



# BUSINESS OWNERS AND CORPORATE ATTORNEYS BEWARE: CORPORATE TRANSPARENCY ACT IMPOSES REGULATORY REGIME

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On January 1, 2021, the United States Congress passed the Corporate Transparency Act (the “CTA”), which was included in amendments to the Anti-Money Laundering Act of 2020 (the “AMLA”). These federal statutes are designed to update and amend the United States’ money laundering laws. The AMLA “seeks to strengthen, modernize, and streamline the existing AMLA regime by promoting innovation, regulatory reform, and industry engagement.” As part of this process, the CTA is designed to increase transparency by requiring entities meeting the statutory definitions of “reporting companies” to file “beneficial ownership” and “company applicant” information with the United States Treasury Department’s Financial Crime Enforcement Network (“FinCEN”). In implementing regulations, the CTA will have a considerable impact, and impose new and significant reporting obligations, on small businesses and entrepreneurs who until now have not had a federal reporting requirement of any kind. These requirements may come as an unwelcome surprise to clients. Practitioners should be aware of the significant obligations and penalties for non-compliance.

Under the CTA, FinCEN is authorized to establish and maintain a national registry of “beneficial owners” of entities that are deemed “reporting companies.” Congress believes that the lack of uniform state laws and regulations requiring entities to disclose beneficial owners had arguably facilitated the use of “shell” companies to engage in illicit activities, including money laundering, securities fraud, terrorism, and human and drug trafficking. CTA is designed to limit the ability of criminals to utilize entities to engage in criminal conduct. As a practical matter, however, law-abiding business owners and entrepreneurs will now be subject to new additional national reporting and compliance requirements.

## APPLICABILITY

Under the CTA, a “reporting company” is defined as any corporation, limited liability company, or similar entity created by way of filing a document with a Secretary of State or similar office in any state, territory or federally recognized Indian Tribe, or formed under the laws of a foreign country and registered to do business in the United States. It should be noted that it is unclear, pending formal adoption of

implementing regulations, whether limited liability partnerships are included. Because the focus of the CTA is on “shell companies and other entities with limited or no operations,” the legislation includes exceptions for entities in a regulated industry, publicly traded companies, investment vehicles operated by investment advisors, non-profits and governmental entities. There is also an exception from required reporting for an entity that: employs more than 20 employees; filed in the previous tax year a tax return demonstrating more than \$5 million in gross receipts or sales; and has an operating presence at a physical office within the United States. In addition, entities that are subsidiaries of such excluded companies are also exempted from the reporting requirements.

## BENEFICIAL OWNER

The CTA defines a “beneficial owner” of an entity as any individual who, directly or indirectly, (i) exercises substantial control over the entity or (ii) owns or controls not less than 25% equity in the entity. Of particular note, the term “substantial control” is not defined in the CTA. Certain individuals are specifically excluded from

the definition of beneficial ownership, including a minor child (as long as the child's parents' or guardian's information is reported); an individual acting as an intermediary or agent on behalf of another; a person whose control over reporting the company derives solely from their employment; an individual whose only interest in a reporting company is through a right of inheritance; or a creditor of a reporting company (unless they qualify as a beneficial owner through substantial control or equity ownership).

When reporting to FinCEN, a reporting company must provide each beneficial owner's name, date of birth, residential or business address, and a form of unique identifying number from an acceptable identification document (e.g., state driver's license or passport). The date for reporting purposes depends on whether a reporting company is an existing entity or a newly formed entity. After the effective date of FinCEN's anticipated implementing regulations, new reporting companies will be required to report beneficial owner information at formation. Existing companies will need to provide such information within two years from the promulgation of the implementing regulations. A reporting company will also be required to update information within the year of any change of new beneficial ownership.

### PENALTIES FOR VIOLATIONS

There are significant penalties for violating the CTA's reporting requirements. Willful failure to provide a report with complete information or otherwise willfully providing false information can result in fines of up to \$10,000 and imprisonment for up to two years. CTA does contain a safe harbor from such civil and criminal penalties for the submission of inaccurate information if the reporting individual voluntarily and promptly corrects the report within 90 days.

