

## Strategic Perspectives

# Are You Considering Not Complying with the Corporate Transparency Act? The Stages of CTA Denial

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### Background

The furthest and widest reaching federal business entity law ever enacted, the Corporate Transparency Act (CTA), will impact an estimated 32 million now-existing businesses, with its implementation going into effect January 1, 2024. Each year after, an estimated additional 5 million newly formed businesses will also be swept under the CTA's purview. But many business owners, investors and advisors are still unaware of the CTA and its looming deadline and are often taken aback by its scope (and even its mere existence). So now is the time to review the CTA's requirements and get prepared before the law goes into effect at the end of the year.

The CTA requires certain businesses (including privately held and non-profit entities) to report direct and indirect, human, beneficial ownership, control and service provider information to the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of Treasury. This information will be used by federal, state, local and tribal law enforcement authorities to streamline their investigations, bypassing the "shell game" historically posed by multiple levels of business entity ownership and affiliation.

The CTA impacts "reporting companies," which include corporations, limited liability companies, limited partnerships, business

trusts and other "similar entities" that are created or registered by the filing of a document with a Secretary of State or a similar Indian Tribal office, provided that it does not fall within specific excluded categories. These excluded entities generally include heavily regulated business entities or large operating companies. However, the vast majority of private and many nonprofit businesses will be swept up in required compliance.

The information to be reported to FinCEN (beneficial owner information or "BOI") is personal identifying information (PII): (1) full legal name, (2) date of birth, (3) residential (or sometimes business) physical street address and (4) an image of an acceptable government issued ID including an ID number and the person's photograph.

This information will need to be reported for persons who have "substantial control" over the business or owning, directly or indirectly, 25% or more of the business (each a beneficial owner). Every business will have at least one person to report, regardless of its ownership structure. Informed business decisions will need to be made as to who constitutes reportable beneficial owners in many instances.

The same PII must also be reported for company applicants (i.e., incorporators and organizers), including those who directed

the formation filing, commencing after January 1, 2024.

Filings will be made through an electronic interface with an on-line Beneficial Ownership Secure System (BOSS). Businesses in existence on January 1, 2024, will have one year to file their initial report – but file an initial report they must do – even if they subsequently dissolve or otherwise alter their structure in a manner to become compliant with a CTA exemption. Businesses formed on or after January 1, 2024, will have 30 days from formation to file their initial report with FinCEN. Businesses will need to compile, maintain and update their reportable PII for their beneficial owners on an ongoing basis. After January 1, 2024, all businesses will have 30 days to file any correction or change to the information previously reported

Any change to the status quo of a business in existence on January 1, 2024, will need to be reported as a separate amendment filing, delivered with the initial "as of January 1, 2024," report filing required to be made on or before December 31, 2024. It bears emphasizing that there is no "grandfathering" of previously formed entities, and the CTA will sweep in all business entities in existence on January 1, 2024, (unless otherwise expressly exempted).

There are steep, escalating fines (\$500 per day up to \$10,000 per violation) and

possible jail time (up to two years) for those failing to timely comply with the CTA's requirements. It bears note that failure to timely file a required initial report could result in up to a \$10,000 fine, but that subsequent events, that would necessitate an amendment to such required but missing filing, had the initial report been made, also accrue - meaning that a failure to file an initial report may result in aggregate fines accruing well in excess of \$10,000 prior to an initial notification of violation coming from FinCEN to the reporting company. Also, the reporting company's and its agent's intent behind non-compliance would be a factor in FinCEN's assessing of possible criminal penalties. Bearing this in mind, the remainder of this article is an appeal to the better angels of our character and is a direct rebuttal of many first impulses expressed by many upon first learning of the CTA.

## The Stages of CTA Denial

### 1. "I have never heard of this." or "I am a sophisticated business leader. I have all kinds of advisors on retainer and if this were a 'thing,' I would have heard about it before now."

The enactment of the CTA in 2021 came as a shock to many (some, an aftershock), including seasoned business attorneys. The underpinning concepts of taking action to end the U.S.'s position as a haven for "shell" companies used in the commission of money laundering, terrorist financing, financial and tax fraud and other domestic and international illicit activity and corrupt practices, however, were circling around Washington, D.C., for decades. The CTA marks a seismic shift in the business entity legal landscape. Prior to the CTA, entity beneficial owner disclosure was solely (if at all) the purview of state or tribal law. Now it is a focus and purview of Uncle Sam.

