



# *Understanding the Corporate Transparency Act*

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# AGENDA

- Introduction
- Primary Goals
- How do you report?
- Penalties
- Who needs to report?
- What needs to be reported?
- Deadlines
- Summary

# INTRODUCTION

- ❖ The Corporate Transparency Act (CTA) is a bipartisan act passed in 2021 to unmask shell and front corporations.
- ❖ Targets the types of corporate structures that “hide” the owners and big decision makers
- ❖ Requires them to reveal their beneficial owners in the hopes of preventing criminals from misusing the U.S. financial system.

# WHO ENFORCES THE CTA?

- ❖ Financial Crimes Enforcement Network (“FinCEN”) is implementing the CTA.
- ❖ FinCen is a part of the U.S. Treasury.
- ❖ Best known for regulating financial institutions and money service businesses.

# CTA'S PRIMARY GOALS

- ❖ Combat money laundering, drug + human trafficking, tax fraud, and other criminal activities
- ❖ Reveal the “bad actors” behind the “shady” companies
- ❖ Minimize the burden on legitimate small businesses

# WHO NEEDS TO REPORT?

Short answer: Reporting Companies

# WHAT IS A REPORTING COMPANY?

## **Domestic Reporting Company**

Any legal business entity  
formed with a filing in any  
state's secretary of state's office  
or tribal equivalent

## **Foreign Reporting Company**

Any legal business entity  
formed abroad and registered to  
do business in any secretary of  
state's office or tribal equivalent

# WHAT IS A REPORTING COMPANY? (Cont'd)

- ❖ Reporting companies include: (depending on state law):
  - Corporations, limited liability companies (LLCs), some partnerships, some statutory trusts
- ❖ Not included:
  - Sole proprietorships, general partnerships



# WHAT IS *NOT* A REPORTING COMPANY?

## THE 23 EXEMPTIONS

- Securities reporting issuer
- Governmental authority
- Bank
- Credit union
- Depository institution holding company
- Money services business
- Securities broker or dealer
- Securities exchange or clearing agency
- Other Exchange Act registered entity
- Investment company or investment adviser
- Venture capital fund adviser
- Insurance company
- State-licensed insurance producer
- Commodity Exchange Act registered entity
- Accounting firm
- Public utility
- Financial market utility
- Pooled investment vehicle
- Tax-exempt entity
- Entity assisting a tax-exempt entity
- Large operating company
- Subsidiary of certain exempt entities
- Inactive entity

# TAX-EXEMPT ENTITY EXEMPTION

Any entity that is:

- ❖ An organization that is described in Sec. 501(c) of the Internal Revenue Code of 1986 and exempt from tax under Sec. 501(a) of the Code
  - 501(c) nonprofit that is exempt paying from taxes
- ❖ A political organization, as defined in Sec. 527(e)(1) of the Code, that is exempt from tax under Sec. 527(a) of the Code, **or**
- ❖ A trust described in paragraph (1) or (2) of Sec. 4947(a) of the Code.
  - Paragraph (1) – charitable trust that is not exempt from paying taxes
  - Paragraph (2) – a nonexempt split-interest trust

# LARGE OPERATING COMPANY EXEMPTION

Any entity that:

- ❖ More than 20 full time U.S. employees,
  - (Can't aggregate number of employees across subsidiaries)
- ❖ A physical operating presence in the U.S.
  - (This **can** include home based businesses!), **AND**
- ❖ More than \$5 million in gross receipts or sales on the previous year's U.S. tax return.
  - Must aggregate sales by U.S. affiliates/subsidiaries.
  - Must exclude gross receipts/sales from outside the U.S.

# INACTIVE ENTITY EXEMPTION

- ❖ Very hard to qualify:
  - Formed before January 1, 2020;
  - No engagement in active business;
  - Not owned in any way by a foreign person;
  - No change in ownership in previous 12 months;
  - No transfer of more than \$1,000 within the previous 12 months; **AND**
  - No assets or ownership interests in any entity in the U.S. or abroad.

