Corporate Transparency Act (CTA)

The CTA became law in January 2021

- The goal of the Law is to foster anti-money laundering through transparency, primarily by requiring numerous business entities to report their beneficial owners.
- The Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department has projected that more than 32 million entities will be impacted by the CTA (Corporate Transparency Act) and the Rule.
- Among these entities, the majority will consist of small businesses and other reporting companies with 4 or less beneficial owners. According to FinCEN, the estimated cost of complying with these regulations will amount to around $21.7 billion in the initial year and approximately $5.65 billion annually thereafter.

Penalties

- Non-compliance with the reporting obligations outlined in the Corporate Transparency Act (CTA) can result in both civil and criminal penalties. These penalties may include a maximum civil fine of $500 per day (up to a total of $10,000) as well as potential imprisonment for a period of up to two years

FinCEN’s Final Rule

- The Final Rule (Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59498 (Sept. 30, 2022)) was issued by FinCEN on September 29, 2022, to enforce the reporting obligations of the Corporate Transparency Act (CTA) in relation to the disclosure of beneficial owners’ information.
- Effective January 1, 2024.

Who Must Report

- Under the Rule, both existing and future domestic and foreign companies are required to report their beneficial ownership information, although there are certain exemptions in place.
- For domestic companies, a reporting entity refers to any corporation, limited liability company, or other entity that is established by submitting a document to a secretary of state or a similar state or tribal office. This definition encompasses non-corporate entities such as limited liability partnerships, limited liability limited partnerships, business trusts, or limited partnerships.
- As for foreign companies, a reporting entity is defined as any corporation, limited liability company, or other entity that is formed according to the laws of a foreign country and has registered to conduct business in any state or tribal jurisdiction by filing a document with a secretary of state or a similar office

Exemptions 1/2

The Corporate Transparency Act (CTA) provides exemptions for 23 categories of entities, excluding them from the definition of a "reporting company." Additionally, the CTA grants FinCEN the authority to establish new exemptions. However, as of now, FinCEN has chosen not to implement any additional exemptions.

Exempted entities include the following (definitions in CTA):

- Large operating companies — companies with 20 or more full-time U.S. employees, more than $5 million in U.S.-sourced revenue, and a physical operating presence in the U.S.;
- Issuers registered with the Securities and Exchange Commission;
- Banks, bank holding companies, savings and loan holding companies, credit unions, financial market utility entities, and money services businesses registered with FinCEN;
- Registered Commodity Exchange Act entities, registered investment companies or investment advisers, broker-dealers, and registered venture capital fund advisers;
- Insurance companies or state-licensed insurance producers;
- Accounting firms;
- Public utilities;
- Certain pooled investment vehicles;
- Tax-exempt entities or certain entities that assist tax-exempt entities; and
- Inactive companies.

Exceptions 2/2

- The Rule implemented by FinCEN includes an exemption for subsidiaries that are controlled or wholly owned, either directly or indirectly, by one or more exempt entities. However, it's important to note that this exemption does not apply to subsidiaries of money services businesses, pooled investment vehicles, or entities that provide assistance to tax-exempt entities.
- Provided that they are wholly-owned subsidiaries of exempted entities.

Who Are Beneficial Owners

- The Rule defines “beneficial owners” as
  - “any individual who, directly or indirectly, either exercises substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such report company.
- An individual is considered to have substantial control over a reporting company if they hold the position of a senior officer within the company, possess authority regarding the appointment or removal of senior officers or a majority of the board, exert significant influence over crucial decisions, or exercise substantial control through any other means. It is important to note that the definition of substantial control is broad and may encompass third parties as well.

Exception to beneficial owner

- There are a few exceptions for the qualifications as a beneficial owner.
- Under the Rule: minor children (provided a parent or legal guardian is reported as a beneficial owner), nominees, employees (excluding senior officers), future inheritors, and creditors.

When to file

- For reporting companies that were in existence or registered prior to January 1, 2024, they are required to submit their initial report to FinCEN by January 1, 2025.
- On the other hand, reporting companies that are created or registered after January 1, 2024, must file their initial report within 30 calendar days following their creation or registration.
- In the event that a reporting company no longer qualifies for a reporting exemption, it must submit its initial report within 30 calendar days from the date it loses its exemption status.

When an updated report is due

- After submitting the initial report, it is mandatory for any reporting company to file an updated report within 30 days of any change in its beneficial ownership information. This includes modifications or updates to the ownership details.
- Additionally, if a reporting company initially did not meet the criteria for an exemption but later qualifies for an exemption, it must promptly file an updated report within 30 days. This updated report notifies FinCEN of the change in the company's status and confirms its eligibility for the exemption

How to Report

- FinCEN is currently developing the reporting forms that will be used by reporting companies to disclose their beneficial ownership information. It is anticipated that the proposed reporting forms will be published in the Federal Register for public comment before January 1, 2024.
- The initial reports submitted to FinCEN must include comprehensive information about the reporting company, its beneficial owners, and, for reporting companies established or registered after January 1, 2024, its company applicants. The Rule provides a detailed description of the specific contents and requirements of these reports.
- The objective of the reporting forms is to ensure that all necessary information regarding beneficial ownership is accurately captured and reported to FinCEN in accordance with the requirements outlined in the Rule.

But …

- If an individual's status as a beneficial owner of a reporting company is solely derived from their ownership of another company that is exempt from reporting, the reporting company is not obligated to report the beneficial ownership of that individual. Instead, the reporting company is required to provide only the names of the exempt entities, in place of furnishing information specifically on the beneficial owners who fall under this category.

Company applicants

- For reporting companies that are established or registered after January 1, 2024, they are obligated to provide information about their company applicants. The required information for company applicants is the same as that for beneficial owners.
- A company applicant refers to any individual who files the document that officially creates a company, as well as any individual who holds primary responsibility for directing or controlling the filing process. It's important to note that a reporting company may have multiple applicants.
- Once the reporting company includes the information on its company applicants in the initial report submitted to FinCEN, there is no requirement to provide subsequent updates specifically regarding the company applicants. However, it's crucial to ensure that any changes to beneficial ownership information are promptly reported as necessary.

“Risk management”

- Companies will be required to establish internal policies and procedures to effectively assess their reporting obligations, accurately identify beneficial owners, and determine the individuals who qualify as company applicants. This may also include consultants who are involved in the company's operations.
- During M&A, it becomes important to conduct thorough due diligence to verify that target companies have fulfilled their reporting obligations in accordance with the law.
- Mitigate the risk of getting inadvertently involved in anti-money laundering or corruption investigations. Proper vetting procedures of vendors and customers are essential to maintain compliance and avoid any potential legal issues.