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Corporate Transparency Act Will Impact All Business Owners in 2024

If you own or have substantial control over an LLC, a corporation, or a partnership, starting next year you may be obligated to disclose to the federal government the existence of that entity and your interest in it. Being slightly more technical, beginning January 1, 2024, the Corporate Transparency Act ("CTA") requires all Reporting Companies to provide FinCEN (part of the Treasury department) with identifying information about the Reporting Company, the Beneficial Owners of the Reporting Company, and the Company Applicant. The remainder of this Client Alert helps define each of these critical terms so you can understand how this new law will impact you, and what your obligations will be next year.

Why is this necessary?

The CTA was originally passed in 2021 and is designed to help law enforcement and government regulators combat terrorism, money laundering, and criminal activities in general. At the moment it's extremely difficult and time consuming for law enforcement and government regulators to determine who owns a business entity. Criminals have taken advantage of this reality to obscure their activities. The CTA seeks to address this issue by requiring business entities to disclose their owners and those who have substantial control over the entity.

What is a Reporting Company?

A Reporting Company is a corporation, LLC, partnership, or any other entity created by filing a document with a secretary of state. Foreign entities that register to do business in the United States through a filing with a secretary of state are also Reporting Companies.

There are 23 types of entities that are exempt from being Reporting Companies. These are entities that are already highly regulated such as banks, broker dealers, investment companies, and tax exempt entities. An important type of exempt entity is the Large Operating Business. Any business with 21 or more full time employees, $5 million or more of U.S. sourced revenue, and a physical office in the U.S. is a Large Operating Company and not a Reporting Company. As an exempt entity, a Large Operating Company does not need to disclose any information to FinCEN.

What does a Reporting Company have to do?

A Reporting Company must disclose the following information about itself: (1) full name of the company, (2) any trade name or "doing business as" name, (3) a business street address, (4) the jurisdiction of formation, and (5) a taxpayer identification number.

A Reporting Company must disclose the following information for each Beneficial Owner: (1) full legal name, (2) date of birth, (3) current residential address, and (4) a copy of a driver's license or passport. The same information must be disclosed for each Company Applicant, but a business address can be used instead of a residential address.

Instead of providing the foregoing information to a Reporting Company, a Beneficial Owner or Company Applicant may provide that information directly to FinCEN and obtain a "FinCEN Identifier." That number can then be provided to the Reporting Company. This allows FinCEN to get the information it needs while providing more privacy for the Beneficial Owner and Company Applicant.

What happens if I move?

If any of the information provided to FinCEN about a Reporting Company or Beneficial Owner changes an updated report must be filed within 30 days. As a result if you move, change your name, or receive a new drivers license/passport an updated report will be required.

Am I a Beneficial Owner?

You are a Beneficial Owner if you own or control 25% or more of a Reporting Company. You are also a Beneficial Owner if you have "substantial control" over the Reporting Company.

In many cases it will be clear who owns 25% or more of a Reporting Company, but the statute and implementing regulations do not answer many questions. If an entity has more than one class of equity you may be treated as a 25% owner if you own 25% of any class. In addition, equity owned indirectly or through different vehicles must be aggregated. For example, if you own 10% of an LLC directly and a trust where you serve as trustee owns 15% of that same LLC you may be treated as a 25% owner.

There are several ways to have "substantial control" over a Reporting Company, and those with substantial control are Beneficial Owners. Substantial control includes (1) serving as a senior officer, (2) having authority over the appointment or removal of any senior officer or a majority of the board of directors (or a similar body), and (3) having the ability to direct, determine, or have substantial influence over important decisions of the Reporting Company. As you can see some forms of substantial control are easily defined (being a senior officer for example), while others are more ambiguous (like having "substantial influence").

What about trusts?

Trusts are generally not Reporting Companies because they are not created through a secretary of state filing. That said, if a trust owns an interest in a Reporting Company it could require multiple people be disclosed as Beneficial Owners.

If there is only one income and principal beneficiary of a trust, ownership of a Reporting Company by the trust will be attributed to that beneficiary. A Marital Trust is a common example of a trust that would meet this description. In addition, a beneficiary with the "right to demand a distribution of or withdraw substantially all of the assets from the trust" will be attributed ownership of trust assets, as will the grantor of a revocable trust.

Trust assets are also attributed to anyone with authority to "dispose of trust assets". This would seem to include any trustee with the authority to sell or distribute trust assets. It may also apply to a beneficiary who has the power to appoint trust assets. In the context of a directed trust, this would seem to include an investment advisor/trustee as well as a distribution advisor/trustee.

As you can see, when a trust owns a significant equity interest in an entity it will require careful analysis to determine who needs to be reported by the Reporting Company as a Beneficial Owner.

Who is a Company Applicant?

A Company Applicant is the person who files the forms with the Secretary of State to create the legal entity or to register a foreign entity to do business in the state. It is also the person who was primarily responsible for directing the formation or registration of the company. For example, an attorney may direct a paralegal to form an LLC, in which case they are both Company Applicants. There can be no more than two Company Applicants for each Reporting Company.

Who can access this information?

The general public will **<u>not</u>** be able to access Beneficial Owner information collected through the CTA. That information will only be available to national security, intelligence, or law enforcement agencies as well as the Department of Treasury for tax administration purposes. Financial institutions will be able to access this information as part of their "know your customer" due diligence, but only with the specific authorization of the relevant Reporting Company.

What happens if I ignore this?

Willfully failing to report or providing false information is punishable by a civil penalty of up to $500 a day and a criminal penalty of up to $10,000 in fines and two years in prison.

What should I do now?

The first step in preparing for the CTA is to identify every Reporting Company you may need to disclose or need to provide with your personal information. This could include a business you own or one where you have substantial influence (most likely because you are a senior officer). For example, if you own a vacation home through an LLC that will be a Reporting Company.

If you identify several Reporting Companies that will need to disclose your status as a Beneficial Owner you may want to obtain a FinCEN Identifier once that website is activated. This will simplify your reporting burden since you will only need to provide a Reporting Company with your FinCEN Identifier instead of providing each company with all of your Beneficial Owner information.

How can Dungey Dougherty PLLC help?

In most instances it will be fairly easy to determine whether an entity is a Reporting Company and who the Beneficial Owners are. For situations that are more complicated Dungey Dougherty PLLC is able to provide advice on whether an entity qualifies for an exception and is not a Reporting Company. We can also help you determine who is a Beneficial Owner. Once FinCEN opens the web portals to register Reporting Companies we can make all required filings on your behalf. Contact us today to start the conversation.