# A MOMENT ON TRUSTS

- ❖ Trusts are usually formed with a trust agreement, not a filing in a secretary of state's office. Therefore, trusts can't be reporting companies.
- ❖ However: a trust may own a legal entity that is a reporting company. In that case, the trustee is a beneficial owner of the reporting company if the trustee meets one of the tests for beneficial ownership (see next section).
  - A sole mandatory income beneficiary of a trust is also a beneficial owner under these circumstances.

# EXEMPTIONS – FINAL THOUGHTS

- ❖ CTA lets FinCEN add exemptions, but FinCEN explicitly rejected a “law firm exemption.”
- ❖ Initial reports: no need to tell FinCEN you’re exempt.
- ❖ But: if a reporting company loses its exemption, then it has 30 days to register.
  - Examples:
    - Loses tax-exempt status for more than 180 days
    - Drops below 20 employees, losing the benefit of the Large Operating Company exemption

# HOW DO YOU REPORT?

- ❖ On or after January 1, 2024, submit an electronic form through FinCEN's secure filing system website.
  - [www.fincen.gov/boi](http://www.fincen.gov/boi)
  - Form is called the "BOI Report".
- ❖ No Fee required.
- ❖ No annual reporting – only submit an updated report when there is a change to the business.
- ❖ NOTE – FinCEN has not yet published the form and will not be accepting applications prior to January 1, 2024.

# PENALTIES ☹️

- ❖ Penalties can occur for willfully:
  - 1) Failing to report or update a reporting company's beneficial ownership information, ***and***
  - 2) Providing false or fraudulent beneficial ownership information
- ❖ **Civil**: \$500 per day for a continuing violation, up to a maximum of \$10,000
- ❖ **Criminal**: Up to 2 years in a federal prison



# WHAT NEEDS TO BE REPORTED?

Short answer:

Reporting company + beneficial owner +  
reporting company applicant

# REPORTING RECORDING COMPANY INFORMATION:

- ❖ The recording company bears the burden of all reporting.
- ❖ The company must certify that the report is “true, correct and complete.”
- ❖ The reporting company must report:
  - ✓ Its full legal name
  - ✓ All trade names and d/b/a's
  - ✓ Address of its principal place of business (if domestic) or primary U.S. location (if foreign)
  - ✓ State of formation or registration
  - ✓ IRS taxpayer ID number (“TIN” / “EIN”) or foreign equivalent

# WHO IS A BENEFICIAL OWNER?

- ❖ A person or entity that, directly or indirectly,
  - Exerts “substantial control” over a reporting company or
  - Owns or controls at least 25% of the outstanding interests of a reporting company.
- ❖ CTA requires reporting companies to report **ALL** individuals/entities who qualify under either definition.
- ❖ All reporting companies will have at least 1 beneficial owner.

# BENEFICIAL OWNER

## #1 – Exert “substantial control”

- ❖ Four ways to exert “substantial control”:
  - 1) Serves as a “senior officer”;
    - General counsel may qualify
    - But not “treasurer” or “secretary”
  - 2) Has authority to appoint/remove a majority of the board of directors or any senior officer;
  - 3) Exerts “substantial influence over important decisions” made by the reporting company; **OR**
  - 4) Has any other form of substantial control over the reporting company (the catch-all).

# BENEFICIAL OWNER

## #1 – “substantial control” – cont’d

- ❖ What are “important decisions”? FinCEN’s non-exhaustive list of factors:
  - 1) Deciding whether to sell, lease or transfer assets;
  - 2) Reorganization, dissolution or merger;
  - 3) Making major purchases, issuing equity, incurring debt, or approving the budget;
  - 4) Selecting/terminating business lines or geographic focus;
  - 5) Determining executive compensation or incentives;
  - 6) Entering/terminating significant contracts; or
  - 7) Amending formation documents, bylaws, and significant policies/procedures.

