THE CORPORATE TRANSPARENCY ACT: WHAT YOU NEED TO KNOW

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On January 1, 2021, Congress passed the Corporate Transparency Act ("CTA") in order to reduce bad actors creating shell companies that engage in illicit activities. More public and anonymous corporations are formed in the United States than in any other part of the world, which is likely due to the ease U.S. entities can be established.

The CTA requires reporting companies to file, in absence of an exemption, information on each beneficial owner and applicant of the reporting company with the Financial Crimes Enforcement Network ("FinCEN"). The CTA will have the most impact on small businesses and investors due to definitional exemptions for larger companies with over $5 million in revenue and 20 employees.

Important Definitions

To know if you are impacted by the Act, it's important to understand the applicable terms.

Reporting Company – A corporation, limited liability company, or other similar entity that is created by filing documents with the secretary of state or similar office.

Applicant – An individual who files an application to form an entity in the U.S.

Beneficial Owner – An individual who (1) directly or indirectly exercises substantial control over the entity or (2) owns or controls not less than 25% of the ownership interests of the entity.

The Requirements

FinCEN will establish and maintain a national registry of beneficial owners of entities who are deemed reporting companies. Reporting companies must provide each beneficial owner's name, date of birth, residential or business address, and a unique identifying number from an identification document, such as a U.S. passport. The information must be updated annually. While the information in this database will not be publicly available, the information may be disclosed to law enforcement agencies and financial institutions if certain conditions are met. These disclosures were not required in the past, making forming anonymous entities easy.

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New reporting companies will be required to provide beneficial ownership at the time of formation. Existing entities will not need to provide beneficial ownership information within two years after the CTA rules and regulations are finalized.

Rules and regulations governing implementation of the CTA have already been proposed and are expected to be finalized later in 2022. The expectation is the rules and regulations will fill in gaps left by the CTA, especially around definitions and reporting procedures.

Violations

The CTA provides that it is unlawful for any person to provide false or fraudulent beneficial ownership information, fail to report beneficial ownership information, or fail to timely update beneficial ownership information to FinCEN. Any person who violates the reporting requirements could be civilly liable for up to $500 each day a violation continues and subject to additional criminal penalties of imprisonment for up to two years and fines up to $10,000.

How to Prepare

Business owners should consult with their attorney and/or accountant and carefully consider if their business qualifies as a reporting company and if so, if an exemption applies. Non-exempt companies should determine the identity of every individual who meets the definition of "beneficial owner" and "company applicant" and obtain the applicable information for each individual. The company will eventually need this information to complete and file a report with FinCEN in a manner that will be officially determined by FinCEN within the coming months.

The contents of this article are for informational purposes only and none of these materials is offered, nor should be construed, as legal advice or a legal opinion based on any specific facts or circumstances.

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