

The Corporate Transparency Act: What We Know, What We Don't, and What to do Next

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On January 1, 2021, Congress overrode President Trump's veto of the National Defense Authorization Act for Fiscal Year 2021 (the "NDAA"), enacting the legislation into law. The NDAA includes the Corporate Transparency Act ("CTA"), which imposes new federal reporting obligations on certain companies, including information on the beneficial owners of those companies. The CTA has been characterized by some as the most significant anti-money laundering reform in a generation and, as the legislation itself states, will help bring the United States into closer alignment with international standards concerning anti-money laundering and countering terrorism financing. While the CTA is an important development that will likely serve as a significant deterrent to registering in the United States by those seeking to conceal ownership information, the CTA's impact is reduced by the number of reporting exceptions and the very limited access to the information to be collected. The reporting requirements will be a burden that largely falls on small businesses, including startups, as well as certain trusts, and shell and holding companies. In addition, beneficial ownership information will only be available to federal and state law enforcement agencies and financial institutions, but with customer consent.

What We Know:

- The CTA requires a "reporting company" to submit beneficial ownership information along with information on each "applicant" for the reporting company to the Department of the Treasury's Financial Crimes and Enforcement Center ("FinCEN").
 - ▶ "Reporting company" is defined as "a corporation, limited liability company, or other similar entity" created under the laws of a U.S. State (including commonwealths, territories, or other U.S. possessions) or tribal territory or a non-U.S. entity registered to do business under the laws of a U.S. State or tribal territory, subject to the many exceptions described below.
 - ▶ "Applicant" is defined as any individual who "files an application" to form or register an entity that qualifies as a reporting company.
- The scope of the CTA's reporting requirements is significantly narrowed by the exclusion of 23 categories of entities from the definition of "reporting company" and the possibility that the Treasury Department will exempt additional categories of entities. An entity that falls into one of these categories will not be required to submit beneficial ownership information to FinCEN. The result is that the reporting requirements largely impact smaller companies in addition to the shell or holding companies that often are targeted by anti-money laundering laws. A simplified list of the exclusions is below, with some of the more significant categories in bold. Companies should carefully review subparagraph (B) to the definition of "reporting company" for a complete list of requirements associated with each exclusion.

Entities Excluded from CTA Reporting Requirements

Public companies	Government entities	Banks
Federal and State credit unions	Bank holding companies	Money transmitting businesses registered with FinCEN

Brokers and dealers	Exchange and clearing agencies	Any other entity registered with the SEC under the Securities and Exchange Act of 1934
Certain registered investment companies and investment advisers	Insurance companies	Certain entities registered under, or covered by, the Commodity Exchange Act
Public accounting firms	Public utilities	Financial market utilities
Certain pooled investment vehicles	501(c) nonprofits; 527 political organizations; trusts under paragraphs (1) and (2) of section 4947(a) of the Internal Revenue Code	Certain entities that operate exclusively to provide financial assistance/hold governance rights over a nonprofit, political organization or certain trusts
Any entity that: 1. employs more than 20 full-time employees in the U.S., 2. has a physical office in the U.S., and 3. reported more than \$5 million in gross receipts or sales on the previous year's Federal income tax return	Any subsidiary or other entity owned or controlled (directly or indirectly) by an entity exempt from reporting requirements (except those owned or controlled by money transmitting businesses; certain pooled investment vehicles; certain entities that operate exclusively to provide financial assistance/hold governance rights over a nonprofit, political organizations, and certain trusts; and certain inactive businesses)	Any entity in existence for over 1 year that is not engaged in active business, not owned by a foreign person, has not in the last 12 months sent or received funds totaling \$1,000, and does not otherwise hold any assets

- The CTA defines a “beneficial owner” as “an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise”:
 - ▶ Exercises “substantial control” over an entity; or
 - ▶ Owns or controls no less than 25 percent of the ownership interests of the entity.
- A beneficial owner does not include:
 - ▶ A minor (the information of the parent/guardian must be reported instead);
 - ▶ An agent/nominee/intermediary/custodian of another individual;
 - ▶ An employee of the entity with no control or economic benefits beyond the terms of employment;
 - ▶ An individual whose only interest in the entity is through inheritance; or

▶ A creditor of the entity unless the creditor otherwise meets the definition of “beneficial owner”

