



Understanding Your Obligations Under the Corporate Transparency Act

Client Advisories

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A new federal law, the Corporate Transparency Act ("CTA"), becomes effective on January 1, 2024. The CTA requires more than 30 million privately-held companies to register with the federal government and disclose certain information about itself and its owners and management. It applies to companies formed in the U.S. as well as companies formed outside the U.S. and registered to do business in the U.S. There are significant civil and criminal penalties on companies, senior management and owners who fail to comply with the CTA.

BACKGROUND

The CTA was enacted into law as part of the Anti-Money Laundering Act of 2020, which is itself part of the National Defense Authorization Act for Fiscal Year 2021 ("NADA"), 31 U.S.C. § 5336. The CTA was enacted by Congress on January 1, 2021 by overriding then-President Trump's veto of the NADA. The CTA aims to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity.

The CTA is administered by the U.S. Department of Treasury's Financial Crimes Enforcement Network ("FinCEN"). FinCEN has published rules implementing the CTA (the "Rules"). The Rules require certain corporations, limited liability companies, and other similar entities to disclose specific identifying information about two categories of individuals: (1) the beneficial owners who own or control such entities, and (2) the company applicants who form or register them. FinCEN will use the information to maintain a database available to law enforcement authorities and financial institutions.

QUESTION 1: IS YOUR COMPANY REQUIRED TO REPORT?

The CTA requires domestic and foreign companies within the scope of the CTA's definition of "reporting company" to file a report with FinCEN, unless they fall within one of 23 exemptions. 31 U.S.C. § 5336(a)(11).

Reporting companies are all domestic corporations, limited liability companies, limited partnerships and any other entities created by the filing of a document with a secretary of state or any similar office under the laws of a state or an Indian tribe. For example, a corporation filing a certificate of incorporation with the New Jersey Division of

Revenue and Enterprise Services or the Delaware Secretary of State is a reporting company. By contrast, sole proprietorships and general partnerships are not reporting companies because they are not created by the filing of a document with a secretary of state or any similar office.

Reporting companies are also all foreign corporations, limited liability companies and other similar entities formed under the laws of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or any similar office under the laws of a state or an Indian tribe. For example, a Canadian corporation registered to do business with the New York Secretary of State is a reporting company.

QUESTION 2: IS YOUR COMPANY EXEMPT?

The CTA expressly exempts 23 categories of companies from the requirement of filing reports, but these companies are primarily larger, highly regulated, or subject to different ownership reporting requirements. 31 U.S.C. § 5336(a)(11)(B). The following is the full list of exemptions:

1. Securities reporting issuer;
2. Governmental authority;
3. Bank;
4. Credit union;
5. Depository institution holding company;
6. Money services business;
7. Broker or dealer in securities;
8. Securities exchange or clearing agency;
9. Other Exchange Act registered entity;
10. Investment company or investment adviser;
11. Venture capital fund adviser;
12. Insurance company and insurance producer;
13. State-licensed insurance producer;
14. Commodity Exchange Act registered entity;
15. Accounting firm;
16. Public utility;
17. Financial market utility;
18. Pooled investment vehicle;
19. Tax-exempt entity;



20. Entity assisting a tax-exempt entity;
21. Large operating company;
22. Subsidiary of certain exempt entities; and
23. Inactive entity.

Some of the more common exemptions include large operating company, subsidiary of certain exempt entities, and an inactive entity, and are explained below.

Large operating company. A large operating company is one that:

1. employs more than 20 full time employees in the U.S., who must be actual employees (not independent contractors or leased employees), working in the U.S., for 30 or more hours per week, and employed by the company (not by a parent or subsidiary company);
2. has a physical location in the U.S., and
3. has filed a federal income tax or information return for the previous year showing more than \$5 million in gross receipts or sales (excluding gross receipts or sales from sources outside of the U.S.). 31 C.F.R. § 1010.380(c)(2)(xxi).

Subsidiary of certain exempt entities. A subsidiary controlled or wholly-owned, directly or indirectly, by one or more exempt companies. 31 C.F.R. § 1010.380(c)(2)(xxii).

Inactive entity. An inactive entity in existence on or before January 1, 2020 that has no foreign owners, no assets (including interests in other entities), no change in ownership during the last 12 months, and has not sent or received funds in excess of \$1,000 in the last 12 months. 31 C.F.R. § 1010.380(c)(2)(xxiii).

It should be clear that most small businesses are reporting companies that must comply with the CTA, unless they satisfy the requirements of a large operating company.

