Corporations, LLCs & Partnerships (Https://Businesslawtoday.Org/Practice-Area/Corporations-Llcs-Partnerships/)

The Corporate Transparency Act Will Change the Way You Practice

19 Min Read By: Robert E. Ward (/author/robert-e-ward/) | Yesterday

The Corporate Transparency Act of 2020 (the "***CTA***") was enacted as part of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021.[1] At the core of the CTA are reporting requirements imposed on substantially every small business organized or registered to conduct business in the United States through any type of limited liability entity. Reporting companies will be required to submit identifying information regarding their owners and individuals who participate in the formation and domestic registration of those businesses. Implementation of the CTA is largely deferred. Its reporting requirements take effect on the date regulations prescribed by the Secretary of the Treasury become effective.[2] No indication

has been given as to when final regulations may be issued, although the proposed regulations discussed later in this article suggest the guidance necessary for implementation is being assembled.

WHO IS REQUIRED TO REPORT?

Domestic or foreign companies may be required to report under the CTA. Domestic entities subject to reporting requirements include corporations, limited liability companies, and any other entity "that is created by filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe."[3] Thus, domestic reporting companies will also include limited partnerships, limited liability partnerships, limited liability limited partnerships, business trusts, and any other entity offering limited liability to its owners by virtue of a State or Tribal charter. Foreign entities that have registered to do business by filing with a secretary of state or similar office of any State or tribal jurisdiction are subject to the same reporting requirements as domestic entities.

WHAT COMPANIES ARE NOT SUBJECT TO REPORTING REQUIREMENTS?

The scope and purpose of the CTA is best understood by recognizing the types of companies that are exempt from its reporting requirements. The proposed regulations identify more than 22 different types of exempt entities. The vast majority of these exempt entities are subject to state or federal supervision, such as companies that report to securities, investment, insurance, and banking regulators.[4] Exemptions are also extended to public companies issuing securities under § 12 of the Securities Exchange Act of 1934, [5] governmental authorities, venture-capital fund advisors, public utilities, pooled investment vehicles, tax exempt entities, and entities assisting tax exempt entities. Also exempt are "large operating companies," defined as any entity that:

- employs more than 20 full-time employees in the United States,

- has an operating presence at a physical office in the United States, and
- filed a federal income tax return or information return for the prior year reporting more than $5 million in gross receipts or sales, excluding gross receipts or sales outside the United States.[6]

In the case of an entity that reports as part of an affiliated group under a consolidated return, the $5 million threshold applies to the amount reported on the consolidated return for the entire group.[7] Thus, any privately-held, for-profit business operating through a limited liability entity in the United States will be subject to the reporting requirements of the CTA unless it satisfies the definition of a "large operating company" and or qualifies for another exemption.

Generally, existing entities get no relief and, as explained below, are subject to the same reporting requirements as newly formed entities. However, certain inactive entities are exempt from the reporting requirements of the CTA. Entities are considered "inactive" if such entities were in existence on or before January 1, 2020, and such entities:

- are not engaged in active business,
- are not owned by a foreign person (directly or indirectly, wholly or partially),
- have not experienced any change of ownership in the preceding 12-month period,
- have not sent or received any funds in an amount greater than $1,000 either directly or through any financial account in which the entity or any affiliate of the entity has an interest in the preceding 12-month period, and
- do not otherwise hold any kind or type of assets (including an equity interest in any limited liability entity).[8]

WHAT INFORMATION ABOUT THE COMPANY MUST BE REPORTED?

The CTA requires reporting companies to disclose:

- the full name of the reporting company,
- any trade name or "doing business as" name of the reporting company,
- the business street address,
- State or Tribal jurisdiction of formation (or, in the case of a foreign entity subject to CTA reporting, the State or Tribal jurisdiction in which the foreign company first registered), and
- the taxpayer identification number (TIN) under which the reporting company reports to the Internal Revenue Service.[9] If the reporting company has not yet been issued a TIN, it may instead use the Dunn and Bradstreet Data Universal Numbering System Number of the reporting company or Legal Entity Identifier.[10]

WHICH INDIVIDUALS ARE SUBJECT TO DISCLOSURE BY THE REPORTING COMPANY?

