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):
  o Corporations, limited liability companies (LLCs), some partnerships, some statutory trusts

❖ Not included:
  o 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
  o 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.
  o Paragraph (1) – charitable trust that is not exempt from paying taxes
  o Paragraph (2) – a nonexempt split-interest trust
LARGE OPERATING COMPANY EXEMPTION

Any entity that:

❖ More than 20 full time U.S. employees,
   o (Can’t aggregate number of employees across subsidiaries)

❖ A physical operating presence in the U.S
   o (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.
   o Must aggregate sales by U.S. affiliates/subsidiaries.
   o 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.
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.
  o www.fincen.gov/boi
  o 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,
  o Exerts “substantial control” over a reporting company or
  o 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).
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:
  o Stock, equity, convertible and profit interests
  o Joint and indirect ownership count toward the total
  o Options treated as exercised
  o Sole income beneficiary of trust or beneficiary with right to withdraw substantially all trust assets
  o Settlor of trust with right to revoke trust

❖ If calculation inconclusive - “Vote or Value” approach
  o Holds at least 25% of any class of interests, or
  o Owns at least 25% of value of the ownership interests
WHO IS NOT A BENEFICIAL OWNER?

5 Exceptions

1) Minor children
   o Report parent/guardian’s info instead, identifying the parent/guardian as such
   o 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
   o 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
   o aka: “Employees acting as employees”
   o Senior officers are explicitly ineligible for this exception

4) An individual who has a future interest in the company through a right of inheritance
   o Future/contingent interests do not create ownership

5) Creditors for a quantified sum of money
   o 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.
     o 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:
  o DO NOT provide applicants’ info

❖ Companies formed on or after Jan. 1, 2024:
  o DO provide up to 2 applicants’ info
  o 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
    • Ex.: 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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