

WHAT IS THE CORPORATE TRANSPARENCY ACT AND WHAT DOES IT MEAN FOR BUSINESS AND INCORPORATORS?

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INTRODUCTION

Businesses and incorporators will be faced with the Corporate Transparency Act (“C.T.A.”), which is contained within the National Defense Authorization Act and is designed to take actions against illegal activities conducted through anonymous shell companies by requiring the reporting of the identity of the Beneficial Owners of companies, subject to certain exceptions. This article answers the eleven most important questions that affect clients that are incorporating a business and the professionals providing advice or assistance in the incorporation process.

1. **What information must be reported?**

Under the C.T.A., businesses will need to disclose the “Beneficial Owner” information to the Financial Crime Enforcement Network (“FinCEN”) at the time of the formation of the company and with the annual filings to report ownership changes made during the prior year.

2. **What information is required to be reported and when?**

The information that must be reported regards the Beneficial Owner of the company. A “Beneficial Owner” is a natural person who

- exercises substantial control over a company,
- owns 25% or more of the equity interests of a company, or
- receives substantial economic benefits from the assets of a company.

3. **Where a discretionary trust meets the ownership threshold for a company, how will the ownership of the company’s shares be attributed among the beneficiaries?**

While no guidance yet exists on the attribution of shares from a discretionary trust to discretionary beneficiaries, the simplest and most effective approach is for the trustee to report on each living beneficiary, including newborn grandchildren. This alternative would match recent experience with K.Y.C. reporting applicable to bank accounts owned by trusts, where information on each beneficiary is provided. However, it would provide a glut of useless information. Other possibilities exist. One example is to look at past distribution patterns. Another might be to look at the intestacy laws that apply in the country of domicile when all beneficiaries are family members. A third is to look at a nonbinding letter of wishes drafted by the settlor. The common problem with such other methods is that all such methods can be gamed by the settlor.

4. What information must be reported at the time of formation?

At the time of formation, the company must file a list of its Beneficial Owners with FinCEN. The list must include the same information that financial institutions are required to collect under FinCEN's Customer Due Diligence rule. This is for each Beneficial Owner:

- The full legal name
- Date of birth
- Current residential or business address
- Current identification number, such as a driver's license or passport number

The applicant is also required to provide his or her information, even if he or she is not a Beneficial Owner. This means that lawyers, accountants, and others who form reporting companies for clients will be required to report their personal information. To protect themselves, and avoid legal problems in the future, applicants will want to know their clients before forming companies on their behalf.

5. Is information available to the public?

No. FinCEN is a bureau of the U.S. Department of the Treasury. FinCEN's mission is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities. Federal, state, local and tribal law enforcement would have access to the information for use in authorized investigations as would financial institutions (with customer consent) that have legally mandated anti-money laundering obligations.

6. What information must be reported annually?

An Annual Report must be filed with FinCEN. The company must report a current list of its Beneficial Owners as well as a list of any changes in the beneficial ownership that occurred during the previous year.

7. Are obligations imposed on States?

Yes. It would be mandatory for the States to inform any applicant seeking to form a company of the obligations to report the information regarding the Beneficial Owners.

8. Who must report?

The type of entities required to report are corporations, limited liability companies, or other similar entities that are

- created by the filing of a document with a secretary of state or a similar office under the law of a state or Indian Tribe, or
- formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a state or Indian Tribe.



9. What companies are exempted from reporting?

In several fact patterns, companies are exempted from reporting information. The most significant exception is for active businesses. A company will not be required to report the information stated in the C.T.A. if the entity

- employs more than 20 employees on a full-time basis in the United States,
- filed in the previous year Federal income tax returns in the United States demonstrating more than \$5 million in gross receipts or sales in the aggregate, including the receipts or sales of (i) other entities owned by the entity and (ii) other entities through which the entity operates, and
- has an operating presence at a physical office within the United States.

While this exception may not exclude small businesses, it will exclude many active businesses from the requirement to report Beneficial Owners to FinCEN on an annual basis. Among the other types of entities that are exempt from reporting are

- public companies under the Securities Exchange Act of 1934;
- churches, charities, nonprofit entities, and any other entity that qualifies for tax-exempt status under sections 501(a), 527, or 4947(a)(1) of the Internal Revenue Code; and
- other companies that already have certain reporting obligations to regulatory bodies. Examples include, insurance companies, banks, Federal or State regulated credit unions, investment companies under the Investment Company Act of 1940, registered public accounting firms, and public utilities.

Although exempt from filing the Beneficial Owners information, an exempt entity must file a written certification with FinCEN identifying the specific applicable exemption, while providing the applicant's information at the same time. Existing entities that qualify for an exemption have two years from the date of issuance of the final regulations to file the required certification with FinCEN stating that it is exempt.

10. When will the C.T.A. become available?

The C.T.A. will not become effective until US Treasury issues regulations, which may not happen until late this year. This will give the business community time to study the C.T.A., consult with their lawyers, and determine how best to comply.

11. What is the penalty for failing to report the information?

It is unlawful under the C.T.A. to

- knowingly file false Beneficial Owner information to FinCEN, or
- willfully fail to provide complete or updated Beneficial Owner information to FinCEN.

Violations are subject to a civil penalty of not more than \$10,000 and criminal penalties under title 18 of the U.S. Code, which can include fines and imprisonment for not more than 3 years. Negligent violations are not penalized. Moreover, a waiver process is provided for violations that are due to reasonable cause and not due to willful neglect, which is modeled on the Internal Revenue Service waiver process for

companies' SS-4 filings. Penalties are also provided for unauthorized disclosures or misuse of beneficial owner.¹

CONCLUSION

For many years, European bankers and their colleagues in the offshore community have complained that the U.S. is the last holdout among countries when it comes to collecting ownership information for corporations. Whether these statements are accurate is open to debate, as the U.S. uses the banking system to identify owners of companies with accounts in the U.S. Once the C.T.A. reporting system comes online, the U.S. will collect information that will be submitted to FinCEN. However, because information submitted to FinCEN is not disseminated publicly, one might expect the complaints of naysayers to continue, but in modified form.

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¹ [“FACT Sheet: A Brief Summary of The Corporate Transparency Act \(Title LXIV of the NDAA, H.R. 6395\).”](#) December 17, 2020.