QUESTION 3: WHAT MUST YOU REPORT?

A reporting company must report the following information about itself:

1. Full legal name;
2. Any trade names, doing business as (dba), or trading as (t/a) names, whether or not formally registered;
3. For a domestic company, the current address of its principal place of business in the U.S. and, for a foreign company registered to do business in the U.S., the street address of its primary location in the U.S. where it conducts business (to be clear, a post office box or an agent's address cannot be used);
4. For a domestic company, its jurisdiction of formation and, for a foreign company registered to do business in the U.S., the jurisdiction in the U.S. where it first registered to do business; and
5. IRS Taxpayer Identification Number (TIN), including an Employer Identification Number (EIN). If a foreign reporting company does not have a TIN, it may provide a tax identification number issued by a foreign



jurisdiction and the name of that issuing jurisdiction. 31 C.F.R. § 1010.380(b)(1)(i).

A reporting company must report the following beneficial ownership information (“BOI”) about its beneficial owners and company applicants:

1. Full legal name;
2. Date of birth;
3. Current business or residence address;
4. Unique identifying number from a non-expired (a) U.S. passport, (b) driver’s license, or (c) identification document issued by a state or local government or Indian tribe (if an individual does not have any of the foregoing documents, a passport issued by a foreign government may be used); and
5. An image of the identification document from which the unique identifying number was obtained. 31 C.F.R. § 1010.380(b)(1)(ii).

QUESTION 4: WHO IS A BENEFICIAL OWNER?

A reporting company must identify its “beneficial owners”. A beneficial owner is any individual (i.e., natural person) who, directly or indirectly, either (1) exercises substantial control over the reporting company or (2) owns or controls 25% or more of the ownership interests of the reporting company. 31 C.F.R. § 1010.380(d). A reporting company must have at least one beneficial owner.

QUESTION 5: WHAT IS SUBSTANTIAL CONTROL?

A person with substantial control of a reporting company includes a person:

1. Serving as a senior officer, such as the president, chief executive officer, general counsel, chief financial officer, chief operating officer, and any other officer, regardless of title, performing similar functions;
2. Having authority over the appointment or removal of a senior officer or a majority of the board of directors or other governing body;
3. Directing, determining, or having substantial influence over important (i.e., major) decisions, such as:
 - the nature and scope of the reporting company’s business;
 - the sale or lease of principal assets;
 - major expenditures or investments;
 - issuance of any equity;
 - incurrence of significant debt;
 - the selection or termination of business lines or ventures, or geographic focus of the reporting company;
 - approval of its operating budget;



- compensation schemes and incentive programs for its senior officers;
- entry into or termination of significant contracts; or
- amendments of any of the reporting company's substantial governance documents, including its certificate or articles of incorporation (or similar formation documents), bylaws, or significant policies or procedures; or

4. Having any other form of substantial control over the reporting company, which is a catch-all provision.

As an example, assume an investor owns only 10% of the equity of a reporting company, but has the right to approve certain major decisions, such as those set forth in #3 above. The investor will likely have "substantial control" and be a beneficial owner of the reporting company.

It is important to note that FinCEN's Rules provide that a person's title is not determinative. Instead, it is the person's authority or function that determines "substantial control". The Rules set forth a non-exhaustive list of examples where an individual may, directly or indirectly (including as a trustee of a trust or similar arrangement), exercise substantial control over a reporting company:

- Board representation;
- Ownership or control of a majority of the voting power or voting rights;
- Rights associated with any financing arrangement or interest;
- Control over one or more intermediary entities that separately or collectively exercise substantial control;
- Arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- Any other contract, arrangement, understanding, relationship, or otherwise.

QUESTION 6: WHAT IS A 25% OR MORE OWNERSHIP INTEREST?

A person who owns or controls 25% or more of the ownership interests of the reporting company is a beneficial owner. Any of the following may be an ownership interest in a reporting company:

- Equity, stock, or voting rights;
- Capital or profits interest;
- Convertible instruments, meaning any instrument convertible, with or without consideration, into equity, stock, or voting rights or any capital or profits interest; including any warrant or right to purchase, sell, or subscribe to a share or interest in equity, stock, or voting rights, or a capital or profits interest, and any future on any such convertible instrument, whether or not characterized as debt;
- Options or other non-binding privileges, such as a put, call, straddle, or other option or privilege of buying or selling any equity, stock, or voting rights or any capital or profits interest without being bound to do so, except to the extent that the option or privilege is held by a third party and not known to the reporting company; or



- Any other instrument, contract, or arrangement, understanding, relationship, or mechanism used to establish ownership, which is a catch-all provision.