- The beneficial owner information to be provided to FinCEN includes:
 - ▶ Full legal name;
 - ▶ Current address (business or residential);
 - ▶ Date of birth; and
 - ▶ Unique identification number (from a passport, driver’s license, other state-issued identification, or FinCEN identifier)
- FinCEN may only share the information collected with:
 - ▶ Other Federal agencies engaged in national security, intelligence, or law enforcement activity;
 - ▶ State, local, or Tribal law enforcement agencies pursuant to a court order;
 - ▶ Certain foreign law enforcement agencies/prosecutors/judges;
 - ▶ A financial institution, *with the consent of the reporting company*, in order to facilitate customer due diligence requirements under applicable law; and
 - ▶ A Federal functional regulator or other appropriate regulatory agency

As a result, the beneficial ownership information collected by FinCEN will not be available to most industries and companies as a tool to support sanctions screening or other due diligence activities. Even financial institutions may find their access to the information itself to be of limited value as it seems unlikely that a customer or prospective customer with something to hide would consent to the release of the information unless the beneficial ownership information provided to FinCEN matches the information separately provided to the financial institution. The act of refusing consent, however, will almost certainly have to be deemed an anti-money laundering red flag by financial institutions, and know your customer/client guidelines will result in financial institutions not doing business with persons who refuse to consent.

■ The CTA outlines general timelines for making beneficial ownership reports as follows:

Entities Created Before Effective Date of FinCEN’s Regulations	Not later than 2 years after the effective date
Entities Created After Effective Date of FinCEN’s Regulations	At the time of formation/registration
Updating Prior Reports	Within 1 year of the change in beneficial ownership information

Absent a shorter period prescribed by Treasury’s implementing regulations, the 1-year period entities are permitted to update beneficial ownership information means that financial institutions (and the government) could be assessing out-of-date information.

- The CTA also requires that the Federal Acquisition Regulation be amended to require “any contractor or subcontractor” that qualifies as a “reporting company” disclose beneficial ownership information “as part of any bid or proposal for a contract with a value threshold in excess of the simplified acquisition threshold,” which is currently set at \$250,000 with certain exceptions.
- The CTA imposes significant penalties for willfully failing to report or update beneficial ownership information or willfully providing false information, including civil penalties of up to \$500 per day that the violation continues and criminal fines up to \$10,000 and/or 2 years imprisonment. Disclosing or using beneficial ownership information without authorization is also subject to a \$500-per-day civil penalty and an even more severe criminal penalty of up to \$250,000 and/or 5 years imprisonment.

What We Don’t Know:

- FinCEN is required to issue implementing regulations by December 31, 2021, but not surprisingly given the short period since passage of the legislation, no proposed regulations have been issued to date. Rulemaking will now begin under the Biden Administration.
- The term “substantial control” within the definition of “beneficial owner” is undefined.

- It is unclear whether the Treasury Department, with the agreement of the Attorney General and Secretary of Homeland Security, will exempt additional entities from the reporting requirements. It seems likely that startups and small business alliances, among others, will exert pressure to grant additional exemptions.
- The mechanism financial institutions will use to get beneficial ownership information from FinCEN has not been determined. It seems unlikely that FinCEN staff could keep up with financial institution requests for beneficial ownership information if FinCEN personnel had to approve each such request and if financial institutions requested this information for all current and prospective customers. A database with restricted access will likely have to be setup so financial institutions can review the information themselves.

Next Steps:

- Carefully evaluate whether one of the 23 current reporting exclusions applies to your company.
- If not, depending on the number of other reporting companies your company owns or controls, your company may wish to begin collecting the required information in advance of the reporting deadlines. Companies should also consider what procedures and resources will be needed to ensure that changes in beneficial ownership are reported in a timely manner. Companies may also consider streamlining their structures to reduce regulatory burdens.
- Monitor FinCEN's implementing regulations or proposed rules. Companies and small business associations may wish to provide comments during the rulemaking process on recommendations to minimize administrative burdens on entities highly unlikely to be involved in money laundering or terrorism financing activities.
- Financial institutions may want to begin considering policies governing which customers or prospective customers will be subject to requests to FinCEN for beneficial ownership information and what policies the financial institution will adopt to address customers or prospective customers who refuse to consent to requests for such information. As noted above, the act of refusing consent will almost certainly have to be deemed an anti-money laundering red flag.

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