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The Corporate Transparency Act: A new federal reporting obligation for business that impacts almost everyone

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Why are we here?

The CTA was passed into law Jan. 1, 2021, by the U.S. Congress over then-President Donald Trump's veto. It is a component of the National Defense Authorization Act for Fiscal Year 2021 (NDAA). Nestled within the NDAA, the CTA is intended to combat the use of shell companies in the

commission of money laundering, terrorist financing, financial and tax fraud, and other domestic and international illicit activity and corrupt practices, as well as to protect U.S. national security. A useful shorthand for understanding who is intended to be ensnared by the CTA dragnet is to think of individuals such as foreign oligarchs, kleptocrats, and despots.^v Despite the limited number of bad actors who form the target of the CTA, the law casts a very wide net, with FinCEN estimating that 32.6 million “reporting companies” will exist as of Jan. 1, 2024, and that approximately 5 million new “reporting companies” will be formed each year thereafter.^{vi} Much of the business community swept into the CTA net will be unwitting and innocent bycatch.

What is the CTA?

If you have not heard of the CTA, you are not alone. Many business owners, and their professional advisors, are taken aback upon first learning of the CTA’s existence and scope. At its core, the CTA requires reporting of personal identifying information (PII) of direct and indirect beneficial ownership and control information pertaining to businesses operating in the U.S. The PII to be reported includes names, birthdates, residential addresses, and photographs.^{vii} This vast influx of PII will be received, stored, and managed by FinCEN in the BOSS, with the BOSS going live Jan. 1, 2024.^{viii}

Who must report?

PII must be reported for persons owning, directly or indirectly, 25% or more of the business or who have “substantial control” over the business (each a “beneficial owner”). Every business will have at least one person to report, regardless of its ownership or control structure. Once the initial report is filed, this information must be updated within 30 days of any subsequent event that causes such information to no longer be accurate. Attribution of ownership and what constitutes substantial control will vary from business to business and will require analysis and advice. Law

enforcement authorities will use this information to streamline their investigations and enforcement activity, thus bypassing the “shell game” historically posed by multiple levels of business entity ownership and affiliation.ix

Who does the CTA impact?

The CTA impacts “reporting companies,”x their incorporators and organizers (i.e., “company applicants”), service providers (also, “company applicants”), and owners and control persons (i.e., “beneficial owners”), as well as the financial institutions (i.e., banks, credit unions, and money service businesses – think Venmo or PayPal) with whom they do business.xi The CTA also implicates the enforcement activity of federal, state, local, tribal, and foreign law enforcement agencies.xii

A “reporting company” is a corporation, limited liability company or other “similar entity”xiii that is created by the filing of a document (“domestic reporting company”) or registered to do business in the United States by the filing of a document (“foreign reporting company”) with a secretary of state or a similar Indian tribal officexiv so long as it does not fall within specific, limited, excluded categories.

These exclusion categories generally include already-regulated business entities: Securities and Exchange Commission-regulated parties, utilities, financial institutions, insurance providers, commodity exchanges, pooled investment vehicles, Internal Revenue Code Section 501(c) federally tax-exempt nonprofits (but, importantly, not other nonprofit entities), and governmental and quasi-governmental entities.xv In addition, there is an exclusion from “reporting company” status for “large operating companies” that meet all three of the following criteria:xvi (1) have a physical street address in the U.S.;xvii (2) have 21 or more full-time employeesxviii; and (3) have more than \$5 million in annual U.S. gross receipts or sales as reported on the business’s prior year’s filed federal tax filings.xix As a matter of logical inference, it bears note that virtually

no business entity formed after Jan. 1, 2023, will have filed a prior year's federal tax filing as of Jan. 1, 2024, and, as such, will not be eligible for the large operating companies exemption. Further, except for an entity that is a wholly owned subsidiary of an exempt entity, all business entities newly formed after Jan. 1, 2024, will not qualify for an exclusion, and will be required to file a CTA report with FinCEN within 30 days of their formation, because they will not be able to qualify for any of the exemptions at the point in time of their formation. The vast majority of U.S. small businesses will not meet any of the exceptions to reporting, including the "large operating company" exception, and will be CTA "reporting companies" requiring a BOSS filing. This fact likely will come as a shock to many small business owners, whose first reaction to learning of the CTA's existence is a variant of: "well, that has to be for large businesses, right?"

In addition, certain parent or subsidiary entities of exempt companies may themselves be CTA "reporting companies." Each business entity is separately evaluated for a CTA exemption on its own merits. As such, even persons noting that their core business entity easily meets a CTA exemption may find that they are pulled into the CTA compliance regime through their affiliated entities and joint venture parties.