A person's ownership or control is calculated on a fully-diluted basis assuming the exercise of all warrants/options and conversion of all debt into equity of the reporting company. Therefore, it includes the current ownership interest and the assumed exercise of all warrants/options and the assumed conversion of all debt into equity. A person's ownership or control is based on a percentage of the total outstanding voting power of all classes of ownership interests entitled to vote or the total outstanding value of all classes of ownership interests. If the facts and circumstances do not permit the calculations to be made with reasonable certainty, an individual owning or controlling 25% or more of any class or type of ownership interest of a reporting company is deemed to have exceeded the 25% ownership or control threshold.

Determining whether a person owns an ownership interest of 25% or more may be straightforward in a company with a simple ownership structure. However, this determination may be more difficult in a company with a more complex ownership structure. That is, one with multiple classes of ownership interests, preference or priority returns, waterfall structures, etc. As an example, a person may have a 10% economic interest in a limited liability company, but a 25% voting interest or the right to approve certain major decisions. A person may have a 15% membership interest in a limited liability company, but may be entitled to preferences in the waterfall distribution such that he may receive more than 25% of the proceeds in a sale or other liquidating event of the company.

A person may have ownership or control through any of the following:

- Having joint ownership of an undivided interest in an ownership interest;
- Acting through a nominee, intermediary, custodian, or agent;
- Being a trustee of a trust having authority to dispose of trust assets;
- Being a beneficiary of a trust who is the sole permissible recipient of the trust's income and principal, or has the right to demand a distribution of or withdraw substantially all of the trust's assets;
- Being the grantor or settlor of a revocable trust; or
- Having ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the reporting company.

The following individuals are not beneficial owners:

- 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 reporting company is derived solely from the person's status as an employee;
- A personal whose only interest in the reporting company is through a right of inheritance; and



- A creditor, unless the creditor meets the substantial control or 25% ownership standards.

A reporting company may have owners that are entities as opposed to natural persons. In such a situation, the owner entities must provide the reporting company with the BOI of its owners. A reporting company is required to “drill down” until it has the BOI of a natural person. However, in certain circumstances, as discussed below, if an owner entity has a FinCEN identifier, it can provide its FinCEN identifier to the reporting company instead of the BOI of its beneficial owners.

It can be tricky determining whether a person is a beneficial owner; that is, whether a person directly or indirectly exercises substantial control over the reporting company or owns or controls 25% or more of the ownership interests of the reporting company. To assist reporting companies in navigating this murky area, FinCEN has published a Small Entity Compliance Guide[1] and Frequently Asked Questions[2].

QUESTION 7: WHO IS A COMPANY APPLICANT?

A reporting company formed or registered on or after January 1, 2024 must also identify any “company applicant”. A reporting company created or registered before January 1, 2024 is not required to report company applicants. 31 U.S.C. § 5336(b)(2)(A); 31 C.F.R. § 1010.380(b)(2)(iv).

There are two categories of company applicants – the “direct filer” and the individual who “directs or controls the filing action”. A direct filer must be identified by a reporting company. The Rules provide that a reporting company should limit its company applicants to at most two individuals.

A direct filer is the person who directly files the document forming a domestic company or registering a foreign company to do business in the U.S. A person who directs or controls the filing is primarily responsible for directing or controlling the filing of the document by another, if more than one person is involved in the filing. 31 U.S.C. § 5336(a)(2); 31 C.F.R. § 1010.380(e).

A reporting company is not required to report any change to required information about a company applicant, assuming that such information was correct when first reported. 31 C.F.R. § 1010.380(b)(3)(i).

If a reporting company was formed by a business formation service, such as CSC or CT, its employees would not be company applicants. If a reporting company was formed by a law firm or an accounting firm, the person directly filing the document would be a company applicant and the person who prepared the document or who was supervising such a person would also be a company applicant. For example, an attorney who prepared the certificate and the legal assistant or paralegal who directly filed it would be company applicants.

QUESTION 8: WHEN MUST YOU FILE THE REPORT?

A company created or registered on or after January 1, 2024 must file an initial beneficial ownership information report (“BOI Report”) within 90 days after receiving notice that the company has been formed or registered. A company created or registered before January 1, 2024 must file an initial BOI Report before January 1, 2025.

