Corporate Law Update

December 2023

Federal Corporate Transparency Act Takes Effect January 1; Some States Following Suit

On September 30, 2022, the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) finalized regulations to implement the Corporate Transparency Act (CTA), originally passed under the 2021 National Defense Authorization Act. The regulations will be effective starting January 1, 2024.

The CTA requires a **"reporting company"** to file reports with FinCEN that provide certain information concerning the company, the **"beneficial owners"** of the company (which, as explained below, includes persons who are not legal or beneficial owners, e.g., C-suite executives and others), and, in some cases, the **"company applicant."** This sounds rather straightforward, but unfortunately, there are many technical grey areas and, in most cases, little clarity.

Who Must Report?

A reporting company will be required to file the FinCEN report. A reporting company includes both domestic entities (e.g., corporation, limited liability company, partnership, any entity formed by the filing of documents with a secretary of state or an Indian Tribe) and foreign entities registered to do business in the U.S. (e.g., corporation, limited liability company, other entity formed outside the U.S.).

The regulations provide 23 specific exemptions from reporting company status, including, but not limited to:

- A "large operating company," defined as an entity that (a) employs more than 20 employees on a full-time basis in the U.S., (b) filed in the previous tax year a federal income tax return demonstrating more than $5 million in gross receipts or sales of other entities owned by the entity, and (c) has an operating presence at a physical office in the U.S.
- Entities that are subject to other governmental regulatory reporting (e.g., SEC reporting entities, tax-exempt entities, banks, credit unions, insurance companies, broker or dealer in securities, public utilities, investment companies, venture capital fund adviser, accounting firms registered under Sarbanes-Oxley Act, public utility, etc.).
- Entities described in Section 501(c) of the Internal Revenue Code that are exempt from tax under Section 501(a) of that Code.
- An "inactive entity," defined as an entity that (a) was formed on or before January 1, 2020 with no active business, (b) has no foreign ownership, (c) had no change in ownership in the prior 12 months, (d) had no direct or indirect transaction of funds over $1,000 in the prior 12 months, and (e) has no assets.
- Entities that are wholly owned by one or more entities exempt from "reporting company" status.

What Information Must Be Reported?

The regulations require that the report must include information concerning (i) the company, (ii) the beneficial owners of the company, and (iii) for entities formed on or after January 1, 2024, the company applicant.

Reporting Company Information

The information required to be reported for a reporting company includes (a) the company's full legal name and any "doing business as" names, (b) the business street address of its principal place of business, (c) its jurisdiction of formation or registration, and (d) its federal tax identification number (if a TIN has not been issued, alternatives include a Dunn and Bradstreet Universal

Numbering System Number or Legal Entity Number). Alternatively, a reporting company may provide its FinCEN identifier, which is a unique identifying number that FinCEN will issue to individuals or entities upon request that can be used for all CTA filings (FinCEN ID). It is the individual's or entity's responsibility to update the information in the personalized FinCEN account for changes such as a new address or legal name.

Beneficial Owner(s) Information

The information required to be reported for a beneficial owner of a reporting company includes (a) full legal name, (b) date of birth, (c) current residence street address, and (d) a unique identifying number from an acceptable identification document (e.g., driver's license or passport) and image of such document which includes both the identifying number and photograph (Personal Data Set). Alternatively, a beneficial owner may provide their FinCEN ID.

A beneficial owner is any individual who either (i) directly or indirectly exercises substantial control over the reporting company or (ii) owns or controls (including through a trust) not less than 25% of the ownership interests in the reporting company.

"Substantial control" means (a) service as a senior officer of a reporting company, (b) authority over the appointment or removal of any senior officer of the reporting company or a majority of the board of directors (or similar body), (c) the right to direct, determine, or have substantial influence over important decisions made by a reporting company, or (d) has any other form of substantial control over the reporting company.

"Senior officer" generally includes any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.

"Important decision" generally includes the power to sell, lease or transfer company assets, effect a reorganization or merger, approve major expenditures or incurrence of significant debt, terminate lines of business or geographic presence, make decisions regarding compensation or incentives for senior officers, enter into or terminate significant contracts, or amend governing documents.

It is very important to note that the determination of whether a person has substantial control must be analyzed on a case-by-case basis.

"Ownership interests" in an entity include both equity and other types of interests, such as capital or profits interest or convertible instruments, warrants, or rights or other options or privileges to acquire equity, capital, or other interests in a reporting company. Debt instruments are included if the holder can exercise the same rights as one of the specified equity or other interests, including conversion rights. It also includes joint ownership (which may include community property interests), certain rights or interests in trusts (trustee, settlor with power to revoke, and certain beneficiaries) and certain other contracts, arrangements, or relationships that establish ownership.

