



The Corporate Transparency Act: New Compliance & Reporting Obligations

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On January 1, 2024, the Corporate Transparency Act (the “CTA”) comes into effect for reporting companies formed after that date, with reporting for existing companies taking effect a year later. With approximately six months remaining before this first date, companies and their advisors, including counsel, should refresh their knowledge of the CTA’s requirements and prepare to comply. On September 29, 2022, the Financial Crimes Enforcement Network (“FinCEN”) of the U.S. Treasury Department issued final regulations on “beneficial ownership information” (“BOI”) reporting requirements intended to enhance its ability to protect the U.S. financial system from money laundering, terrorist financing and other illicit activity (the “Final Rule”).^[1]

The Final Rule implements *Section 6403* of the CTA, requiring various entities to report beneficial ownership information to FinCEN. That is, the natural persons who own and control said entities, as well as information about the persons (termed “company applicants”) who form or register those corporate entities.

What is the Corporate Transparency Act and Why Is It Important?

The CTA was enacted January 1, 2021, as part of the National Defense Authorization Act, representing the most significant reformation of the Bank Secrecy Act and related anti-money laundering rules since the U.S. Patriot Act.

The CTA’s goal is to strengthen the anti-money laundering regime by increasing transparency, primarily by requiring numerous business entities to report their beneficial owners for the first time. Although the Final Rule exempts many companies from reporting obligations (see below), FinCEN estimates that the CTA and the Final Rule will affect over 32 million entities, imposing significant new compliance burdens.^[2]

The Final Rule addresses a major perceived deficiency in the U.S. anti-money laundering regime and will expand the scope of information that certain legal entities are required to disclose under U.S. law. Importantly, the scope of reportable BOI has been substantially expanded, and by January 1, 2025, will require millions of existing smaller-sized legal entities to initially register directly with FinCEN—as well as each time a new reporting company is either formed or registered.

Penalties for willfully violating the CTA’s reporting requirements include a civil penalty of not more than \$500 for each day that the violation continues and has not been remedied, and may be fined not more than \$10,000, imprisoned for not more than 2 years, or both.

Who Must Report?

The Final Rule specifies that “reporting companies” — will be required to report their BOI to FinCEN unless an exemption applies (see below). There are two types of reporting companies — domestic and foreign reporting companies.

In both cases, the definition includes corporations, limited liability companies, and any entity formed with (or, in the case of foreign entities, registered to do business with) a secretary of state or similar office of any U.S. jurisdiction or Native American tribe. This covers most forms of corporate entities but would exclude trusts, sole proprietorships, and general partnerships; however, as FinCEN noted, this may vary based on a given state’s formation practices. The operative question for domestic reporting companies is whether the company is “an entity created by the filing of a document with a secretary of state or other similar office.”

Importantly, among other exempt entities subject to other reporting and regulatory regimes, the Final Rules does not apply to large operating companies. Large operating companies include companies that: (1) employ more than twenty employees on a full-time basis in the United States; (2) filed in the previous year Federal income tax returns in the United States demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate, including the receipts or sales of other entities owned by the large operating company and through which the other entity operates; and (3) have an operating presence at a physical office within the United States. (See below for more information on exemptions).

What to Report?

The Final Rule requires reporting companies to provide FinCEN with BOI information on (1) the reporting company itself; (2) each “beneficial owner” of the reporting company; and (3) the reporting company’s “company applicant(s).”