In addition to the information regarding the reporting company that must be disclosed under the CTA, the reporting company must also provide information regarding every individual who is a beneficial owner and every individual who is a company applicant. The proposed regulations define a beneficial owner as "any individual who, directly or indirectly, either exercises substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such reporting company."[11]

HOW IS "SUBSTANTIAL CONTROL" OF A REPORTING COMPANY DETERMINED?

For purposes of defining a "beneficial owner," substantial control over a reporting company is defined to include:

- service as a senior officer of the reporting company,
- authority over the appointment or removal of any senior officer or a majority or dominant minority of the members of the board of directors (or similar body),
- direction, determination, or decision of, or substantial influence over, important matters affecting the reporting

company as more specifically set forth in the proposed regulations, and
- "[a]ny other form of substantial control over the reporting company."[12]

The proposed regulations further clarify the circumstances in which an individual's authority will be viewed as sufficiently substantial as to require reporting information regarding that individual. Regardless of office or title, substantial control over a reporting company includes the ability to direct, determine, decide, or exercise substantial influence over important matters affecting the reporting company. Such matters include

- the nature, scope, or attributes of the business conducted by the reporting company, including mortgage, lease, sale, or other transfers of its principal assets, reorganization, dissolution, or merger of the reporting company,
- major expenditures or incurring significant debt,
- issuance of any equity interests by the reporting company,
- approval of the operating budget of the reporting company,
- selection or termination of business lines or geographic areas in which the reporting company does business,
- approval of compensation schemes,
- adoption of incentive programs for senior officers,
- approval, performance, or termination of important contracts,
- amendment of any substantial governance documents of the reporting company, including the articles of incorporation, other formation documents,
- amendment of important polices or procedures of the reporting company, or
- exercise of any other form of substantial control over the reporting company.

The person executing the foregoing authority with respect to a reporting company will be subject to the disclosure requirements of the CTA.[13] The means through which such control is exercised by an individual is irrelevant and such

control may be direct or indirect, formal or informal, including simple business relationships. An individual may be deemed to have substantial control for purposes of the CTA if the ability to exercise substantial control (as set forth in the CTA) exists, even if such control is never actually exercised.[14]

Disclosure of information regarding non-controlling owners is required if their ownership of the reporting company equals or exceeds 25 percent. Ownership interest is broadly defined to include a variety of interests. Any type of equity interest — whether financial or simply voting — including "participation in a profit-sharing arrangement" is sufficient to be measured and considered to identify beneficial owners. In the case of non-corporate entities, any proprietary interest, any interest in capital or profits including limited and general partnership interests must be accounted for. Less direct interests are also considered ownership interests, including convertible debt, warrants, rights to purchase or subscribe to equity interests, and any "put, call, straddle, or other option or privilege of buying or selling" any ownership interest.[15]

Measuring whether an individual owns or controls 25 percent of the ownership interests of a reporting company requires accounting for "all ownership interests of any class or type, and the percentage of such ownership interests that an individual owns or controls shall be determined by aggregating all of the individual's ownership interests in comparison to the undiluted ownership interests of the company."[16] Consistent with the statute, the proposed regulations are clear that certain equity owners will be exempt and, therefore, not subject to reporting, including:

- minor children (provided the reporting company discloses the required information regarding the parent or legal guardian of the minor child);
- individuals acting as nominees, intermediaries, custodians, or agents;
- employees of reporting companies "acting solely as an employee and not as a senior officer, whose substantial control over or economic benefits from such entity are

derived solely from the employment status of the employee";
- individuals whose only interest is an expectancy through a right of inheritance; and
- creditors of the reporting company.[17]

With respect to creditors, the proposed regulations make it clear that creditors who are not required to be disclosed are individuals whose beneficial ownership is derived "solely through rights or interests in the company for the payment of a predetermined sum of money…and the payment of interest on such debt."[18] If the right or interest in the value of the reporting company is a right or interest in its value or profits, such an obligation is not one "for payment of a predetermined sum" even if it takes the form of a debt instrument. This means participating debt must be accounted for as an ownership interest.