When and how to report

No CTA filings may be made prior to the BOSS system's live date. Filings will be made via electronic interface with BOSS. Businesses in existence on Jan. 1, 2024, will have a one-year grace period to file their initial report with FinCEN, but they must file an initial report, even if they subsequently terminate or otherwise alter their structure in a manner to become compliant with a CTA exemption. Any change to the status quo of a business in existence on Jan. 1, 2024, will need to be reported as a separate amendment filing, delivered with the initial "as of Jan. 1, 2024," report filing required to be made on or before Dec. 31, 2024. Notably, there is no grandfathering of previously-formed entities and the CTA will

sweep in all business entities in existence on Jan. 1, 2024. Shockingly, for many legal practitioners and their clients who chose to “not bother” with formally terminating past business entities that are no longer actively conducting business, FinCEN has taken the position that all administratively dissolved entities not otherwise meeting an exemption^{xx} are required to file a CTA report like all other covered reporting companies.^{xxi}

Businesses formed on or after Jan. 1, 2024, will have a shorter, 30-day grace period after formation to file their initial report. Businesses will need to compile, maintain, and update their reportable PII for their beneficial owners on an ongoing basis. After Jan. 1, 2024, all businesses will have 30 days to file any correction or change to their previously reported information.^{xxii} This includes instances where a reporting company subsequently becomes eligible for an exemption from the reporting requirement.^{xxiii} Any exempt company that no longer meets the criteria for an exemption must file an initial report within 30 days after the date that it no longer meets the exemption criteria.^{xxiv}

What is a company applicant?

The same PII as disclosed for beneficial owners must also be reported for company applicants (these are the entity’s incorporators or organizers), including those who directed the business’s formation filing.^{xxv} However, this applies only for businesses newly formed after Jan. 1, 2024. Once reported, company applicant information is not required to be updated in the future.

What is a FinCEN Identifier?

The CTA contemplates that an individual may provide his or her PII to FinCEN, and may thereby obtain a FinCEN Identifier, an identification number that may then be provided to reporting companies and to FinCEN in the future in lieu of other required PII about that person.^{xxvi} Reporting companies may obtain a FinCEN Identifier in a similar manner,

but a reporting company may report an intermediate entity's FinCEN identifier (rather than specific beneficial owner's information) only when the intermediate entity and the reporting company have the same beneficial owners.^{xxvii}

Who may access the BOSS?

Reporting company information and associated PII of such business entity's beneficial owners and company applicants may be accessed for national security, intelligence, or law enforcement activity; for use in furtherance of such activity by officers or employees of any U.S. agency; by officers or employees of any state, local, or tribal agency; or by officers or employees of any permitted financial institution.^{xxviii} Except as authorized by the CTA and the associated FinCEN promulgated protocols, however, company information and PII reported under the CTA is confidential and may not be disclosed by a U.S. officer or employee; an officer or employee of any state, local, or tribal agency; or an officer or employee of any financial institution or regulatory agency receiving information that was collected under the CTA.^{xxix} Such officials are subject to stiff sanctions for any instance of violation of the CTA's access parameters.^{xxx}

Penalties for CTA noncompliance

There are steep, escalating fines (\$500 per day up to \$10,000 per violation) and possible jail time (up to two years) for those failing to timely comply with the CTA's requirements.^{xxxi} It bears note that failure to timely file a required initial report could result in up to a \$10,000 fine, but that subsequent events that would necessitate an amendment to such required but missing filing, had the initial report been made, also accrue — meaning that a failure to file an initial report may result in aggregate fines accruing well in excess of \$10,000 prior to an initial notification of violation coming from FinCEN to the reporting company. One may assume that the intent behind noncompliance of a reporting company

and its agent(s) will serve as a factor in FinCEN's assessing of possible criminal penalties.

What is the CTA's application to professional associations, including law practices?

The CTA applies to professional associations — such as law practices and many accounting practices. There is no specific CTA exemption for professional associations (other than an express exemption for “[a]ny public accounting firm registered in accordance with Section 102 of the Sarbanes-Oxley Act of 2002.”).^{xxxii} The only likely category of potential CTA exemption for a professional association would be through the “large operating company” exemption noted above. Some professional associations (including law firms) may be particularly susceptible to reporting company compliance obligations based on their ownership structure, whereby the entity's professional owners may be excluded from the “full time employee” count based on their non-employee status for federal income tax purposes, which may impede meeting a “large operating company” exception.^{xxxiii}

Conclusion

The CTA is intended to cause the collection, maintenance, safeguarding, and disclosure of beneficial ownership information, with the stated goal to facilitate important national security, intelligence, and law enforcement activities. Reporting under the CTA is designed to help prevent criminals, terrorists, proliferators, and other bad actors from abusing business entity structures in their efforts to hide illicit proceeds in the United States. The CTA is a new extension of federal oversight to the regulation of business entities and their operations. This oversight traditionally has resided with U.S. states. Attorneys and their clients will now need to swiftly adjust to this new legal compliance landscape.

