New Corporate Reporting…Just Around the Corner

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Effectiveness of new federal reporting requirements under the Corporate Transparency Act (31 U.S Code § 5336, CTA) is just around the corner. Are you— who have formed or are about to form a business entity—ready for the new requirements?

Stated Purpose—

CTA's stated purpose is creating a database of beneficial owners of reporting entities (Beneficial Owners). Its further stated purpose is combating money laundering and concealment of illicit income through shell companies.

Those Who Must Report—

Under CTA (enacted by the US Congress in January 2021, effective January 1, 2024), existing, amended, or new business entities must each file reports with the Financial Crimes Enforcement Network within the US Department of the Treasury (FinCEN) providing certain information (Beneficial Information). These entities include a corporation, limited liability company or other entity created by filing registration documents under laws of a state or territory of this country (collectively, state) and having one or more Beneficial Owners.

They also include an entity formed under tribal laws or foreign country laws (with the entity registered to do business in this country) and having such Beneficial Owners. However, the balance of this article focuses on state-law-registered entities.

Beneficial Information--

Beneficial Information for the entity is as follows:

- Business name (legal and alternative (doing business as) names, if any).
- Current address of principal place of business.
- State of formation or registration.
- Taxpayer Identification Number and Employer Identification Number (as used by the Internal Revenue Service).
- *As to each Beneficial Owner of the entity*—full legal name, birth date, current address and government issued photo identification (driver's license or passport).

Regulations—

Regulations under CTA were issued in September 2022 and adopted by FinCEN, effective January 1, 2024. The FinCEN release on them, including the regulations, may be found in the Federal Register at Vol. 87, No. 189, September 30, 2022 (collectively, Regulations).

Beneficial Owners—

CTA reporting requirements regarding Beneficial Owners (Reporting Requirements) apply to all individuals, who each exercise substantial control over, or who each owns or controls not less than 25% of the ownership interests of, an entity. Such control may be exercised through contract or other arrangement.

The Regulations further clarify control may be direct or indirect through various means. Examples include where a person exercises substantial control as a senior officer or person having authority over appointment of, or removal of, any senior officer or a majority of a board of directors.

Exemptions—

Some entities are exempt from the Reporting Requirements. They are identified in 23 CTA exemption categories, including non-profit organizations and certain regulated entities. These regulated entities include banks or credit unions (whose deposits are insured through federal insurance), certain broker-dealers, investment companies and insurance companies.

Also included as an exemption category is an entity with more than 20 employees on a full-time basis in this country. Furthermore, the entity must have filed in the previous year a federal income tax return in this country demonstrating more than $5 million in gross receipts or sales. The entity must also have an operating presence at a physical office within this country.

An entity not otherwise exempt from Reporting Requirements is hereafter referred to as a "Reporting Company."

Added Risk Factors—

Entity control, requiring compliance with Reporting Requirements, likely requires disclosure as a risk factor in an entity's securities offering.

The material risk is that a prospective purchaser in the offering, in subscribing to securities of the entity and becoming a Beneficial Owner of it, identifies the entity as a Reporting Company and requires that entity to file with FinCEN personal information about the Beneficial Owner. This risk factor may also include disclosure of penalties for failure to comply with Reporting Requirements.

An entity likely must make a similar offering disclosure as to subsequent purchases of its securities. That is, should a person thereafter acquire additional securities sufficient to become a Beneficial Owner, the entity becomes a Reporting Company subject to the full rigors of CTA and the Regulations.

Reporting Accuracy—

Importantly, Reporting Requirements extend to anyone who actually files the entity's organizational documents with the state. That filer could be the Reporting Company's lawyer and the lawyer's paralegal or other staff person involved in the FinCEN filing. The Reporting Company in its FinCEN report must include information on that filer similar to that for the Beneficial Owner.

Reporting Company change in control after an initial filing with FinCEN precipitates an additional filing with the agency, updating or otherwise correcting the initial filing.

Timely Reporting—

A Reporting Company created before January 1, 2024, must satisfy Reporting Requirements (file a report) before January 1, 2025. Any Reporting Company created on or after January 1, 2024, must satisfy Reporting Requirements (file a report) within 30 calendar days of the earlier of the following:

- Date on which it receives actual notice of effectiveness of its creation.
- Date on which the state first provides public notice of entity creation.

Regulation-required updates (changes to Beneficial Information previously submitted to FinCEN), must be submitted within 30 calendar days after the date the change occurred.

Any entity no longer meeting the criteria for an exemption from Reporting Requirements must, within 30 calendar days after such event, file a FinCEN report in accordance with those requirements.

Penalties—

CTA penalties for willfully providing Beneficial Information to FinCEN that is false or fraudulent are significant. Similarly, CTA penalties for willfully not providing complete or updated Beneficial Information to the agency are also significant.

In both cases, civil penalties for liability to the United States of not more than $500 per day for each day of violation may be imposed, as well as fines of not more than $10,000 or imprisonment for not more than two years, or both.

CTA also provides significant penalties for knowing, unauthorized disclosure of, or use of, Beneficial Information. Fines in these cases can be up to $250,000 or imprisonment for not more than five years, or both.

Significant Expansion of Federal Reporting Requirements—

CTA and Regulations set forth significant expansion of the regulatory framework in the United States in combating illicit finances. For example, Business Know-How (a blog powered by *zenbusiness* on the internet), estimated on January 1, 2023 that about 30 million existing businesses and about 2 million new businesses each year are to be required to report Beneficial Information under the Regulations.

The FinCEN form to be used by a Reporting Company in satisfying Reporting Requirements (FinCEN Form) was not included in CTA or the Regulations. It remains to be seen when the FinCEN Form is provided.

Further Challenges—

FinCEN faces challenges to its ability to receive, store and maintain anticipated volume of Beneficial Information. Additional FinCEN challenges loom in developing a security system for maintenance of that information.

CTA provides a state must update its websites and forms relating to entity organization, alerting users to Reporting Requirements. Notification must include an internet link to the FinCEN Form and a statement of the purpose of the form in combating money laundering.

Effect on Entities, Generally—

FinCEN estimated Reporting Company costs for providing Beneficial Information to the agency as nominal (about $85 per report). Actual cost figures remain to be seen. Also, there remain other entity challenges in understanding fully prerequisites for, and ramifications of, becoming a Reporting Company.

Effect on Alaska Entrepreneurs—

CTA and Regulation impact on small businesses in Alaska is readily apparent.

A sole proprietor Alaska entrepreneur (100% owner), in organizing a business as a corporation, limited liability company or other business entity to gain a protective shield from personal liability for the contemplated business, immediately becomes a substantial holder of the entity's outstanding securities. In so doing, the entity becomes a Reporting Company, and the entrepreneur becomes a Beneficial Owner of it.

The Alaska entrepreneur might be a small retail shop owner, physician, engineer, owner of a fishing boat or fishing lodge, or other small business owner in Alaska. Furthermore, that entrepreneur may clearly not be involved in any way with money laundering. Nevertheless, that Alaska business is stuck with trying to comply with the dictates of CTA and the Regulations.

Further Prudent Practitioner Steps—

While this article covers some provisions of CTA and the Regulations in limited fashion, a prudent practitioner, in advising a client, ought to become familiar with all provisions of CTA and the Regulations.

Good luck on your read of CTA and the Regulations!

This article was prepared solely to provide general information about the topic. Its content was not prepared as, and must not be construed as, legal, tax, investment, or other advice to anyone. Nothing in this article is intended in any way to form an attorney-client relationship or any other contract.

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