

The Corporate Transparency Act: Federalizing Your Business Operations

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In this article, the authors discuss the requirements of the Corporate Transparency Act.

The Corporate Transparency Act¹ (CTA), at its core, requires reporting of human being direct and indirect beneficial ownership and control information pertaining to businesses operating in the United States. This information is to be reported to the Financial Crimes Enforcement Network (FinCEN) of the U.S. Department of Treasury.² FinCEN is in the process of standing up an on-line Beneficial Ownership Secure System (or BOSS) to receive, retain and process this disclosure information. BOSS will “go live” on January 1, 2024.³ The information in BOSS will be accessible to federal, state, local and tribal law enforcement, certain financial institutions (where the financial institution’s customer has “opted in”) and other authorized requestors.⁴ However, reports filed into BOSS under the CTA are exempt from search and disclosure under the Freedom of Information Act (FOIA), “open government” or similar laws.⁵

WHY ARE WE HERE?

The CTA was passed into law January 1, 2021, by the U.S. Congress over then President Trump’s veto. It is a component of the National Defense Authorization Act for Fiscal

Year 2021 (NDAA). Nestled within the NDAA, the CTA is intended to combat 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, as well as to protect U.S. national security. A useful shorthand for understanding who is intended to be ensnared by the CTA dragnet is to think: foreign oligarchs and despots.⁶ Despite the limited number of bad actors who form the target of the CTA, the law casts a very wide net, with FinCEN estimates that approximately 32 million “reporting companies” will exist as of January 1, 2024, and that approximately 5 million new “reporting companies” will be formed each year thereafter.⁷ Much of the business community swept into the CTA net will be unwitting and innocent bycatch.

WHO MUST COMPLY?

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 FinCEN.⁸ This information will be used by federal, state, local and tribal law enforcement authorities to streamline their

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investigations, bypassing the “shell game” historically posed by multiple levels of business entity ownership and affiliation.⁹

WHO DOES THE CTA IMPACT?

The CTA impacts “reporting companies,”¹⁰ their incorporators and organizers (i.e., “company applicants”), service providers (i.e., “company applicants”), and owners and control persons (i.e., “beneficial owners”), as well as the financial institutions (i.e., banks, credit unions and money service businesses - such as Paypal or Venmo) with whom they do business.¹¹ The CTA also implicates the enforcement activity of federal, state, local, tribal and foreign law enforcement agencies.¹²

A “reporting company” is a corporation, limited liability company or other “similar entity”¹³ that is: created by the filing of a document (i.e., a domestic reporting company) or registered to do business in the United States by the filing of a document (i.e., a foreign reporting company), with a Secretary of State or a similar Indian Tribal office,¹⁴ provided that it does not fall within specific excluded categories. These excluded entities generally include heavily regulated business entities such as SEC regulated parties, utilities, financial institutions, insurance providers, commodity exchanges, pooled investment vehicles, Internal Revenue Code Section 501(c) registered nonprofits, and governmental and quasi-governmental entities.¹⁵ However, the vast majority of private and many nonprofit businesses will be swept up in required compliance.

One additional category of exclusion from “reporting company” status is for “large operating company” businesses that meet all three of the following criteria:¹⁶ the business must have:

- (1) A physical street address in the United States;¹⁷
- (2) Twenty-one or more full time employees;¹⁸ and
- (3) More than \$5 million in annual gross receipts or sales as reported on the business’s prior year’s filed federal tax return.¹⁹

By necessity, after January 1, 2024, every newly formed business entity (as well as most entities formed in 2023) may not qualify for this exclusion, because it will not have a prior year tax return.

Further, the vast majority of U.S. small businesses will also not be able to meet all three of these criteria, and thus will be deemed “reporting companies” under the CTA, requiring a BOSS filing. This fact will come as a shock to many business owners, whose first reaction to learning of the CTA’s existence is a variant of: “well, that has to be for large businesses, right?”

It bears further note that certain subsidiaries or parent entities of exempt companies may themselves be “reporting companies” under the CTA. As such, even persons noting that their core business entity easily meets a CTA exemption may find that they are still pulled into the CTA compliance regime through affiliated entities and joint venture parties.

WHAT TO REPORT

The information to be reported to FinCEN (i.e., beneficial owner information or BOI) is the following personal identifying information (PII):

- (1) Full legal name;
- (2) Date of birth;
- (3) Residential (or sometimes business) physical street address; and
- (4) An acceptable government issued ID number.

In addition, a scanned copy of the underlying government ID utilized, with the person's photograph, must also be included in the submission into BOSS.

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

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.

WHEN AND HOW TO REPORT

As stated above, FinCEN intends to "go live" with its BOSS on January 1, 2024. At present (and it is not anticipated in the future) there is no available opportunity to make any CTA filings prior to January 1, 2024. Filings will be made through an electronic interface with 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.²⁰ This includes instances where a reporting company subsequently becomes eligible for an exemption from the reporting requirement, which change in status is deemed to be a change requiring an updated report.²¹ Any exempt company that no longer meets the criteria for an exemption is required to file an initial report within 30 days after the date that it no longer meets the exemption criteria.²²

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).

