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CLIENT ALERT:

Corporate Transparency Act – Required Disclosure of Beneficial Owners of Closely Held Entities

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On January 1, 2021, the Senate voted to override former President Trump's veto of the National Defense Authorization Act of 2021, introducing significant amendments in U.S. anti-money laundering law. Among those amendments was the passage of the Corporate Transparency Act ("CTA") which will require certain U.S. entities and foreign entities registered to do business in the U.S. to file reports disclosing their beneficial owners to the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN"). The law has broad impact on closely held businesses and investment vehicles.

The Treasury will release regulations by year's end clarifying the reporting requirements and process, and establish the CTA's effective date. Any qualifying entity formed or registered before the effective date must file a report to the FinCEN no later than two years after such effective date. Any qualifying entity formed after the effective date will be required to file a report at the time of formation.

Applicability: The CTA defines a qualifying "reporting company" as a corporation, limited liability company, or other similar entity that is created by the filing of a document with a secretary of state or similar office under state law. Foreign entities that register to do business in the United States by similarly filing documents with state offices must also disclose their "beneficial owner(s)."

Beneficial Owner: A "beneficial owner" is an individual who, directly or indirectly:

i. exercises substantial control over the reporting company; ***or***
ii. owns or controls not less than 25% of the ownership interests of the reporting company.

Exceptions to Beneficial Owner Definition: The term "beneficial owner" shall not include:

- A minor child;
- An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
- An individual acting solely as an employee of a company and whose control over or economic benefits from the company derives solely from the individual's employment status;
- An individual whose only interest in the company is through a right of inheritance; or
- A creditor of a company, unless the creditor also meets the requirements of the beneficial owner definition.

Information Required: Reporting companies will be required to report the identity of their beneficial owner(s) and provide the following information:

- Full legal name;
- Date of birth
- Residential or business street address (current as of the date on which the report is delivered); and
- Unique identifying number (from a non-expired passport, personal identification card, driver's license, or FinCEN identifier).

<u>Any change in beneficial owner information must be reported within a year of such change.</u>

Entities Exempt from Reporting: Entities specifically exempt from the required FinCEN reporting include, among others:

- Public companies;
- Most financial services institutions;
- Certain dormant entities; and
- Entities that:
    - i. Employ more than 20 employees on a full-time basis in the U.S.;
    - ii. Filed in the previous year federal income tax returns in the U.S. demonstrating more than $5,000,000 in gross receipts or sales; ***and***
    - iii. Have an operating presence at a physical office within the U.S.

Access to Information: The information reported to FinCEN will not be public information, but may be disclosed, subject to protocols to be promulgated to protect the security and confidentiality of such information, to the following:

- A federal agency for national security, intelligence, or law enforcement activity;
- A state, local, or tribal law enforcement agency, if a court has authorized the agency to seek such information;
- A foreign authority, pursuant to a treaty, agreement, etc.;
- A financial institution with the consent of the reporting company;
- A federal regulatory agency overseeing the financial institution solely for purpose of conducting such oversight and subject to appropriate protocols; or
- Employees of the Department of Treasury whose duties require inspection or disclosure of beneficial ownership information, including for tax administration purposes.

Penalties: Violations of the CTA reporting obligations can incur civil penalties of up to $500 for each day that a violation has not been remedied and fines of not more than $10,000, imprisonment for not more than 2 years, or both. The unauthorized disclosure or use of beneficial information obtained through a FinCEN report or disclosure carries the same civil penalty of not more than $500 a day, but an individual may face fines of up to $250,000 and/or five years' imprisonment, or, if such disclosure or use occurs in connection with other criminal activity or as a part of a pattern of illegal activity involving more than $100,000 in a 12-month period, fines of up to $500,000 and/or ten years' imprisonment. A safe harbor from civil or criminal penalties exists where a person who has reason to believe a submitted report contains false information on such person promptly (and in no case more than 90 days after submitting the report) submits a corrected report.

Future Regulations: Within the next year, the Treasury will release regulations specifying how the CTA will be implemented and create a registry to collect and maintain the information. The Treasury will further specify the term "beneficial ownership," how ownership interests shall be measured, and which entities will qualify as a "reporting company."

Notably, such regulations should clarify how the CTA will impact special purpose vehicles, legal entities created to fulfill limited, specific transactional purposes (such as holding assets) that do not have employees or maintain physical offices. Closely-held companies and partnerships will likely fall under the requirements of the CTA, as they are formed by filing documents with a secretary of state. Similarly, statutory trusts, through their filing with a secretary of State, may be subject to the same requirements.
For the full text of the law, please visit: https://www.congress.gov/bill/116th-congress/house-bill/6395/text

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