MUST THE OWNERSHIP INTEREST IN THE REPORTING COMPANY BE OWNED BY THE BENEFICIAL OWNER?

An individual may be deemed a beneficial owner in a reporting company without holding an ownership interest in such reporting company. Not only are the equity and other interests described above sufficient to establish beneficial ownership, whether owned directly or indirectly, but beneficial ownership may also exist when the beneficial owner shares ownership or does not directly or indirectly hold the ownership interest. Specific examples set forth in the proposed regulations include:

- joint ownership,
- control of an ownership interest owned by another, and
- holding an interest as a settlor, trustee, or beneficiary of a trust or similar arrangement that holds the ownership interest.[19]

In the case of an ownership interest owned or controlled by a trust, the identity of the trustee or other individuals (if any) with the authority to dispose of trust assets will always

require disclosure. In addition, if the trust has a single beneficiary that is the sole permissible recipient of income and principal from the trust, the identity and other reporting information regarding such beneficiary must be disclosed. In the case of a trust with more than one beneficiary, disclosure of information is only required of those beneficiaries who have the right to withdraw or demand distributions of substantially all the trust assets.[20] If the settlor of the trust has the ability to revoke the trust or otherwise withdraw trust assets, the identity and other information regarding the settlor of the trust must be disclosed. Thus, in the right set of circumstances, an ownership interest in a reporting company held through a trust may require disclosure of the trustee, one or more beneficiaries, and the settlor of that trust. It is probably not coincidental that the revocation and withdrawal rights that make settlors or beneficiaries subject to disclosure also make those persons owners of trust income and corpus under the grantor trust rules of subpart E of the Internal Revenue Code.[21]

WHO ARE "COMPANY APPLICANTS" REQUIRING DISCLOSURE?

For professionals involved in entity formation, the most intrusive aspect of the CTA is the requirement for disclosure of information regarding company applicants. The proposed regulations define the term "company applicant" to mean any individual who files the document that creates the domestic reporting company or registers a foreign reporting company "including any individual who directs or controls the filing of such document by another person…."[22] Thus, a company applicant is not only the lawyer or paralegal who files the articles of incorporation, certificate of limited partnership, articles of organization, or similar document for establishing a domestic company (or the registration of a foreign entity) with a State or Tribal authority, but also a partner, senior lawyer, or any other person directing the activity of the paralegal or associate undertaking the organization or registration.

WHAT INFORMATION MUST BE REPORTED REGARDING BENEFICIARIES AND COMPANY APPLICANTS?

In the case of every individual who is a beneficial owner and every individual who is a company applicant with respect to a reporting company, the reporting company must disclose

- the full legal name of the individual;
- the individual's date of birth;
- the complete address of either:
  - such individual's business, in the case of a company applicant who files the document organizing or registering the company in the course of such individual's business, or
  - in the case of any other individual, the residential street address used by that individual for tax residency purposes; and
- either the passport number, driver's license number, or other unique identifying number from a non-expired identification document issued to the individual by a State, local, or Tribal government for identification purposes.[23]

In addition to providing the foregoing information, the reporting company must also provide a picture ID for the beneficial owner or company applicant which includes the disclosed identification number. In lieu of any beneficial owner or company applicant providing the information described above, the individual who is a beneficial owner or company applicant may, instead, provide a FinCEN identifier.[24] The proposed regulations do not provide guidance regarding how an individual may obtain a FinCEN identifier. Presumably that guidance will be forthcoming and will involve direct submission of the information described above to FinCEN. The proposed regulations require updating and correcting information submitted to FinCEN regarding beneficial owners and company applicants "at the same time and in the same manner" as updated or corrected reports are required to be submitted by reporting companies.[25]

WHEN IS REPORTING REQUIRED?

The initial report for domestic or foreign reporting companies must be filed within 14 calendar days of the date of formation (in the case of a domestic reporting company) or within 14 calendar days of registration (in the case of a foreign reporting company).[26] For entities that pre-exist the effective date of final regulations, the initial report of the company is due not later than one year after the effective date of the final regulations.[27] In the case of an entity that no longer meets the criteria for exemption, the initial report is due within 30 calendar days after the date the exemption criteria are no longer satisfied.[28] Initial reports must be updated in a variety of circumstances, including:

- within 30 days of the date on which there is "any change with respect to any information previously provided, including changes with respect to beneficial ownership, as well as any change with respect to the information reported for any particular beneficial owner or applicant";[29]
- when the reporting company becomes an exempt entity; and
- within 30 days of settlement of the estate of a deceased beneficial owner.

