identifier in lieu of individuals' Beneficial Ownership Information if:
 - An individual is or may be a BO of Entity 1 by virtue of an ownership interest held in Entity 2; and
 - BO's of Entity 1 and Entity 2 are the same
 - Helpful for more complex corporate structures with multiple entities



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FinCEN Identifier



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FinCEN Identifier

- If an individual or entity receives a FinCEN identifier, any changes to such recipient's information must be reported to FinCEN within 30 days



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Noncompliance and Consequences

- Remember initial reporting deadlines:
 - Before January 1, 2025 for all companies formed before January 1, 2024
 - Within 30 days of formation for all companies formed after January 1, 2024



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Noncompliance and Consequences

- Remember updated reporting deadlines - within 30 days of any change
 - Changes with respect to the Company (name, address, etc.)
 - Changes with respect to Beneficial Owners
 - Who the Beneficial Owners are
 - Must be reevaluated each time there is a change in ownership OR a change in management
 - If information with respect to any previously disclosed BO changes
 - Unless FinCEN ID was previously used



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Noncompliance and Consequences – Reporting Violations

- Unlawful for a person to:
 - Willfully provide, or attempt to provide, false or fraudulent beneficial ownership information; OR
 - Willfully fail to report complete or updated beneficial ownership information to FinCEN
- Willfully = “voluntary, intentional violation of a known legal duty”
 - But beware “ignorance of the law” excuse



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Noncompliance and Consequences – Reporting Violations

- Safe harbor if person corrects a deficient report promptly (and in no case later than 90 days after the original deficient report was submitted)
 - But does not apply if person intentionally evaded reporting requirements, or had actual knowledge that information submitted was false



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Noncompliance and Consequences – Reporting Violations

- Civil penalty of up to \$500 per day for each day violation continues
- Criminal fine of up to \$10,000, and imprisonment up to 2 years



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Noncompliance and Consequences – Reporting Violations

- Who may run afoul of the law?
 - Reporting Company is ultimately responsible for filing reports
 - Senior officers may be held responsible on behalf of the company
 - Failure to timely file is an obvious violation, but so would submitting false information that the senior official knew (or possibly had reason to know) was incorrect
 - Reporting Company should undertake diligent inquiry to report and update all required information



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Noncompliance and Consequences – Reporting Violations

- Who may run afoul of the law?
 - A beneficial owner who willfully provides false information to the reporting company is also clearly in violation
 - A BO willfully refusing to provide the requisite information to the reporting company - thereby causing the company to have to file an incomplete report - may also be in violation



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Noncompliance and Consequences – Reporting Violations

- Reporting companies *may* have the option to leave information about owners blank/unknown on reporting form and state the reason why they were unable to obtain it
 - “CYA” or “snitching”?



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Use of Reporting Company Information

- Who will have (legal) access to all this information that is being reported?
 1. Federal agencies engaged in law enforcement, national security, or intelligence
 2. State law enforcement with a court order
 3. Federal agencies on behalf of foreign governments if certain requirements are met
 4. Financial institutions for KYC purposes, only with the Reporting Company's permission
 5. Federal regulators in connection with financial institution KYC requirements



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Use of Reporting Company Information

- Regulations on government access are not final yet
- Significant privacy concerns
 - Vast amounts of personally identifiable information on millions of Americans will be stored in one or more databases by Treasury
 - Treasury/IRS has been hacked before



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