

Corporate Transparency Act: Is Your Company Subject to the New Beneficial Owner Reporting Requirements?

Description

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In 2021, as part of the Anti-Money Laundering Act of 2020, Congress enacted the Corporate Transparency Act in an effort to prevent and combat illicit activities such as money laundering, terrorist financing, corruption, and tax fraud. In furtherance of this goal, beginning on January 1, 2024, the vast majority of new and existing, non-exempt domestic and foreign entities will be subject to reporting requirements under the Corporate Transparency Act and its related rules and regulations (collectively, the "Reporting Rule") and required to submit beneficial ownership information to the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN").

The Reporting Rule will require business owners and their advisors to comply with additional requirements when forming new entities and when making changes to existing entities. Complicated beneficial ownership reporting situations may arise, and companies and their professional advisors must ensure that they are taking proactive steps to prepare for compliance with the Reporting Rule by developing internal procedures to identify beneficial owners and track changes in ownership.

A. Who is Required to Report?

Reporting Companies

All domestic and foreign entities filing with a secretary of state will be required to file a beneficial ownership report with FinCEN, subject to certain exemptions. The definition of "reporting company" under the Reporting Rule includes corporations, limited liability companies, any entity that is created by filing a document with the secretary of state or any similar office under the law of a state or tribal jurisdiction, and foreign entities that are registered to do business in any state or tribal jurisdiction.

The 23 types of entities exempted from the Reporting Rule are predominantly already subject to extensive regulation or are otherwise required to report beneficial ownership information. Included in the exemptions are securities issuers, governmental authorities, banks, investment companies, and accounting firms.

Notably, the Reporting Rule contains an exemption for "large operating companies," defined as those companies that (1) employ more than 20 full time employees, (2) have a physical operating presence within the United States, and (3) generate at least \$5 million in annual gross receipts. As such, the Reporting Rule will have an outsized impact on small and medium sized private businesses.

Beneficial Owners and Company Applicants

Reporting companies are required to report certain information regarding beneficial owners and company applicants. A company applicant is the individual who directly files the document to register the reporting company and is primarily responsible for directing or controlling such filing. In many cases, a company applicant may be employed by a business formation service firm, law firm, or other professional advisor. Only reporting companies formed on or after January 1, 2024 are required to report company applicants.

The definition of a “beneficial owner” is more complex. The Reporting Rule defines a “beneficial owner” as any individual who (1) owns or controls at least 25% of the reporting company’s ownership interest, or (2) exercises substantial control over the reporting company.

Ownership Interest

Subject to certain exceptions, anyone who owns or controls at least 25% of the reporting company’s ownership interest is classified as a beneficial owner. The definition of “ownership interest” encompasses any:

1. equity interest (regardless of voting rights);
2. capital or profit interest;
3. convertible instrument (regardless of whether characterized as debt);
4. put, call, straddle, or other option or privilege of buying or selling equities, capital interests, or convertible instruments (except to the extent created and held by a third party without knowledge of the reporting company); and
5. other instrument, contract, or arrangement to establish ownership.

Substantial Control

Any individual who exercises direct or indirect substantial control over a reporting company is classified as a beneficial owner. The definition of substantial control includes (1) individuals serving as a senior officer of the reporting company, (2) individuals with authority over the appointment or removal of any senior officer or a majority of the board of directors, (3) anyone who directs, determines, or has substantial influence over important decisions made by the reporting company, and (4) individuals with any other form of substantial control over the reporting company.

The final prong of the definition of “substantial control” is intended as a broad catchall provision to account for any other major decisionmaker associated with the reporting company. The potential breadth of this catchall provision is where the definition of “substantial control” becomes murkier. For instance, it is possible that creditors or investors who do not meet the ownership requirement to be considered a beneficial owner would be deemed to have substantial control due to being granted management rights, veto rights, special voting or approval rights, or other protective provisions that might allow them to exert control over the reporting company. Individuals who have no direct ownership, position of authority, or other direct connection to an entity may also be deemed to have substantial control, for instance, where a non-owner spouse directs the actions of a spouse who is a beneficial owner or the trustee(s) of a trust that owns equity in a reporting company. Companies and their advisors will therefore need to carefully consider the list of beneficial owners to be reported to FinCEN.

B. What Information Must Be Reported, and When?

A reporting company must disclose information about itself, company applicants, and beneficial owners to FinCEN through a yet-to-be established portal. For an initial report, each reporting company is required to report:

1. A full legal name of the reporting company, including any trade names or “doing business as” names.
2. A complete current business address.
3. Jurisdiction of formation for domestic entities, and for foreign entities, the state or tribal jurisdiction of registration.
4. A unique identification number, such as a TIN, EIN, or LEI.

Each reporting company is also required to report certain information regarding its beneficial owners and company applicants, including:

1. Full legal name.
2. Date of birth.

3. Current residential or business address.
4. A unique identifying number from an acceptable identification document (such as a state issued ID or passport) along with an image of the document.

Each reporting company bears the responsibility of certifying that the information provided by the company and from its beneficial owners and company applicants is true, correct, and complete.

Reporting entities formed prior to January 1, 2024 must file this report with FinCEN before January 1, 2025. Any newly created reporting entity formed on or after January 1, 2024 will have 30 days from the date of formation to submit an initial report. Further, when a reporting company experiences a beneficial ownership change, it will be required to submit an updated report within 30 days after such change.

C. Violations and Penalties

Willful violations of the Reporting Rule through either failing to report or providing false or fraudulent beneficial ownership information may lead to civil penalties of up to \$500 for each day that a violation continues and criminal penalties, including fines up to \$10,000 and imprisonment for up to two years.

FinCEN has made clear that its initial efforts will be aimed primarily at educating reporting companies about the requirements of the Reporting Rule, and not civil or criminal enforcement, but reporting companies who fail to comply with the Reporting Rule will do so at their own peril.

[Partridge Snow & Hahn's Corporate & Business Group](#) is ready to answer questions regarding this article. For more information, contact [Madeline Ursini](#), [Brian J. Reilly](#) or [Lawrence J. Sheh](#).

Date Created

May 9, 2023