The CTA has largely flown under the radar so far, but it is now time to become educated

on the actions that may be taken prior to the CTA's January 1, 2024, implementation date, and after. The CTA has not received wide-spread mass media attention to date. The Act's impact and implications to businesses, particularly small businesses, are complicated and difficult to succinctly communicate. The Act's impact is also counterintuitive to many business owners who erroneously believe their business is "too small" to be within FinCEN's sights and the Act's purview – quite the opposite, their small size is precisely why their business must comply with the Act! The Act is designed to cast a broad dragnet to "catch" a small niche of nefarious actors hiding behind the "corporate veil." Unfortunately, the vast majority of business entities that now must comply with the CTA are unwitting and innocent bycatch.

Many professional advisors and business professions have been caught off-guard by the fundamental change in business entity law, now taking on a federal facet for the first time in the U.S. Those that are aware have by and large taken a wait and see approach to either advising their clients and business associates, or evaluating their own compliance profile, because much of the mechanics of compliance remain elusive. The ability for businesses to begin directly interfacing with FinCEN on filing and compliance continues to be in the future, giving those persons "in the know" little to offer as current action items – causing many to defer sounding the alarm bell until more is known from FinCEN. However, the wait is now over and it is time to take action before the window of opportunity closes at the end of 2023.

### 2. "That can't be right. I have a small business, surely the Corporate Transparency Act does not apply to me."

Quite the opposite: a business's small size is precisely why such a business must

comply with the Act! The Act is designed to cast a broad net to "catch" a small niche of nefarious actors hiding behind the "corporate veil." Unfortunately, the vast majority of business entities that now must comply with the CTA are unwitting and innocent bycatch in the CTA's net.

The CTA's impact on small businesses is counterintuitive to many business owners who erroneously believe their business is "too small" to be within FinCEN's sights and the CTA's purview. There is an exception (the "large operating company" exception) to the CTA's reporting requirements for businesses that meet all three of the following criteria:

- (1) the business must have a *physical street address* in the U.S.,
- (2) the business must have *twenty-one or more full-time employees* (excluding full-time equivalent employees, part-time employees, independent contractors and leased employees), and
- (3) the business must have filed a prior year's federal income tax return demonstrating more than \$5 million in annual, U.S. only, gross receipts or sales.

By necessity, every business entity formed after January 1, 2024, will not initially qualify for this exclusion, because that business entity will not have a prior year tax return.

Most small businesses will be unwitting and innocent bycatch tangled in the CTA compliance net. This is because they will not be able to meet the criteria to be a "large operating company" expressly excluded from CTA compliance. Further, even many large portfolios of business entities will likely not meet this exception because employees of the portfolio's operations are typically consolidated into one or a few of the portfolio entities, with the remaining business entities not having employees.

**3. “My [insert name of industry]’s lobbyists will be all over this!” or “Lobbyist would never allow such a law to get passed.”**

**Part 1: Origin and Implementation**

The 116th United States Congress, which was majority controlled by Republican lawmakers in both the House and the Senate, each by supermajority vote, passed the CTA as part of the 2021 National Defense Authorization Act on January 1, 2021, overriding then President Trump’s sole veto during his term of office. Since its adoption, the political landscape has changed. President Biden and a Democratic controlled Senate now hold office through at least 2024. A change of Party control, if any, of the Presidency or the Senate will not take effect until mid-January 2025. By that time, all existing business entities will have been required to file their initial CTA report into the BOSS, and a full year of newly formed entities will also have been required to comply with the CTA.

Further, the Biden Administration has shown no indication of delaying the CTA’s implementation, with the Department of Treasury and FinCEN expressing publicly, and repeatedly, that implementation of the CTA by the end of 2023 is a top priority. The stated goals of the CTA: combatting the use of “shell” companies in the commission of money laundering, terrorist financing, financial and tax fraud and other domestic and international illicit activity and corrupt practices, appear to align with the Administration’s agenda. In other matters, the Administration has shown a proclivity to support initiatives to reign in business, rather than favor it.

In short, hopes of a government sea change, with an overturning of the CTA, doesn’t account for the Act’s conservative lawmaker origins or the political cycle timing between now and the Act’s January 1, 2024, implementation.

