

The Corporate Transparency Act: Understanding the New Beneficial Ownership Reporting Requirements

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What is it?

- A new federal law, the Corporate Transparency Act ("CTA"), requires privately-held companies to identify and provide personal information about their owners to the federal government.

When did it happen?

- The CTA was included as part of the National Defense Authorization Act for Fiscal Year 2021 (“NDAA”).
- The CTA was enacted by the U.S. Congress on January 1, 2021 by overriding President Trump’s veto of the NDAA.

Why did it happen?

- Privately-held U.S. companies are not required to identify their owners.
- This makes the U.S. one of the most secretive countries in the world, comparable to the Cayman Islands and Switzerland.
- As a result, U.S. companies have been used for money laundering, financing terrorism, and other illegal and criminal activities.

What is a Reporting Company?

- A “reporting company” is broadly defined and includes:
 - any corporation, limited liability company, or similar entity created by the filing of a document with the secretary of state (or similar office) in any U.S. state
 - any foreign entity that registers to do business with the secretary of state (or similar office) in any U.S. state

What is not a Reporting Company?

- It appears that domestic general partnerships are not included in the definition of “reporting company” because they are not created by the filing of a document with the secretary of state (or similar office) in any U.S. state; however, it is anticipated that pending regulations will address this issue.

Are there exemptions?

- Basically, all entities are “reporting companies” unless they fall within one of 24 exemptions.
- One exemption is for publicly traded companies, financial services companies, public utilities, and other heavy regulated entities.

Are there exemptions?

- Another exemption is for operating companies that:
 - Employ 20 or more employees in the U.S.;
 - In the prior tax year, have filed federal income tax returns with \$5,000,000 or more of gross revenues; and
 - Have a physical presence in the U.S.

What is required?

- A reporting company must file a report with the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") with identifying information about its "beneficial owners" and "applicants".

Who is a Beneficial Owner?

- An individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise
 - (1) exercises substantial control over the entity, or
 - (2) owns or controls 25% or more of the equity of an entity.

What is substantial control?

- The CTA does not define the term “substantial control” so presumably it will be addressed in the pending regulations.

“Substantial control” open issues?

- A private equity firm owns only 10% of the equity of a reporting company, but has the right to approve certain major decisions. Does the private equity firm have “substantial control” of the reporting company? If so, which individual of the private equity firm will be designated as the beneficial owner?
- A reporting company is owned by five owners each holding a 20% interest with equal voting and economic rights? Who has substantial control?

“Ownership” open issue?

- How do warrants, options, convertible debt, and similar rights impact the determination of ownership or control of 25% or more of the equity of a reporting company? Is it on a fully-diluted basis assuming the exercise of all warrants/options and the conversion of all debt?

Who is an Applicant?

- An individual who files a document to form a domestic entity or register a foreign entity (i.e., the incorporator of a corporation, the authorized person of a limited liability company, etc.)

Does an Applicant need to provide personal information to the Reporting Company?

- An applicant may provide his/her personal information to FinCEN and receive a FinCEN ID Number.
- The reporting company would include the applicant's FinCEN ID # on its reports in lieu of the applicant's personal information.

Who is not a Beneficial Owner?

- A minor child, as long as the information of a parent or guardian is provided.
- A person acting as a nominee, intermediary, custodian or agent of another person.
- A person acting solely as an employee and whose control over, or economic benefits from, the company is derived solely from the person's status as an employee.

Who is not a Beneficial Owner?

- A person whose only interest in the company is through a right of inheritance.
- A creditor, unless the creditor meets the substantial control or 25% ownership standards.

What must be reported?

- A reporting company must report the following information to FinCEN for each beneficial owner and applicant:
 - (1) full legal name
 - (2) date of birth
 - (3) current business or residence street address
 - (4) ID number from an unexpired driver's license, passport or other government ID document

What is not reported?

- A reporting company does not report any business, tax or financial information to FinCEN.

What about an exempt entity that owns a Reporting Company?

- If an exempt entity has an ownership interest in a reporting company, the reporting company is required to report only the name of the exempt entity.

When must the info be reported?

- New entities must file reports upon incorporation or formation (and foreign entities must file upon registration to do business)
- Existing entities must file reports within two years of the effective date of the regulations

When must the info be updated?

- Entities must update the information within one year of any changes, such as:
 - changes in Beneficial Owners
 - changes in names and addresses

When does the CTA become effective?

- There is no reporting obligation until the Treasury Department adopts regulations implementing the CTA.
- Also, FinCEN will need to create a database and filing procedures.
- The CTA requires the foregoing to be completed by January 1, 2022, but who knows how long it will take to prepare regulations.

Is the information confidential?

- Beneficial ownership information reported to FinCEN is confidential and cannot be used or disclosed except as authorized in the CTA and its regulations
- The general public will not have access to the beneficial ownership information

Who will have access to the info?

- FinCen may disclose the information to:
 - Federal agencies involved in national security, intelligence or law enforcement pursuant to an appropriate request
 - State and local law enforcement agencies pursuant to a court order
 - Financial institutions for KYC purposes, with the consent of the reporting company

Are there penalties for non-compliance?

- There are civil and criminal penalties for 1) willfully failing to report, 2) willfully providing false information, or 3) willfully failing to update information
 - Civil penalty of up to \$500 for each day the violation continues or is not remedied; and
 - Criminal penalties including a fine of up to \$10,000, up to two years in prison, or both.

Are there penalties for violations?

- There are penalties for knowing unauthorized 1) disclosure or 2) use of the information
 - Civil penalty of up to \$500 for each day the violation continues or is not remedied; and
 - Criminal penalties including a fine of up to \$250,000, up to five years in prison, or both.

What should you do now?

- When forming a company, collect required beneficial information from all owners.
- Revise agreements to:
 - require owners to provide beneficial ownership information and required documentation
 - impose penalties for owners failing to do so (e.g., indemnification for FinCEN fines, no dividends or distributions, etc.)
 - provide that the company will not disclose such information, except to comply with the CTA

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