# BENEFICIAL OWNER

## #2 – Own or control 25%

- ❖ “Ownership” is defined broadly:
  - Stock, equity, convertible and profit interests
  - Joint and indirect ownership count toward the total
  - Options treated as exercised
  - Sole income beneficiary of trust or beneficiary with right to withdraw substantially all trust assets
  - Settlor of trust with right to revoke trust
- ❖ If calculation inconclusive - “Vote or Value” approach
  - Holds at least 25% of any class of interests, or
  - Owns at least 25% of value of the ownership interests

# WHO IS NOT A BENEFICIAL OWNER?

## 5 Exceptions

- 1) Minor children
  - Report parent/guardian's info instead, identifying the parent/guardian as such
  - To determine when child reaches age of majority: use law of the state where the *entity's formation filing took place*, not state where child lives.
- 2) An individual acting on behalf of a beneficial owner
  - Many attorneys acting on behalf of a client will fall here

# WHO IS *NOT* A BENEFICIAL OWNER?

- 3) A non-senior officer employee who exerts substantial control over the company solely from their employment status
  - aka: “Employees acting as employees”
  - Senior officers are explicitly ineligible for this exception
- 4) An individual who has a future interest in the company through a right of inheritance
  - Future/contingent interests do not create ownership
- 5) Creditors for a quantified sum of money
  - But: creditors who exert substantial control may lose the benefit of this exception



# DATA TO REPORT ON BENEFICIAL OWNERS

- ✓ Full legal name
- ✓ Date of birth
- ✓ Personal “residential street address”
- ✓ Unique ID number from an unexpired identification document
- ✓ Jurisdiction which issued the ID
- ✓ Scan of the ID itself, which must include a photo
- ✓ But not Social Security Number

# DATA TO REPORT ON BENEFICIAL OWNERS – cont'd

- ✓ U.S. driver's license or state-issued ID is preferred
  - If unavailable, foreign passport is OK
- ✓ Document must be current when submitted
- ✓ No duty to update: document is renewed, new photo
- ✓ Duty to update within 30 days:
  - Change to who is a beneficial owner
  - Changed data about beneficial owners: new name, address, jurisdiction issuing the ID

# WHO IS A RECORDING COMPANY APPLICANT?

- ❖ Two ways to become a recording company's "applicant":
  - 1) Actually makes the filing, **or**
  - 2) Directs or controls the decision to file the formation document with the secretary of state's or tribal office.
    - Add this person **only if** there was more than 1 individual involved in filing the company's creation or first registration document
- ❖ FinCEN capped the number of applicants at **two**.
- ❖ Only individuals can be company applicants, not businesses.
- ❖ A reporting company's applicants could be (1) its attorney and (2) their paralegal/secretary.

# WHO IS A RECORDING COMPANY APPLICANT?

- ❖ Companies already formed **before** Jan. 1, 2024:
  - DO NOT provide applicants' info
- ❖ Companies formed **on or after** Jan. 1, 2024:
  - DO provide up to 2 applicants' info
  - However: No need to keep applicants' info updated

# RECORDING COMPANY'S APPLICANT INFORMATION

You must report the following information:

- ✓ Full legal name,
- ✓ Date of birth,
- ✓ Home or Business street address, ***and***
- ✓ The unique ID number from a government-issued identification document + a picture of the document

# WHEN TO REPORT

The CTA goes into effect on January 1, 2024

FinCen will begin accepting reports on  
**January 1, 2024**

# DEADLINES!

Company created/registered:

**Before January 1, 2024**

You have until **January 1, 2025**, to file your initial beneficial ownership report.

**Between January 1, 2024 – January 1, 2025**

You have **90 days** after creation/registration to file your initial beneficial ownership report.

**After January 1, 2025**

You only have **30 days** after creation/registration to file your initial beneficial ownership report.

# WHEN ARE UPDATED REPORTS DUE?

- ❖ All updates due within 30 days of a change
  - Change to identity of beneficial owners
    - Ex.: BO dies; clock starts when estate is settled
    - Exs: New limited partner added, change share ownership
- ❖ Change to BO's reportable data (name, address, ID#)
- ❖ Gain/loss of an exemption from the definition of an RC
  - Ex.: Entity loses tax-exempt status
- ❖ Loss of an exception from the definition of a BO
  - Ex.: Minor beneficial owner attains majority under the law of the state where the RC is registered



# SUMMARY

The Corporate Transparency Act is not designed to burden small business owners like yourselves; however, strict adherence is required as a matter of national security. If you have any questions, please reach out to LSEM and we will connect you with the proper resources.



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