**3. “My [insert name of industry]’s lobbyists will be all over this!” or “Lobbyist would never allow such a law to get passed.”**

**Part 2: ... and they were.**

Lobbyists had staved off attempts to implement The CTA and its predecessor bills for decades. However, as stated above, a supermajority of both the House and the Senate enacted the CTA, over a presidential veto, on January 1, 2021. The CTA mandated that FinCEN promulgate regulations under the CTA prior to January 1, 2022. On December 7, 2021, FinCEN published a proposed rule related to BOI under the CTA, with a public comment period extending through February 7, 2022. In response to this Notice of Proposed Rulemaking (NPRM), FinCEN received over 240 formal comments, with submissions coming from a broad array of individuals and organizations, including Members of Congress, government officials, groups representing small business interests, corporate transparency advocacy groups, the financial industry and trade associations representing their members, law enforcement representatives, and other interested groups and individuals. In addition to these formal responses to the NPRM, FinCEN also received, accepted and considered many additional comments and inquiries from the public. The extensive, thorough, detailed and pointed feedback, often in direct opposition to the proposed implementation of the Act and to specific components of the Act, was considered, weighed and utilized by FinCEN in their adoption of the CTA BOI Final Rule, issued on September 30, 2022. FinCEN went to great length in the Final Rule to describe, with specificity, the extreme vetting on each point in the Final Rule. That Final Rule, with limited exceptions, stayed true to the CTA and the Proposed Rule initially proposed. FinCEN did not exercise its discretion to expand the list or scope of the enumerated reporting company

exceptions (in spite of numerous pleas to do so), nor did it show any reluctance to, or anticipate delay in, implementing the CTA. Based on this process, the implementation of compliance and enforcement of the CTA’s reporting obligations will most certainly begin January 1, 2024. Hopes that a white knight will ride in to save the day, or of a delay or elimination of this reporting obligation implementation, were vanquished last year (in 2022).

**4. “They’re not going to require my photograph.”**

The CTA makes it unlawful for any person to willfully provide, or attempt to provide, false or fraudulent BOI, including a false or fraudulent *identifying photograph* or document, to FinCEN, or to willfully fail to report complete or updated BOI to FinCEN in complying with the CTA (*i.e.*, reporting violations).

The CTA Rules provide that “[a]n initial report of a reporting company shall include the following information: ... [f]or every individual who is a beneficial owner of such reporting company, and every individual who is a company applicant with respect to such reporting company: ... A unique identifying number from one of the following documents: (1) A non-expired passport issued to the individual by the United States Government; (2) A non-expired identification document issued to the individual by a State, local government, or Indian tribe for the purpose of identifying the individual; (3) A non-expired driver’s license issued to the individual by a State; or (4) [if the individual does not possess any of the foregoing documents, then a ] non-expired passport issued by a foreign government to the individual; and [A]n *image* of the [above described] document from which the unique identifying number... was obtained, *which includes both the unique identifying number and photograph in sufficient*

*quality to be legible or recognizable.”* Further, “[w]ith respect to an image of an identifying document required to be reported [under the CTA], a change with respect to required information will be deemed to occur when the name, date of birth, address, or unique identifying number on such document changes.” “It [is] unlawful for any person to willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN in accordance with [the CTA], or to willfully fail to report complete or updated beneficial ownership information to FinCEN....”

#### **5. “I just won’t file/report, and will deal with the consequences later, if ever.”**

Statements similar to the foregoing are uttered by a shocking number of business owners with whom we speak on the CTA and its reach, application and exposure. There are a number of factors uniquely associated with the CTA, its origins, and its implementation that make its enforcement and your possible non-compliance exceptionally problematic. Chief among these, at least for individuals,<sup>1</sup> is that their refusal will be conspicuously noted on a reporting company’s filing with FinCEN: a checkbox is included on the BOI reporting questionnaire: “(check if you are unable to obtain any required information on one or more Beneficial Owners).” Once checked, this conspicuous omission will be a red flag to FinCEN, and other law enforcement agencies, for initial or further investigation.

Further, the Internal Revenue Service (IRS) recently announced its Taxpayer Enforcement Initiatives, which includes

plans to hire nearly 87,000 new employees and invest \$80 billion over the coming years to improve tax enforcement and customer service, with more than one-third of the new hires being enforcement staff. The agency also plans to hire more data scientists to complement traditional tax attorneys and revenue agents in using new data analytics technology to identify audit targets. FinCEN’s BOSS database, created under the CTA, will likely be a key component to such data analytics technology, and will provide an inexpensive, efficient, investigative tool and corroborating (or “red flag”) source of taxpayer information to the IRS. The IRS initiative’s stated aims are to close the “tax gap” between taxes owed and those paid, and to rebuild the IRS’s audit capabilities and computer technology. The IRS’s stated goals also include expanding enforcement for taxpayers with complex tax filings and high-dollar noncompliance, including high-income and high-wealth individuals, complex partnerships and large corporations.