### NATIONAL REGISTRY

Significantly, it is anticipated that FinCEN will be responsible for storing the collected information required to be submitted pursuant to the CTA in a secure "private database." CTA provides that beneficial ownership information will only be made available in connection with a request by a federal law enforcement agency; a state, local or tribal law enforcement agency (if authorized by court order); a federal agency on behalf of a foreign country; or a financial institution for customer due diligence purposes and if authorized by the reporting company. Additionally, it is expected that the laws regarding "know your

customer" due diligence requirements for financial institutions will be updated to conform to the CTA's anticipated methodology to verify financial institutions' customer information.

### IMPLEMENTING REGULATIONS

FinCEN released proposed regulations on December 7, 2021, to implement the requirements of the CTA. Notably, the proposed rules seek to clarify the meaning of "beneficial owner" by defining the terms "substantial control" and "ownership interest." The proposed CTA regulations set forth three specific indicators of "substantial control" as follows: service as a senior officer of a reporting company; authority over the appointment or removal of any officer or dominate majority of the board of directors or similar body of a reporting company; or direction, determination or decision of, or substantial influence over, important matters of the reporting company, including sale, lease or transfer of any principal assets of the company, the entry into or termination of significant contracts, major expenditures, and investments by the company in compensation programs for senior executives. The proposed regulations also include an omnibus provision defining "substantial control" to include "any other form of substantial control over the reporting company." FinCEN has noted this catch-all provision was included to make it clear that a substantial control can take additional forms not specifically listed in the regulations and to prevent individuals from evading compliance by hiding behind formalism.

The proposed regulations also take a broad view of what constitutes an "ownership interest." Under the proposed rules, an ownership interest would include both equity in the reporting company and other types of interests, such as capital or profit interest, including partnership interest or convertible instruments, warrants or rights, or other options or privileges to acquire equity, capital or other interest in the reporting company. An ownership interest would also include any ownership interest by another person who an individual has the ability to control. With respect to the required information to be disclosed, the proposed rules or regulations state that individual beneficial owners and company applicants who do not act as formation agents must report their residential address for tax residency purposes because such information would be most "useful for establishing the ambiguous identity of an identified good and official owner."

Regarding company applicants, FinCEN has proposed a bifurcated ap-

proach. Company applicants who provide a business service as a corporate or formation agent would need to report their business address. For all other company applicants, the reporting company would need to report the residential street address the individual uses for residency purposes. Under the proposed regulations, FinCEN has determined it has the authority to require reporting companies to provide scanned copies of identification documents to the agency in connection with reporting the unique identifying number. FinCEN believes collecting such images would "significantly contribute to the creation of a highly useful database for law enforcement and other authorized users and that the proposed requirement would make it more difficult to provide false identification information." In addition, although not specified by the CTA, under the proposed rules, reporting companies will be required to provide certain information to FinCEN, including the following data: name and alternative name; business street address; jurisdiction of formation or registration; and a unique identification number. The rulemaking process with respect to the CTA is ongoing. It is anticipated that future rulemaking administrative proceedings will address other aspects of the CTA, including the establishment of protocols to determine access to and disclosure of beneficial ownership information.

### RECOMMENDATIONS

While the goals of the CTA may be laudable, law-abiding entrepreneurs and businesses will be required to comply with a new and rigorous regulatory regime. Corporate attorneys should be mindful of the new obligations imposed under the CTA and educate their clients (some of whom may not be enthusiastic) on the requirements. Practitioners would be well advised to (i) assemble beneficial ownership information for legacy entities subject to the CTA requirements; (ii) analyze governance documents for provisions that conflict with the requirements of the CTA; (iii) where necessary, amend such agreements to provide for compliance; and (iv) develop protocols to address ongoing reporting obligations.



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