For some businesses, CTA compliance will require nothing more than filing a simple, straightforward, online report into the BOSS. For many

sophisticated businesses, however, CTA compliance will be a minefield for potential failures. The CTA's reporting obligations touch on the sensitive issue of personal anonymity historically enjoyed by U.S. beneficial owners. Providing personal identifying information (and a photograph) into a governmental law-enforcement database implicates considerations of personal privacy, attribution of associations with business partners and association with particular types of investment,xxxiv data security, and other meaningful considerations.

Business owners and their control persons have only the waning remainder of 2023 to take actions to best avail themselves of a CTA exemption or otherwise influence their ownership or control position within their business entities, to limit or eliminate their required disclosure into the BOSS. Business owners and their control persons will also have the same time period to establish necessary authorized personnel, policies, procedures, protocols, and systems to ensure timely compliance with the CTA's short compliance windows commencing and continuing from Jan. 1, 2024. Now is the time to engage expert, professional advisors to prepare for this new business world order.

Endnotes

[1] §§ 6401 – 6403 under Title LXIV of the National Defense Authorization Act for Fiscal Year 2021.

[2] See FinCEN Frequently Asked Questions 3 and 5; <https://www.fincen.gov/boi-faqs> < <https://www.fincen.gov/boi-faqs>> (last visited July 28, 2023) ("No one needs to report beneficial ownership information to FinCEN until January 1, 2024. FinCEN is currently not accepting any beneficial ownership information reports." "Beneficial ownership information reports will not be accepted before then." [Issued March 24, 2023]).

[3] 31 C.F.R. § 1010.380 (b)(5).

[4] See 31 U.S.C. § 5319; 31 C.F.R. § 1010.960.

[5] E.g., for the *Wall Street Journal* readers, envision the “Pandora Papers” (circa 2021) (https://en.wikipedia.org/wiki/Pandora_Papers < https://en.wikipedia.org/wiki/Pandora_Papers >), “Panama Papers” (circa 2016) (https://en.wikipedia.org/wiki/Panama_Papers < https://en.wikipedia.org/wiki/Panama_Papers >) and “Paradise Papers” (circa 2017) (https://en.wikipedia.org/wiki/Paradise_Papers < https://en.wikipedia.org/wiki/Paradise_Papers >). For the Netflix fans, think of “Gunter’s Millions” (“*Was the 'world's richest dog' a front to avoid taxes? Netflix documentary exposes truth behind Italian pharma heir's infamous hoax claiming German Shepherd Gunther VI is worth \$400M*”: <https://www.dailymail.co.uk/news/article-11692671/Netflix-documentary-Gunthers-Millions-exposes-truth-worlds-richest-dog.html> < <https://www.dailymail.co.uk/news/article-11692671/Netflix-documentary-Gunthers-Millions-exposes-truth-worlds-richest-dog.html> >); see also “Liechtenstein Papers” (circa 2008) (https://en.wikipedia.org/wiki/2008_Liechtenstein_tax_affair < https://en.wikipedia.org/wiki/2008_Liechtenstein_tax_affair >).

[6] See 31 C.F.R. § 1010.380.

[7] 31 C.F.R. § 1010.380(b) (2022).

[8] See note 3 *supra*.

[9] CTA § 6403(c)(2)(B)(i). See 31 C.F.R. § 1010.380 (printed page 59547).

[10] It is important to note that these are “reporting companies” as defined in the CTA only, and NOT “reporting companies” obligated to file reports under Sections 13 or 15(d) of the Securities Exchange Act (which entities are expressly excluded from the CTA’s “reporting” company classification).

[¹¹] § 6403 under Title LXIV of the National Defense Authorization Act for Fiscal Year 2021.

[¹²] CTA § 6403(c)(2)(B)(i). *See* 31 C.F.R. § 1010.380 (printed page 59547).

[¹³] *See, e.g.*, limited partnerships, limited liability partnerships, limited liability limited partnerships, business trusts, decentralized autonomous organizations (DAOs), cooperative associations, series of a series LLC and other entities created through filings with a secretary of state or tribal authority.

[¹⁴] 31 U.S.C. § 5336 (a)(11)(A) (2021).

[¹⁵] 31 U.S.C. § 5336 (a)(11)(B).

[¹⁶] Failure to meet any one or more of these three criteria will result in the exemption not applying to the business entity in question, and such business entity being classified as a “reporting” company under the CTA.