The Final Rule requires the following information in each report:

- **Name** – the full legal name of the reporting company and all trade or d/b/a names, regardless of whether they are registered.
- **Address** – (1) for reporting companies with a principal place of business in the United States, the street address of that principal place of business; and (2) for reporting companies with a principal place of business outside of the United States, the street address of the primary location in the United States. This requirement is not satisfied by reporting a P.O. box or the address of a company formation agent or other third party.
- **Jurisdiction of Formation and Registration** – (1) for domestic reporting companies, the State or Tribal jurisdiction of formation; and (2) for foreign reporting companies, the foreign jurisdiction of formation and the State or Tribal jurisdiction where it first registers.
- **Company Identification Numbers** – reporting companies are required to provide a Taxpayer Identification Number (“TIN”). Newly created domestic reporting companies will have sufficient time to apply for and receive a TIN within the extended reporting timeframe applicable to such entities. Foreign reporting companies without a TIN will be required to provide a foreign tax identification number and the name of the relevant jurisdiction as an alternative.

Who is a “Company Applicant”?

In the case of a domestic reporting company, a company applicant is defined to be the individual who files the document that forms the entity. In the case of a foreign reporting company, a company applicant would be the individual who files the document that first registers the entity to do business in the United States.

In both cases, the Final Rule specifies that anyone who directs or controls the filing of the relevant document by another would also be a company applicant.

Who is a Beneficial Owner?

This new definition of beneficial ownership is generally much broader than that provided by Rule 13d-3 of the Securities Exchange Act of 1934. A beneficial owner is one who fulfills either of two criteria. Either the beneficial owner is (1) in “substantial control” of the entity, or (2) they own 25% or more of the entity. Substantial control is defined by an individual’s capacity as a senior officer of a company or entity, an individual’s power over such an official, or an individual’s influence over significant business matters.

Substantial Control

Under the Final Rule, an individual exercises substantial control of a company if the individual:

1. **Is as a Senior Officer.** FinCEN adjusted the meaning of “senior officer” to exclude the roles of corporate secretary and treasurer, which FinCEN considered to be primarily ministerial functions. A “senior officer” under the Final Rule means “any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.”
1. **Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body).** The Final Rule narrows this factor by removing the authority to appoint a “dominant minority” of directors from its scope, in response to comments that the meaning of “dominant minority” was ambiguous.
1. **Directs, determines, or has substantial influence over important decisions made by the reporting company.** FinCEN clarified that the Final Rule is concerned with the internal decision making of the company. The Final Rule also provides a non-exclusive list of examples of “important decisions.” However, this factor remains exceptionally broad.
1. **Has any other form of substantial control over the reporting company.** FinCEN indicated that this catch-all language is intended to recognize that control can be exercised through a variety of arrangements and governance structures that might not otherwise be addressed by the other factors. For example, under the Final Rule, a person may directly or indirectly exercise substantial control over a reporting company by acting as trustee of a trust or similar arrangement, even if the trust itself would not qualify as a reporting company under the definition in the Final Rule.[\[3\]](#)

Indirect Control

Under the Final Rule, an individual may indirectly exercise substantial control of a company through:

- Board representation;
- Ownership or control of a majority of the voting power or voting rights of the reporting

company;

- Rights associated with any financing arrangement or interest in a company;
- Control over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company;
- Arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- Any other contract, arrangement, understanding, relationship, or otherwise.

Ownership Interests

The Final Rule deems both equity interests and other types of interest in a reporting company to be “ownership interests,” including capital or profit interests (including partnership interests) or convertible instruments, warrants or rights, or other options or privileges to acquire equity, or other interests as those indicating an “ownership interest” in a reporting company, as well as via debt instruments in some cases.

An ownership interest of a reporting company can be held indirectly through any contract, arrangement, understanding, relationship, or otherwise. The Final Rule defines how total ownership interest is calculated, setting out separate standards with respect to individuals, companies that issue capital or profit interest, and corporations that issue shares of stock.

Total ownership interests are calculated as a percentage of the reporting company’s “total outstanding ownership interests,” with any options or similar interests treated as exercised.

When to Report?

Reporting companies formed after January 1, 2024 will have thirty days to submit initial BOI reports. Reporting companies in existence before January 1, 2024 will have until January 1, 2025 to comply.