In addition to updating the initial reports for changes in the status of the company, its beneficial owners, and company applicants, reporting companies are also obligated to correct inaccuracies and information reported within 14 calendar days after the date on which the reporting company becomes aware or has reason to know any required information previously submitted to FinCEN was inaccurate when filed and remains inaccurate.[30] How reporting companies will know or compel disclosure of corrections to the reporting information of beneficial owners and company applicants remains a mystery.

IN WHAT FORM IS INFORMATION REQUIRED TO BE DISCLOSED?

The proposed regulations do not provide any further elucidation as to the manner or form under which reporting will be undertaken other than to specify that it be done "in the form and manner that FinCEN shall prescribe in the forms and instructions for such report or application…."[31]

WHAT PENALTIES APPLY TO FAILURES TO REPORT COMPLETELY AND ACCURATELY?

The proposed regulations do not elaborate on the penalty regime that will apply in the case of failures to report or for inaccuracies in reporting. Consistent with the statue, the proposed regulations simply assert that "it shall be unlawful for any person to willfully provide or attempt to provide, false or fraudulent beneficial ownership information…or to willfully fail to report, complete, or update beneficial ownership to FinCEN in accordance with this section."[32] The proposed regulations do make it clear that a willful failure to report is subject to penalty. Persons who direct or control others with reporting obligations will also be held to have violated the CTA.[33]

OBSERVATIONS

The proposed regulations fill in some, but not all, of the gaps left by the CTA's statutory language. For example, the proposed regulations provide no definitive guidance with respect to attribution of beneficial ownership other than as described above. Thus, there are no specific rules corresponding to §318 or §958 of the Internal Revenue Code by which constructive ownership would be attributed to a potential beneficial owner. While the proposed regulations require accounting for a broad array of ownership interests — including convertible debt, straddles, jointly owned interests, and beneficial interests in trusts — they provide no guidance as to measurement of these interests for purposes of the 25 percent threshold for disclosure of their owners, although aggregation of such interests with an individual's other ownership interests is clearly required.

There appear to be multiple ways to avoid the reporting requirements:

- Only entities deriving limited liability through State or Tribal charter (in the case of domestic entities) or registration with State or Tribal authorities (in the case of foreign entities) are subject to reporting.
- Ownership of a reporting company through a non-grantor multi-beneficiary trust with respect to which the beneficiaries do not possess withdrawal rights requires disclosure of information regarding the trustee, but not the settlors or beneficiaries of the trust. Consequently, trusts with Crummey powers will not avoid disclosure of beneficiaries holding powers of withdrawal, nor will section 2503(c) trusts. However, many settlors may be willing to forego annual exclusions for gifts to such trusts if the identity and information regarding beneficiaries can be protected.
- Organization of the reporting company as one of the types of organizations exempted from reporting avoids disclosure of beneficial owners and company applicants, as well. Obviously, this opportunity is limited and may require a willingness to assume other reporting obligations and regulatory oversight. However, in certain cases, regulatory oversight may not exist or may not extend to disclosure of individuals exercising substantial control or satisfying the 25 percent beneficial ownership threshold of the CTA.

Although the information the CTA requires regarding the reporting companies may be seen as not significantly greater than that necessary to organize or register the company with State or Tribal authorities, do not be deceived. The reporting obligations the proposed regulations impose on reporting companies regarding the professionals who organize those companies are clearly intended to compel disclosure of the beneficial owners of those reporting companies. Without proper planning, the corporate curtain of secrecy will be lifted.