Please note that under the CTA, it is the reporting company that is responsible for filing the BOI Report. It is not the responsibility of the beneficial owners, the company applicants, or the reporting company’s attorneys or accountants.



QUESTION 9: WHEN MUST YOU UPDATE OR CORRECT YOUR REPORT?

A reporting company is obligated to update its report whenever there is a change in information of the company or a beneficial owner. The Rules state that there is no materiality threshold and the reporting company must report all changes. An update must be filed within 30 days after any change in information reported to FinCEN about the reporting company or any beneficial owner. 31 C.F.R. § 1010.380(a)(2). For example, a reporting company is required to report an update for any of the following changes:

- When a reporting company becomes an exempt entity;
- When an entity no longer qualifies as exempt and becomes a reporting company; or
- When there is a change in the reporting company's beneficial ownership (e.g., a transfer of a beneficial owner's interest after death, or the parent or guardian of a minor is reported as the beneficial owner and the minor reaches the age of majority).

FinCEN does not, however, expect a reporting company to file an updated BOI Report upon its dissolution or termination.

A reporting company must file a corrected BOI Report within 30 days after becoming aware of or having reason to know of any previously reported information was inaccurate when filed and remains inaccurate.

QUESTION 10: WHERE DO YOU FILE THE REPORT?

A reporting company must file its reports electronically through FinCEN's secure filing system or use a third-party service provider to do so, such as CT[3], CSC[4], Cogency[5], or RASi[6]. FinCEN's filing system is currently under development and will not be available until January 1, 2024. Further instructions and technical guidance on how to complete the BOI Report form will be available at www.fincen.gov/boi.

QUESTION 11: WHAT IS A FINCEN IDENTIFIER?

A FinCEN identifier is a unique identifying number that FinCEN will issue to individuals and entities upon request. An individual or entity may receive only one FinCEN identifier.

An individual may electronically apply for a FinCEN identifier by providing the same information in BOI reports. Once a beneficial owner or company applicant has a FinCEN identifier, he or she may provide the reporting company with his or her FinCEN identifier rather than his or her personal information.

A reporting company may request a FinCEN identifier when it submits its BOI report by checking a box on the reporting form. As noted above, a reporting company may report an owner entity's full legal name and FinCEN identifier instead of reporting the BOI of the beneficial owners. However, a reporting company may do so only if:

- An individual is or may be a beneficial owner of the reporting company by virtue of an ownership interest that the individual holds in the other entity; and
- The beneficial owners of the other entity and the beneficial owners the reporting company are the same individuals.



QUESTION 12: WHO HAS ACCESS TO YOUR PERSONAL INFORMATION?

FinCEN will store BOI in a secure nonpublic database – the Beneficial Ownership Secure System (“BOSS”). The general public will not have access to BOI. It will remain confidential and cannot be used or disclosed except as authorized in the CTA and its regulations.

Under the CTA, FinCEN is authorized to disclose BOI only in limited circumstances on receipt of a request from the following entities:

- U.S. federal agencies engaged in national security, intelligence, or law enforcement activities, for use in furtherance of those activities;
- A state, local, or tribal law enforcement agency, with a court’s authorization to seek the information in a criminal or civil investigation;
- A federal agency on behalf of non-U.S. law enforcement or a foreign prosecutor or judge;
- A financial institution subject to customer due diligence requirements, with the consent of the reporting company, to facilitate the financial institution’s compliance with customer due diligence requirements;
- Federal and state regulators assessing financial institutions for compliance with legally required customer due diligence obligations; and
- Officers and employees of the U.S. Treasury Department for tax administration purposes.

QUESTION 13: WHAT HAPPENS IF YOU DON’T COMPLY?

The CTA provides for significant civil and criminal penalties for reporting violations and unauthorized disclosure or use of reported BOI.

Reporting Violations. Reporting violations include (1) willfully failing to report BOI to FinCEN, (2) willfully providing false or fraudulent BOI to FinCEN, and (3) willfully failing to update BOI. 31 U.S.C. § 5336(h)(1). (The definition of “willful” is yet to be determined and may be explained based on either the evasion of reporting requirements or the actual knowledge of inaccuracies.) The penalties may apply to (a) the reporting company, (b) senior officers of the reporting company at the time of its failure to fulfill its obligation to report or update BOI, and (c) any individual who causes a reporting company not to report. 31 C.F.R. § 1010.380(g). Therefore, if a beneficial owner fails to provide BOI to a reporting company, the beneficial owner is subject to the penalties under the CTA.

