

Locke Lord QuickStudy: Corporate Transparency Act Goes ?Into Effect January 1st

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The material set forth below was developed before the 2024 and 2025 district court injunctions regarding the CTA (which were subsequently stayed and continue to be litigated). As a result, the material set forth below, including filing deadlines, may not be current. Please consult FinCEN's [website](#) for the latest filing due dates and other information regarding the CTA and its requirements.

The [Corporate Transparency Act](#) (“CTA”), which goes into effect on January 1, 2024, requires filings with the Financial Crimes Enforcement Network (“FinCEN”) (part of the U.S. Department of the Treasury) by most newly formed and many smaller existing corporations, limited liability companies, limited partnerships and other entities formed by a filing with a state Secretary of State or similar authority (each a “Reporting Company”). The CTA was enacted as part of the Anti-Money Laundering Act of 2020. Its principal focus is on start-ups, small companies, and shell companies with limited to no operations, which are the entities perceived to be those most often found engaging in money laundering and other illicit activities. The CTA and FinCEN's [regulations](#) and guidance, are written in a very broad and inclusive way to cover all Reporting Companies unless they meet one of the statutory exemptions.

Reporting Companies formed on or after January 1, 2024, will be required to file a report electronically with FinCEN within 30 days following the date of its formation (90 days if a proposed amendment to the regulations is adopted and the company is formed in 2024).

Reporting Companies existing on December 31, 2023, will be required to file a report with FinCEN beginning January 1, 2024, and before January 1, 2025.

The report must provide information about the company and personal information about those individuals (“Beneficial Owners”) in substantial control of the Reporting Company. “Substantial Control” derives from (a) significant ownership interests or (b) the right or ability to exercise substantial control through official positions or contractual or other arrangements. A Reporting Company formed on or after January 1, 2024, also will be required to file personal information for up to two “Company Applicants.” No Company Applicant information is required to be filed for Reporting Companies existing on or before December 31, 2023.

The information in the CTA report to FinCEN will not be available to the general public, but it will be available to virtually all federal security, intelligence and law enforcement agencies, and state law enforcement agencies, as well as foreign officials who are granted access via submission of a request through a U.S. federal government

agency. If the Reporting Company gives consent, the filing will also be available to authorized financial institutions for purposes of their meeting the “know your customer regulations” under the Bank Secrecy Act.

What is a Reporting Company? Except as noted under “Exempt Companies” below, a Reporting Company is (a) any company that is or was created by filing a document with the Secretary of State or a similar office in any state, U.S. territory or federally recognized Indian Tribe, or (b) is a foreign-formed entity that is registered with a Secretary of State or similar office in any state, U.S. territory or federally recognized Indian Tribe to do business in the United States.

Exempt Companies. Sole proprietorships, common law trusts, and general partnerships are not currently within the definition of a Reporting Company because they are not formed by filing a document with a Secretary of State or similar official. Accordingly, no filing from these businesses will be required at this time.

Entities already subject to regulatory ownership reporting requirements, such as publicly traded companies registered under the Securities Exchange Act of 1934, banks, credit unions, investment companies, registered investment advisors, investment vehicles managed by registered investment advisors, many accounting firms, and government entities are also exempt.

A significant number of exempt entities will fall under the Large Company Exemption, but only if the entity meets all three of the following requirements:

1. it has more than 20 full-time employees in the United States;
2. it filed in the previous year a federal tax return reporting more than \$5 million in gross sales or receipts; and
3. it has an operating physical location in the United States.

Importantly, note that holding companies of entities meeting the three-prong test above which do not have their own 20 full time employees will not qualify for the exemption. Generally, aggregation of the number of employees in separate but related entities is not permitted for meeting the 20-employee test. Companies directly or indirectly owning real estate, without employees, likely will be required to report to FinCEN under the CTA as Reporting Companies.

Conversely, wholly owned subsidiaries of entities exempt from reporting also generally are exempt.

Because a newly formed entity will not have filed a federal tax return in the previous year, it will not be able to satisfy the federal income tax return reporting requirement, and thus the exemption will not be available to it initially.

What is a Beneficial Owner? The general rule is that a Beneficial Owner is any individual who (i) directly or indirectly exercises “Substantial Control” over the Reporting Company or (ii) owns or controls not less than 25% of the ownership interests of the Reporting Company. Understanding this general rule requires knowing what the CTA deems to be “Substantial Control” and how someone may be deemed a 25% owner, even without a substantial direct ownership interest. Although there can be and will likely be more than one Beneficial Owner reported for each Reporting Company, there must be at least one Beneficial Owner reported for each Reporting Company.

“Substantial Control” is defined by the CTA and FinCEN very expansively. Board members, managers and managing members of an LLC or general partners of a limited partnership, executive officers and anybody exercising similar control over important matters concerning the entity, its business or finances will be deemed to have “Substantial Control.” Many different types of contractual, and even informal, arrangements may confer “Substantial Control,” including but not limited to a person having the right to elect or cause the removal of a director or officer, a person having control over another person who is a director or officer, a person having approval rights over major decisions, and a person having control over an intermediary entity that gives that person effective control over the Reporting Company. All such persons will be considered Beneficial Owners for whom reports must be filed under the CTA. Having instruments, such as convertible debt, options, rights to purchase or subscribe for equity, etc., will be counted towards the 25% threshold for which a person will be deemed to have or control the requisite ownership interest for reporting purposes and also may be considered to convey “Substantial Control,” thus making the holder of the instrument a Beneficial Owner.