The CTA will significantly impact lawyers who organize business entities. The exposure it creates for counsel and their staff involved in preparing and filing organizational documents will require rethinking the information to be gathered and the content of client engagement letters. If a

client is unwilling to provide the information the CTA requires, the terms of the law firm's engagement should permit termination of its representation. It would be prudent to gather the necessary information regarding beneficial owners before the engagement commences and to set forth in engagement letters who will be responsible for updating and correcting information previously filed. New engagement letters will likely be compelled for existing clients when they form new entities and when entities formed prior to the effective date of the CTA are compelled to report to FinCEN.

There is no grandfathering of existing entities unless those entities are "inactive" as defined by the CTA. Making this determination requires the ability to contact the persons who currently operate the reporting company and solicit information regarding its operations, revenues, and expenditures. Every existing entity provided limited liability by a State or Tribal government and every foreign entity registered to do business with a State or Tribal government that is not otherwise exempt must not only provide information about itself, but also must provide information about its beneficial owners. Reluctance to provide required information should be anticipated, as should be possible reluctance to compensate counsel for the effort involved to collect and report that information to FinCEN. Like it or not, the CTA will change the way you practice law.

Robert E. Ward, J.D., LL.M. is a fellow of the American College of Tax Counsel who advises businesses and individuals on U.S. international and domestic tax matters from his firm's offices in Vancouver, British Columbia and Bethesda, Maryland.

1. Pub. L. No. 116-283 (January 1, 2021) §6403; 31 USC §5336. ↑

2. "The requirements of this subsection shall take effect on the effective date of the regulations prescribed by the Secretary of the Treasury under this subsection, which

shall be promulgated not later than 1 year after the date of enactment of this section." 31 USC §5336(b)(5). ↑

3. 31 CFR §1010.380(c)(1)(i)(C). All citations are to the regulations as proposed and published at 86 Fed. Reg. 69920-69974 (Dec. 8, 2021). ↑

4. The types of exempt entities are identified in Prop. Reg. §31 CFR §1010.380(c)(2). ↑

5. See 15 USC §78l; Prop. Reg. §1010.380(c)(2)(i). ↑

6. 31 CFR §1010.380(c)(2)(xxi). ↑

7. Id. ↑

8. 31 CFR §1010.380(c)(2)(xxiii). ↑

9. 31 CFR 1010.380(b)(1). ↑

10. 31 CFR 1010.380(b)(1)(i)(E)(1), (2). ↑

11. 31 CFR 1010.380(d). ↑

12. 31 CFR 1010.380(d)(1)(iv). ↑

13. 31 CFR 1010.380(d)(1)(iii). ↑

14. 31 CFR 1010.380(d)(2). ↑

15. 31 CFR 1010.380(d)(3). ↑

16. 31 CFR 1010.380(d)(3)(iii). ↑

17. 31 CFR 1010.380(d)(4). ↑

18. 31 CFR 1010.380(d)(4)(v). ↑

19. 31 CFR 1010.380(d)(3)(ii)(C). ↑

20. 31 CFR 1010.380(d)(3)(ii)(C)(2)(i). ↑

21. See IRC §673 and §676 with respect to settlors and §678 with respect to beneficiaries. ↑

22. 31 CFR 1010.380(e)(1). ↑

23. In the case of an individual who does not have one of the foregoing identification documents, a non-expired passport issued by a foreign government to such individual will suffice. 31 CFR 1010.380(b)(1)(ii)(D)(4). ↑

24. 31 CFR 1010.380(b)(5)(ii)(A). ↑

25. 31 CFR 1010.380(b)(5)(ii)(D). ↑

26. 31 CFR 1010.380(a)(1)(i), (ii). ↑

27. 31 CFR 1010.380(a)(iii). ↑

28. 31 CFR 1010.380(a)(iv). ↑

29. 31 CFR 1010.380(a)(2). ↑

30. 31 CFR 1010.380(a)(3). ↑

31. 31 CFR 1010.380(b). ↑

32. 31 CFR 1010.380(g)(1). ↑

33. "A person fails to report complete or updated beneficial ownership information to FinCEN if such person directs of controls another person with respect to any such failure to report, or is in substantial control of a reporting company when it fails to report compete or updated beneficial ownership information to FinCEN." 31 CFR 1010.380(g)(5). ↑

By: Robert E. Ward (/author/robert-e-ward/) | Yesterday