WHAT IS A FINCEN IDENTIFIER?

The CTA contemplates that an individual may provide his or her PII to FinCEN, and may thereby obtain a "FinCEN Identifier," which identification number may then be provided to FinCEN in the future in lieu of other required PII about that individual.²³ Reporting companies may also obtain a FinCEN Identifier in a similar manner, but a reporting company may report an intermediate entity's FinCEN identifier, rather than specific beneficial owners' in-

formation, only when the intermediate entity and the reporting company have the same beneficial owners.²⁴

WHAT IS THE BENEFICIAL OWNERSHIP SECURE SYSTEM (BOSS) AND WHO MAY ACCESS IT?

Reporting company information and associated PII of such business entity's beneficial owners and company applicants may be accessed for national security, intelligence, or law enforcement activity, for use in furtherance of such activity, by officers or employees of any United States agency, by officers or employees of any state, local, or Tribal agency, or by officers or employees of any permitted financial institution.²⁵ Except as authorized by the CTA and the protocols promulgated thereunder by FinCEN, however, company information and PII reported under the CTA is confidential and may not be disclosed by an officer or employee of the United States, an officer or employee of any state, local, or Tribal agency or an officer or employee of any financial institution or regulatory agency receiving information that was collected under the CTA.²⁶ These officials are subject to stiff sanctions for any instance of violation of the CTA's access parameters.²⁷

PENALTIES FOR CTA NONCOMPLIANCE

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.²⁸ 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.

FOR COMMERCIAL REAL ESTATE ENTITIES

Most players in the commercial real estate arena are not likely to qualify for an exemption from the CTA reporting obligations, aside from certain publicly traded real estate investment trusts or large operating companies. Businesses in the real estate industry heavily rely upon partnership taxed entities (frequently limited liability companies or limited partnerships) for their development, investment and holding company ownership. Although aggregation of gross receipts or sales will flow up to holding companies from their subsidiaries, in meeting the third prong of the large operating company exception, the opposite, applying holding company receipts to subsidiary revenue count, will not apply. Further, commercial real estate CRE portfolios often utilize leased employees or shared employees to provide services across the portfolio, leaving certain entities within the portfolio vulnerable to having less than 21 employees employed by certain entities. Each entity within the portfolio must independently qualify for CTA exempt status.

Further, many real estate investors themselves are business entities, often with multiple layers of direct and indirect ownership and

control, lending to a complex web of necessary indirect beneficial ownership collection and reporting, which will be time consuming and burdensome to complete by the reporting deadlines.

It also bears note that certain states, New York in the lead with its June 20, 2023, State Assembly passage of a “Limited Liability Company Transparency Act,”²⁹ are proposing and passing state level beneficial ownership disclosure laws that dovetail with, and even surpass, the disclosure obligations present in the CTA. New York’s law takes specific aim at the anonymity of ownership of New York real estate through LLCs.

CONCLUSION

The CTA is a new extension of federal oversight to the regulation of business entities and their operations. This oversight traditionally resided with the states. Attorneys and their clients will now need to swiftly adjust to this new legal landscape.

For some businesses, CTA compliance will require only a simple, straight forward online reporting. For many sophisticated businesses, however, CTA compliance will be a minefield for potential failures. The CTA reporting obligations touch on the sensitive issue of personal anonymity historically enjoyed by U.S. beneficial owners. No one will relish the idea of providing their personal identifying information into a governmental law enforcement database, and all that implicates for personal privacy, attribution of associations with business partners and types of investment,³⁰ and data security, among other considerations.

Business owners and their control persons have only the waning months of 2023 to take

any actions to avail themselves of a CTA exemption, or otherwise influence their ownership or control position within their business entities, to limit or eliminate their required disclosure into BOSS. Business owners and their control persons will also have the same time period to stand up necessary authorized personnel, policies, procedures, protocols and systems to timely comply with the CTA’s 30 day compliance window commencing and continuing from January 1, 2024. Now is the time to engage expert, professional advisors to prepare for this new business world order.

NOTES:

¹§§ 6401 — 6403 under Title LXIV of the National Defense Authorization Act for Fiscal Year 2021.

²The U.S. Department of Treasury also houses the Internal Revenue Service (IRS). The IRS recently announced plans to hire nearly 20,000 new employees and invest \$80B 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, could 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 available to the IRS. The IRS initiative aims 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 goal is to expand enforcement for taxpayers with complex tax filings and high-dollar noncompliance, including high-income and high-wealth individuals, complex partnerships, and large corporations. See Internal Revenue Service Inflation Reduction Act Strategic Operating Plan FY2023 - 2031; <https://www.irs.gov/pub/irs-pdf/p3744.pdf>.