Exceptions. There are five exceptions to the definition of beneficial owner for (a) a minor child, if a parent or guardian's information is reported; (b) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual; (c) an individual acting as an employee of a reporting company who is acting "solely as an employee" and derives control or economic benefits "solely from the[ir] employment status"; (d) an individual whose only interest in a reporting company is a future interest through a right of inheritance; and (e) a creditor of a reporting company.

Company Applicant Information

A company applicant is a person who files a document to form the reporting company (or in the case of a foreign entity, files the document to register to do business in the U.S.) and also includes any person who directs or controls filing (such as an attorney supervising the work of a paralegal). Each reporting company may have up to two company applicants listed.

A company applicant will be required to provide either their Personal Data Set or their FinCEN ID to the reporting company that such person(s) formed. As noted above, information for a company applicant is only required for an entity formed on or after January 1, 2024.

When Will Reporting Be Required?

The timing requirements for submitting reports under the CTA depends on the reporting company's formation date:

- For entities formed before January 1, 2024, reports are due within **one year** (by January 1, 2025).
- For entities formed between January 1 and December 31, 2024, reports are due **90 days** after the entity has actual notice that it has been registered to do business, or the Secretary of State (or similar officer) provides public notice of entity registration.
- For entities formed on or after January 1, 2025, reports are due **30 days** after the entity is formed.

Regardless of the time frames listed above, after the initial FinCEN report, a reporting company is required to file:

- A correction to any reported information within **30 days after** the date it knows or should have known the information was inaccurate.
- Any changes to information (e.g., company adds a senior officer, ownership changes, etc.), the reporting company has **30 days** from the date of the change to file an updated report.

Additionally, if an entity was previously exempt but later becomes a reporting company, the company will be required to make an initial filing (a) within **90 days** after the status change (if formed in 2024) or (b) within **30 days** after the status change (if formed prior in any year other than 2024).

Where To File?

FinCEN indicates the reporting form, instructions, and FinCEN ID application will be available January 1, 2024. You can check for updates from FinCEN and sign up for tailored notifications on its website.

CTA Penalties

Noncompliance with the CTA is against federal law and can lead to (a) a $10,000 fine and two years in jail for providing false information, or (b) $500/day in fines for failing to provide required information.

Who Can Access This Information?

The CTA does *not* permit public access to information concerning beneficial owners. On December 21, 2023, FinCEN finalized regulations governing access to information gathered, and in a press release stated that FinCEN is "committed to creating a highly useful database for authorized … recipients while protecting this sensitive information from unauthorized disclosure."

Access to CTA information filed with FinCEN is limited to:

- U.S. federal agencies engaged in national security, intelligence, or law enforcement activity.
- U.S. state, local, and tribal law enforcement agencies.
- Foreign law enforcement agencies, judges, prosecutors, central authorities, and competent authorities (foreign requesters).
- Financial institutions to facilitate compliance with customer due diligence (CDD) requirements under applicable law.
- Federal functional regulators and other appropriate regulatory agencies acting in a supervisory capacity assessing financial institutions for compliance with CDD requirements under applicable law.
- Certain Treasury Department officers and employees.

State-Level Corporate Transparency Acts

Various states have considered creating a state-level reporting requirement in addition to the FinCEN report. Chief among them is in New York, where Governor Kathy Hochul signed an LLC transparency act that requires disclosure of information similar to that under the CTA, which must be delivered to the New York Department of State. The text of the bills originally passed by the state legislature required the disclosed information be available on a public database, but the law signed by Governor Hochul includes a compromise to make the information available solely to law enforcement agencies. We expect other states may now follow suit with their own tailored versions of transparency laws.

How Thompson Hine Can Help

If you think you need assistance with understanding your requirements under the CTA, you can reach out to your Thompson Hine contact or a member of our CTA Working Group listed below. After being engaged for CTA-related work, Thompson Hine can assist you in determining whether your company is a reporting company, determining beneficial owners, and identifying categories of data required to be submitted to FinCEN. Thompson Hine will not prepare or file your FinCEN reports or monitor your business to determine the need for corrected or updated reports, but we can provide third-party referrals for those CTA filings and related services. Given the very broad applicability of the CTA, we are already seeing many businesses and owners requesting assistance, so we strongly suggest reaching out well in advance of any filing requirements. Thompson Hine will only provide advice related to CTA compliance or the applicability of CTA exemptions when we are explicitly retained to do so.

FOR MORE INFORMATION

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