[¹⁷] *See* 31 C.F.R. § 1010.380(f)(6) (“The term ‘has an operating presence at a physical office within the United States’ means that an entity regularly conducts its business at a physical location in the United States [which] the entity owns or leases, and [which] is physically distinct from the place of business of any other unaffiliated entity.” Neither shared space (e.g., WeWorks or Regis facilities), nor a registered agent’s office nor the law office of a client’s attorney may serve as such an address.).

[¹⁸] 31 U.S.C. § 5336(a)(11)(B)(xxi)(A) (2014). 31 C.F.R. § 1010.380(f)(1). A full-time employee must average 30 hours per week or 130 hours per month. *See* 26 C.F.R. § 54.4980H-1(a) (21) (2014). This may not include part-time employees, independent contractors or leased employees, nor full-time-equivalents. *But note* that FinCEN, in its FAQs (Question 8, Answer XXI, <https://www.fincen.gov/boi-faqs> < <https://www.fincen.gov/boi-faqs>> (last visited July 28, 2023), describes this threshold as “Large operating companies with *at least 20* full-time

employees...”(emphasis added) (internal citation omitted); note: this position is contrary to the express provision in the CTA, requiring more than 20 full-time employees. See 31 U.S.C. § 5336 (a)(11)(B)(xxi)(I).

[¹⁹] 31 U.S.C. § 5336(a)(11)(B)(xxi)(I). A “large operating company” must have filed “a Federal income tax or information return in the United States for the previous year demonstrating more than \$5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under Federal income tax principles. For an entity that is part of an affiliated group of corporations within the meaning of 26 U.S.C. 1504 that filed a consolidated return, the applicable amount shall be the amount reported on the consolidated return for such group.” 31 C.F.R. § 1010.380(c)(2)(xxi)(C). It bears note that aggregation on consolidated returns only applies to federal tax purposes “corporations” and not federal tax purposes “partnerships,” the tax category selected by most limited liability companies and limited partnerships.

[²⁰] See “Inactive Entities” exemption at § 5336(a)(11)(B)(xxiii); 31 C.F.R. § 1010.380(c)(2)(xxiii).

[²¹] Anything short of a formal termination of an existing entity by December 31, 2023, would constitute that entity as a reporting company under the CTA, absent its qualification for an exemption. See 31 C.F.R. § 1010.380 (printed pages 59545 and 59553), discussing how dissolved entities will have CTA reporting obligations because the vast majority of company dissolutions are temporary and do not prevent a dissolved entity from conducting business, with many such entities in a temporary administrative dissolution status. Administratively dissolved entities typically may be reinstated with a simple remedial filing, with retroactive good standing effect.

[22] 31 C.F.R. § 1010.380(a)(2).

[23] 31 C.F.R. § 1010.380(a)(2)(i).

[24] 31 C.F.R. § 1010.380 (a)(1)(iv). However, 501(c) exempt companies, “for the 180-day period beginning on the date of the loss of such tax-exempt status” “shall be considered to be continued to be [exempt under that CTA exemption].” 31 C.F.R. § 1010.380(c)(2)(xix).

[25] 31 C.F.R. § 1010.380 (b)(1)(ii); 31 C.F.R. § 1010.380(e).

[26] 31 C.F.R. § 1010.380 (b)(5).

[27] *See* Proposed 31 C.F.R. § 1010.380(b)(4)(ii)(B).

[28] CTA § 6403(c)(2)(B)(i).

[29] CTA § 6403(c)(2)(B)(ii).

[30] 31 U.S.C. §§ 5336(h)(2), 5336 (h)(3)(B).

[31] 31 U.S.C. §§ 5336(h)(1), 5336(h)(3)(A).

[32] *See* Proposed 31 C.F.R. § 1010.380 (c)(2)(xv); (NPRM 87 Fed. Reg. 77404). *See* FinCEN FAQs (Question 8, Answer XV; <https://www.fincen.gov/boi-faqs> < <https://www.fincen.gov/boi-faqs>> (last visited July 28, 2023).

[33] 31 C.F.R. § 1010.380 (c)(2)(xxi), *referencing* 26 C.F.R. § 54.4980H-1(a); *see* 26 C.F.R. § 54.4980H-1(a)(15): “Employee. The term *employee* means an individual who is an employee under the common-law standard. *See* § 31.3401(c)-1(b). For purposes of this paragraph (a)(15), a leased employee (as defined in section 414(n)(2)), a sole proprietor, *a partner in a partnership, a 2-percent S corporation shareholder, or a worker* described in section 3508 is not an employee.” (emphasis added).

[34] Consider co-investments with notorious individuals. Or in businesses receiving poor press and investigative attention, such as payday lending. Or investments in businesses with challenging legal status (such as businesses in the cannabis industry, which, while legal under Missouri law, remains illegal in other states (including Kansas), and under federal law for any purpose – see the Controlled Substances Act of 1970, 21 U.S.C. § 801 et. seq.).