Hopes that the CTA is nothing more than another proforma survey data collection initiative by the government are naïve and misguided. FinCEN’s BOSS database will be a critical point of diligence for investigation by federal government agencies. Your business entity’s conspicuous absence from the BOSS database, or your personal omission from a reporting company’s CTA filing, will most certainly be discovered, and will spearhead other federal investigation into you and your business practices.

#### **6. “I’ll just pay the fine, if I get caught.”**

The CTA provides for civil fines of \$500 per day, up to \$10,000, per violation of the Act. The Act also provides for a criminal penalty

of up to two (2) years’ imprisonment for CTA violations. It is important to note that the fine is per violation – not simply for violating the Act. The Act has requirements for filing report corrections and amendments based on changing circumstances, and CTA violations will likely involve multiple instances of non-compliance before FinCEN comes knocking on your door. Each reporting obligation also has a very short window (30 calendar days) within which to make the required filing, making inadvertent violations of the CTA highly likely. Further, with only 20 days needed to reach the maximum fine of \$10,000 per violation, many violations will likely come with a \$10,000 price tag.

These factors, in combination, could cause a simple act of not reporting to turn into tens of thousands of dollars, or even hundreds of thousands of dollars, in fines to have accrued by the time FinCEN identifies the violation and pursues collection. This will be particularly true in the first year of implementation when 32 million reporting companies are projected to require reporting, with five million additional reporting companies being added each year thereafter.

Also, did we mention prison time? *Noncompliance could be a costly proposition – far in excess of an initial \$10,000 price tag.*

#### **7. “Fiduciary duties be damned!”**

Persons with “substantial control” over a reporting company under the CTA, not only will be required to disclose their own personal identifiable information (PII) as “beneficial owners” of the reporting company, but will also, in

<sup>1</sup> It bears note that the person responsible for a reporting company’s CTA filing, in some instances, may not be a “beneficial owner” of the business entity, or only one of several “beneficial owners,” and will likely make the filing (even over potential objections) to avoid personal culpability. The willingness of one person to violate the law, problematic on its face, also implicates the rights and risk profile of other persons associated with the reporting company. The other implicated individuals in the business organization may not share this risk tolerance.

many instances, owe fiduciary duties to the reporting company as well as to the (other) owners of the reporting company to properly comply with the CTA. Any decision by a reporting company's management not to report under the CTA, or partially report, or inaccurately report, will directly implicate actionable duties owed to the reporting company, its owners and possibly third parties. Further, such actions may constitute "for cause" termination events with respect to such "substantial control" person, as the act or omission may constitute gross negligence, willful misconduct, fraud, material misrepresentation or an illegal act with respect to the reporting company. A "substantial control" person's evasion of the law could also result in the cancellation of the reporting company's insurance coverage for the event in question, and exposure of the individual to uncovered personal liability for the action in question. Further, grievous failure to comply with the CTA could result in imposition of a criminal sentence of up to two (2) years in prison for the offending individual.

Under most State's business statutes, the concept of fiduciary duties is prevalent and applies to the behavior of officers, managers, directors and other governing and management parties to the business entity itself, and in some instances to the owners of the business entity directly. Principal among the fiduciary duties is the "duty of care." The duty of care requires that a person act with the prudence that a reasonable person in similar circumstances would use. If a person's actions do not meet this standard of care, then the acts are considered negligent, and may result in actionable damages enforceable against the individual. However, a fiduciary may discharge the duty of care by exerting appropriate diligence and informed consideration with respect to the action in questions. Further, in most instances, a fiduciary may discharge their duty of care on a subject by hiring a professional adviser the fiduciary reasonably believes has the necessary experience and expertise to advise on the subject, and the fiduciary relies on such advice in making the business

decision. In this way, "substantial control" person's may insulate themselves against such claims by retaining legal counsel to evaluate and advise on the reporting business decisions in question.

## **Conclusion**

The Corporate Transparency Act is a fundamental shift in the State level beneficial owner reporting regimes in the United States, disturbing long established norms. Beginning January 1, 2024, tens of millions of unwitting and innocent U.S. business entities will become bycatch in FinCEN's dragnet designed to catch nefarious actors hiding behind the "corporate veil." Whether you like it, hate it or are indifferent, the CTA has been thoroughly vetted and is here to stay. Compliance is both mandatory and advisable. Just as anonymity in the business entity structure has been pierced by the CTA, so has anonymity in the Act's compliance, with various touch points and red flags aiding in FinCEN's ultimate enforcement regime.