Corrections to reports must be filed within thirty days after a reporting company becomes aware or has reason to know that reported information is inaccurate, and updates to reports must be filed within thirty days of a change in information requiring an update. There is a safe harbor of ninety days for submitting a correction if filed within ninety calendar days after the date on which an inaccurate report was filed.

How to Report?

If you are required to report your company’s beneficial ownership information to FinCEN, you will do so electronically through a secure filing system available via FinCEN’s website. FinCEN will not be accepting any beneficial ownership information before January 1, 2024.

Who is exempted?

The Final Rule (consistent with the CTA) excludes twenty three types of corporate entities from the definition of reporting company – notably including large operating companies, banks, credit unions, depository institution holding companies, broker-dealers, clearing agencies, investment companies, investment advisers and other Exchange Act-registered entities, and pooled investment vehicles. Many of the exempt entities are already subject to substantial federal and/or state regulation or must already provide their BOI to a regulatory authority.[\[4\]](#)

The legislation also expressly excludes certain individuals from the definition of beneficial ownership, including (1) a minor child (as long as the child's parent's or guardian's information is reported); (2) an individual acting as an intermediary or agent on behalf of another; (3) a person whose control over a reporting company derives solely from their employment; (4) an individual whose only interest in a reporting company is a future interest through a right of inheritance; or (5) a creditor of a reporting company (unless they qualify as a "beneficial owner" through substantial control or equity ownership).

It must be emphasized that all of the above exemptions are interpreted narrowly. In case of uncertainty, a reporting company should either consult directly with FinCEN or assume that they do not fall within one of these exceptions.

How Should Clients Prepare for Compliance with the CTA?

To prepare for compliance with the Final Rule, reporting companies will have to develop internal policies and procedures to assess their reporting obligations, identify beneficial owners, and identify company applicants, which could include third parties such as consultants. Further, companies will need to develop policies and procedures to monitor changes to their reporting status or beneficial ownership on an ongoing basis to avoid potential penalties. These policies and procedures should address the application of the CTA to the formation of subsidiary or affiliate companies and entities that may trigger reporting obligations.

For any companies involved in M&A activity, it will be important to ensure target companies have fulfilled their reporting obligations. This is a new risk area to consider during due diligence. More broadly, companies should expect law enforcement agencies to deploy increasingly sophisticated data mining approaches to look for suspicious activity among the trove of data FinCEN will collect. The data retrieved by FinCEN will be accessible to federal, state, and local law enforcement agencies and financial institutions as they work to combat corruption, money laundering, terrorist financing, tax fraud, and other illicit activity.^[5] The information is available to them by request only.

The CTA at its core was developed in an effort to combat tax evasion and fraud, money laundering, and other financial crimes.^[6] The disclosure of beneficial owners is thought to play a key role in increasing tax transparency and promoting the integrity of the U.S. tax system.^[7] Tax practitioners will also need to understand the compliance and reporting obligations under the CTA that are reported to FinCEN.

Conclusion

The CTA is expected to blaze a trail for FinCEN to develop a system of standardized reporting of companies being formed in the United States and the disclosure of their beneficial ownership information.

Kelley Drye lawyers are available to assist with any questions you may have regarding these issues.

This client advisory was drafted with the assistance of summer associate, Tammy Zapata.

^[1] 87 Fed. Reg. 59498 (Sept. 30, 2022).

^[2] See, Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,498, 59,565 (Sept. 30, 2022) (Regulatory Impact Analysis).

[3] See, (31 CFR 1010.380(d)(1)).

[4] See, Final Rule at 59539, 59593-94.

[5] *Fact Sheet: Beneficial Ownership Information Reporting Notice of Proposed Rulemaking (NPRM)*, Financial Crimes Enforcement Network, (Dec. 7, 2021).

[6] Jennifer M. Graff, *The Corporate Transparency Act: Tidbits for Tax Practitioners*, American Bar Association (Mar. 9, 2023).

[7] *Id.*