³See FinCEN Frequently Asked Questions 3 and 5; <https://www.fincen.gov/boi-faqs> (“No one needs to report beneficial ownership information to FinCEN until January 1, 2024. FinCEN is currently not accepting any beneficial ownership information reports.” “Beneficial ownership information reports will not be accepted before then.” [Issued March 24, 2023]).

⁴31 C.F.R. § 1010.380(b)(5).

⁵See 31 U.S.C.A. 5319; 31 CFR 1010.960.

⁶E.g., for the Wall Street Journal readers, envision the “Pandora Papers” (circa 2021) (https://en.wikipedia.org/wiki/Pandora_Papers), “Panama Papers” (circa 2016) (https://en.wikipedia.org/wiki/Panama_Papers) and “Paradise Papers” (circa 2017) (https://en.wikipedia.org/wiki/Paradise_Papers). For the Netflix fans, think of “Gunter’s Millions” (“Was the ‘world’s richest dog’ a front to avoid taxes? Netflix documentary exposes truth behind Italian pharma heir’s infamous hoax claiming German Shepherd Gunther VI is worth \$400M”: <https://www.dailymail.co.uk/news/article-11692671/Netflix-documentary-Gunther-s-Millions-exposes-truth-worlds-richest-dog.html>); see also “Liechtenstein Papers” (circa 2008) (https://en.wikipedia.org/wiki/2008_Liechtenstein_tax_affair).

⁷See 31 C.F.R. § 1010.380.

⁸§ 6403 under Title LXIV of the National Defense Authorization Act for Fiscal Year 2021.

⁹See 31 C.F.R. § 1010.380.

¹⁰It is important to note that these are “reporting companies” as defined in the CTA only, and NOT “reporting companies” obligated to file reports under Sections 13 or 15(d) of the Securities Exchange Act (which entities are expressly excluded from the CTA’s “reporting” company classification).

¹¹§ 6403 under Title LXIV of the National Defense Authorization Act for Fiscal Year 2021.

¹²CTA § 6403(c)(2)(B)(i). See 31 C.F.R. § 1010.380 (printed page 59547).

¹³E.G., limited partnerships, limited liability partnerships, limited liability limited partnerships, business trusts, decentralized autonomous organizations (DAOs) and other entities created through filings with a secretary of state or tribal authority.

¹⁴31 U.S.C.A. § 5336(a)(11)(A).

¹⁵31 U.S.C.A. § 5336(a)(11)(B).

¹⁶Failure to meet any one or more of these three criteria will result in the exemption not applying to the business entity in question, and such business entity being classified as a “reporting” company under the CTA.

¹⁷See 31 CFR 1010.380(f)(6), (“The term “has an operating presence at a physical office within the United States” means that an entity regularly conducts its business at a physical location in the United States that the entity owns or leases and that is physically distinct from the place of business of any other unaffiliated entity.”).

¹⁸31 U.S.C.A. § 5336(a)(11)(B)(xxi)(A). 31 C.F.R. § 1010.380(f)(1). A full-time employee must average 30 hours per week or 130 hours per month. (see 26 C.F.R. § 54.4980H-1(a) (21)) This may not include part-time employees, independent contractors or leased employees, nor full-time-equivalents. *But note* that FinCEN, in its FAQs (Question 8, Answer XXI; <https://www.fincen.gov/boi-faqs>), describes this threshold as “Large operating companies with at least 20 full-time employees . . .” (emphasis added).

¹⁹31 U.S.C.A. § 5336(a)(11)(B)(xxi)(I). A “large operating company” must have filed “a Federal income tax or information return in the United States for the previous year demonstrating more than \$5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity’s IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under Federal income tax principles. For an entity that is part of an affiliated group of corporations within the meaning of 26 U.S.C.A. 1504 that filed a consolidated return, the applicable amount shall be the amount reported on the consolidated return for such group.”

²⁰31 C.F.R. § 1010.380(a)(2).

²¹31 C.F.R. § 1010.380(a)(2)(i).

²²31 C.F.R. § 1010.380 (a)(1)(iv).

²³31 C.F.R. § 1010.380 (b)(5).

²⁴See Proposed 31 C.F.R. § 1010.380(b)(4)(ii)(B).

²⁵CTA § 6403(c)(2)(B)(i).

²⁶CTA § 6403(c)(2)(B)(ii).

²⁷31 U.S.C.A. §§ 5336(h)(2), 5336(h)(3)(B).

²⁸31 U.S.C.A. §§ 5336(h)(1), 5336(h)(3)(A).

²⁹See New York 2023 -2024 Legislative Session State Assembly Bill A9415 and Senate Companion Bill S995B.

³⁰Consider co-investments with notorious individuals. Or investments in businesses with challenging legal status (such as businesses in the cannabis industry, which, while legal under many states’ laws, remains illegal in other states, and under federal law for any purpose - see the Controlled Substances Act of 1970, 21 U.S.C.A. 801 et. seq.).