The civil penalty is not more than \$500 for each day that the violation continues or has not been remedied. The criminal penalties are fines of not more than \$10,000, imprisonment for not more than 2 years, or both.

Unauthorized Disclosure or Use. A civil penalty of not more than \$500 for each day that the unauthorized disclosure or use of BOI continues or has not been remedied. The criminal penalties include fines of not more than \$250,000, or imprisoned for not more than 5 years, or both. If the unauthorized disclosure or use occurs while violating another U.S. law or is part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period, the criminal penalties may include fines of not more than \$500,000, imprisonment for not more than 10 years, or both. 31 U.S.C. § 5336(h)(2).



Safe Harbor. The CTA provides a safe harbor from the civil and criminal penalties. 31 U.S.C. § 5336(h)(3)(C). As noted, a reporting company must file a corrected BOI Report within 30 days after becoming aware of or having reason to know of any previously reported information was inaccurate when filed and remains inaccurate. However, this safe harbor does not extend to inaccuracies that:

- Are corrected more than 90 days after the filing of an inaccurate BOI report, even if a reporting company files a correction promptly after becoming aware of an inaccuracy;
- Were made for the purpose of evading the reporting requirements; or
- Were known to the person submitting the report at the time submitted. 31 U.S.C. § 5336(h)(3)(C)(i).

QUESTION 14: WHAT SHOULD YOU DO NOW?

If you intend to form a company, do so prior to January 1, 2024. This will give you until January 1, 2025 to comply with the CTA.

If you intend to form a company on or after January 1, 2024, you should start gathering BOI from beneficial owners and company applicants.

If you are, or may become, a reporting company, you should amend your governing documents (e.g., bylaws, shareholder agreements, operating agreements, etc.) to:

- require owners to provide their BOI and required documentation to the company;
- impose penalties on owners failing to do so (e.g., indemnification of the company for FinCEN fines, no right to receive dividends or distributions until the required BOI and documentation is provided); and
- provide that the company will maintain the confidentiality of the BOI, except to comply with the CTA.

If you have, or may have, non-owners who may be deemed beneficial owners, such as senior officers, holders of warrants, options, convertible debt, etc., they are not bound to the company's governing documents. Therefore, you may want to amend employment agreements and agreements governing warrants, options, convertible debt, etc. to address an obligation to provide BOI to the company. You may also want to adopt a CTA compliance policy to do likewise.

A reporting company should designate a person responsible to gather BOI from beneficial owners and company applicants and ensure timely filing of reports. It should also establish and maintain a secure process for collecting and storing BOI to prevent unauthorized access.

Additionally, a reporting company should maintain detailed records of correspondence relevant to the preparation and filing of BOI reports. This practice can help establish that any BOI reporting errors were not willful failures, potentially avoiding more severe penalties.

CONCLUSION

Archer & Greiner, P.C. stands ready to assist its clients with their analysis of their obligations under the CTA; for example, determining whether a client is a reporting company and who may or may not be a beneficial owner



required to be included in the reporting company's filing with FinCEN, which advice would be based upon information provided by the client. Clients would remain responsible for filing any required reports with FinCEN, either directly or through a third-party vendor, such as CT, CSC, Cogency, or RASi.

If you have any questions about the Corporate Transparency Act, please contact **Gianfranco Pietrafesa** at gpietrafesa@archerlaw.com or 201-498-8559, **Zhao Li** at zli@archerlaw.com or 856-673-7140, or any member of Archer's **Business Counseling Group**.

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[1] https://www.fincen.gov/sites/default/files/shared/BOI_Small_Compliance_Guide_FINAL_Sept_508C.pdf.

[2] <https://www.fincen.gov/boi-faqs>.

[3] <https://www.wolterskluwer.com/en/solutions/ct-corporation/resources/corporate-transparency-act-resources>.

[4] <https://www.cscglobal.com/service/corporate-filings/corporate-transparency-act>.

[5] https://www.cogencyglobal.com/corporate-transparency-act-resources?utm_campaign=Corporate%20Transparency%20Act&utm_source=hs_email&utm_medium=email&_hsenc=p2ANqtz-8UCLtWlxCMTFBef5EoethfSJkKKp6ctoV-6UrsFircZS5fWQYawvjFeZNXQtA4e2A5i2TJ.

[6] <https://www.rasi.com/compliance-governance/corporate-transparency-act.asp>.

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