

CORPORATE TRANSPARENCY ACT: WHAT YOU NEED TO KNOW

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Effective January 1, 2024, most new and existing entities formed or based in the United States will be required to file reports disclosing their *Beneficial Owners* and *Company Applicants* (defined below) with the U.S. Department of Treasury's Financial Crimes Enforcement Network ("FinCEN"). These requirements are borne out of the Corporate Transparency Act ("CTA"), an expansion of anti-money laundering laws, and are expected to impact millions of business entities.

"The CTA aims to detect, prevent, and combat such misconduct along with other illegal acts, including but not limited to, money laundering, terrorist financing, and tax fraud."

Historically, entities formed in United States jurisdictions, such as Delaware, were not required to publicly disclose or publicly maintain the names of their record shareholders or ultimate beneficial owners. As such, it was possible for unknown shareholders to own or control entities conducting business in the United States, while the ultimate beneficial owners of said entities were prohibited from doing so due to sanctions or other laws. The CTA aims to detect, prevent, and combat such misconduct along with other illegal acts, including but not limited to, money laundering, terrorist financing, and tax fraud.

WHICH ENTITIES MUST REPORT?

The entities that must comply with the reporting rules and disclosures of beneficial ownership include:

- **Domestic reporting companies:** U.S. formed corporations, limited liability companies ("LLCs"), or any other entity created by the filing of formation documents with a state or any similar office under the law of a state or Indian tribe; and
- **Foreign reporting companies:** Entities formed under the law of a foreign country, treated as a corporation or an LLC for U.S. purposes, and registered to do business in any state or tribal jurisdiction.

Notwithstanding the above, the following are certain entities exempt from the reporting requirements:

- SEC-reporting companies;
- regulated financial services companies, including banks, credit unions, depository institution holding companies, and registered securities broker-dealers;

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- insurance companies;
- PCAOB-registered accounting firms;
- tax-exempt entities;
- inactive entities that existed before January 1, 2020; are not engaged in active business; are not owned by a foreign person, whether directly or indirectly or wholly or partially; have not experienced a change in ownership in the preceding 12 months; have not sent or received funds greater than US\$1,000 in the preceding 12 months, and do not hold any kind or type of assets;
- subsidiaries of certain exempt entities; and
- entities that employ more than 20 full-time employees in the U.S., have an operating presence at a physical office within the U.S., and demonstrate more than US\$5m in gross receipts or sales (net of returns and allowances) on their federal income tax return (excluding receipt/sales from sources outside the U.S.).

WHAT BENEFICIAL OWNERSHIP AND COMPANY APPLICATION INFORMATION IS REPORTED?

The CTA defines a '*Beneficial Owner*' of an entity as any individual who, directly or indirectly:

- exercises "substantial control" over the entity; or
- owns or controls not less than 25% equity in the entity.

In defining the contours of who has substantial control, the rules set forth a range of activities which may constitute substantial control of a reporting company. This list captures anyone who is able to make important decisions on behalf of the entity. It is therefore possible for multiple persons to be the Beneficial Owner of one entity, including entities that have only one shareholder.

The following do not constitute Beneficial Owners:

- minor child (as long as the child's, parent's, or guardian's information is reported);
- individual acting as an intermediary or agent on behalf of another;
- individuals whose control over a reporting company derives solely from their employment, provided that the person is not a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer who performs a similar function, regardless of official title;
- individual whose only interest in a reporting company is through a right of inheritance; or
- creditor of a reporting company (unless they qualify as a "beneficial owner" through substantial control or equity ownership).

"It is unlawful for any person to 'willfully provide, or attempt to provide, false or fraudulent beneficial ownership information... to FinCEN' or to 'willfully fail to report complete or updated beneficial ownership information to FinCEN'."

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A *Company Applicant* is (1) the individual who directly files the document creating the entity, or in the case of a foreign reporting company, the document that first registers the entity to do business in the United States and/or (2) the individual who is primarily responsible for directing or controlling the filing of the relevant document, if more than one individual is involved in the filing of the document. Reporting companies existing or registered as of January 1, 2024 do not need to identify and report their Company Applicants. In addition, reporting companies formed or registered after January 1, 2024 also do not need to update company applicant information after the initial filing.

WHAT INFORMATION IS DISCLOSED?

Under Section 31 U.S.C. 5336 of the CTA, each report to FinCEN must include the following information about each beneficial owner:

- name;
- date of birth;
- residential or business address;
- unique identifying number from an acceptable identification document; and
- image of the identification document (i.e. the state issued ID) used to provide unique identification number.

Though certain governmental agencies will have access to the information, reports filed with FinCEN will not be accessible to the public and will not be subject to requests under the Freedom of Information Act.

REPORTING TIMEFRAME

Different timing rules apply to existing and newly formed entities for initial reporting:

- **Existing entities:** Entities formed prior to January 1, 2024 are required to submit an initial report within one year of the effective date; and
- **Newly Formed Entities:** Newly created entities will have 30 days after receiving notice of their creation or registration to file their initial reports.

In either case, if there is any change with respect to information previously reported, the reporting company is required to file an updated report within 30 calendar days after the date on which the change occurs.

PENALTIES

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It is unlawful for any person to “willfully provide, or attempt to provide, false or fraudulent beneficial ownership information... to FinCEN” or to “willfully fail to report complete or updated beneficial ownership information to FinCEN.” In addition, such person “shall be” liable for a civil penalty of up to US\$500 for each day a violation continues or has not been remedied and “may be” fined up to US\$10,000 and imprisoned for up to two years, or both. There are additional penalties and criminal consequences for a person to knowingly disclose or knowingly use the beneficial ownership information obtained by the person through a report submitted to FinCEN or certain disclosures made by FinCEN.

The CTA contains a safe harbor from such civil and criminal liability for the submission of inaccurate information on the basis that the individual who submitted the report voluntarily and promptly corrects it within a period of 90 days.

HOW DO YOU FILE?

FinCEN is currently designing the Beneficial Ownership Secure System to collect and store CTA reports. This system is not yet available.

This article was written by Partner Steven Hollander and Associate Krisly Zamor. If your organization is one of the entities that must comply with the reporting rules and disclosures of beneficial ownership, please contact one of the authors or your regular Watson Farley & Williams contact.

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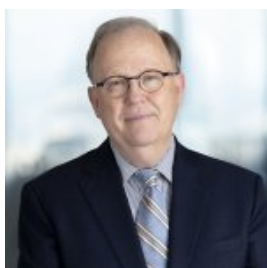
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