For companies with simple governance structures this analysis will be fairly simple. However, as the complexity of ownership, profits waterfalls and governance structures increase, the analysis may become more difficult. Generally, true credit arrangements, designed to secure the right to repayment, will not create a Beneficial Owner relationship sufficient to require disclosure as a Beneficial Owner of an entity.

The second element, “percent of ownership,” may also entail complexity. A 25% equity ownership may be difficult to determine when there are varying classes of stock or member or partner capital or income interests. If the shares or interests are held in a trust, the sole beneficiary of the trust and the trustees, as well as any other persons exercising control, will likely be considered Beneficial Owners for reporting purposes. As an example, a member of an LLC with a 15% percentage interest but a 40% capital or profits interest will likely be a Beneficial Owner. A shareholder whose stock has preference or conversion rights, or both, may be deemed to own 25% or more of the equity by virtue of dividend or liquidation preferences or conversion rights conferred by the stock.

Because potential penalties (see below) may be significant, and for most people reporting as a Beneficial Owner will not have any negative consequences, it would be prudent to err on the side of reporting as a Beneficial Owner in cases that are difficult to resolve with certainty.

What Must be Included in the Reporting Company’s Report to FinCEN?

For the Reporting Company (including companies that no longer qualify for any exemption):?

1. Full legal name from document of formation t.
2. Trade names (d/b/a, fictitious names or key names under which business is conducted)?
3. Current address (street address of Company headquarters or main facility in the U.S.)?
4. State of formation
5. Taxpayer ID Number issued by the IRS

For Each Beneficial Owner/Company Applicant:?

1. ?Full legal name ?
2. ?Date of birth
3. ?Current street address

- i. For Company Applicant, residential or office address.
 - ii. For others, current residential address
1. Government issued identification number (i.e., U.S. passport number, currently effective ID document issued by a state, local government or Indian tribe (e.g., current driver's license number) or current passport issued by the U.S. or a foreign government if none of the above is available), along with copy of the applicable Government Issued ID Document with the reported number. ?

Note: If the Beneficial Owner or Company Applicant has applied for and received a FinCEN Identifier, that is sufficient to report to the Reporting Company in lieu of the above items.?

Who Must File the Report? Any Reporting Company newly formed on or after January 1, 2024, unless it is exempt, must timely file the report with FinCEN electronically on or after January 1, 2024. Reporting Companies in existence prior to January 1, 2024, unless it is exempt, must file with FinCEN by January 1, 2025. Accordingly, the Reporting Company must obtain the necessary information from its Beneficial Owners to be able to determine if the Reporting Company has any applicable exemption, and who is a Beneficial Owner for CTA reporting purposes. Reporting Companies should consider appointing an executive as point person to collect the necessary data from the Company and its Beneficial Owners for the Reporting Company to file an accurate and complete CTA report with FinCEN, file the report (or engage a third-party service provider to file the report) with FinCEN, and securely maintain the underlying data necessary to support the information contained in each FinCEN report and exemption from filing.

A Reporting Company entitled to claim an exemption from filing is not required to file a report, unless it ceases to be entitled to any exemption.

A Reporting Company must make a diligent effort to obtain information from each person who is or may be deemed to be a Beneficial Owner or Company Applicant required to be reported. It is important that the Reporting Company preserve and maintain documentation to support the information filed with FinCEN concerning the Reporting Company, its Beneficial Owners and Company Applicants, and any claim of an exemption from filing.

Updating Reports. If the information in a report becomes outdated, the Reporting Company is required to file an amended report within 30 days following the event causing the report to become outdated. Some examples of the need to update a report include name changes for a Beneficial Owner, a change in address for the Reporting Company or for a Beneficial Owner, the expiration of the government issued ID document of a Beneficial Owner, or the issuance of a new government issued ID number or government issued ID document to the Beneficial Owner. If a Reporting Company files a CTA report and later is entitled to claim an exemption from filing, it must file an amendment claiming the exemption.

Who Are the Company Applicants? For FinCEN reporting purposes, these are up to two of the individuals who file or cause the filing of the document that creates the Reporting Company, including any individual who "directs or controls" that filing by another person. For purposes of the two-person limit, the Company Applicants would be the person who files the formation document, plus the person most responsible for directing or causing the formation of the Company.

Penalties. Willful failure to timely report information concerning the Reporting Company and complete Beneficial

Owner information to FinCEN, or to update that information, or willfully filing false entity or Beneficial Owner information, may subject the Reporting Company or Company Applicant to a daily civil penalty, a criminal fine or possible imprisonment.

Locke Lord LLP has established a team familiar with the CTA and the FinCEN regulations. It stands ready to assist its clients with their analysis of possible exemptions from the filing requirements and determining who may or may not be a Beneficial Owner required to be included in the Company's filings with FinCEN. Clients may make the required filings themselves or may use third-party service providers to do so. FinCEN has issued a Guide for small businesses and has issued FAQs to assist companies to work through the filing requirements and the need to amend and update filed reports. The Guide can be accessed here: [Small Entity Compliance Guide – Beneficial Ownership Information Reporting Requirements](#).

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