The Corporate Transparency Act ("CTA") was enacted January 1, 2021, as part of the National Defense Authorization Act, representing the most significant reformation of the Bank Secrecy Act and related anti–money laundering rules since the U.S. Patriot Act. The CTA is intended to address and guard against money laundering, terrorism financing, and other forms of illegal financing by mandating certain entities (primarily small and medium size businesses) to report "beneficial owner" information to the Financial Crimes Enforcement Network ("FinCEN").

The CTA authorizes FinCEN, a bureau of the U.S. Treasury Department, to collect, protect, and disclose this information to authorized governmental authorities and to financial institutions in certain circumstances.

This article is intended to provide a high-level overview of some of the key CTA provisions and address significant issues, critical unknowns, and potential risks facing accounting firms.

What entities are subject to the new CTA reporting requirements?

Entities required to comply with the CTA ("Reporting Companies") include corporations, limited liability companies (LLCs), and other types of companies created by a filing with a Secretary of State ("SOS") or equivalent official. The CTA also applies to non-U.S. companies registered to do business in the U.S. through a filing with a SOS or equivalent official. Since the definition of a domestic entity under the CTA is extremely broad, additional entity types could be subject to CTA reporting requirements based on individual state law formation practices.

There are a number of exceptions to who is required to file under the CTA. Many of the exceptions are entities already regulated by federal or state governments and as such already disclose their beneficial ownership information to governmental authorities.

Another notable exception is for *"large operating companies"* defined as companies that meet **all** of the following requirements:

- Employ at least 20 full-time employees in the U.S.
- Gross revenue (or sales) over $5 million on the prior year's tax return
- An operating presence at a physical office in the U.S.

As currently promulgated, the CTA has an exemption for "any public accounting firm" registered in accordance with Section 102 of the Sarbanes-Oxley Act of 2002 (firms registered with the Public Company Accounting Oversight Board). However, other public accounting firms could be deemed Reporting Companies subject to compliance with the CTA.

Who is considered a "beneficial owner" of a Reporting Company?

A beneficial owner is any individual who, directly or indirectly, exercises "substantial control" or owns or controls at least 25% of a reporting company's ownership interests.

An individual exercises "substantial control" if the individual (i) serves as a senior officer of the company; (ii) has authority over the appointment or removal of any senior officer or a majority of the board; or (iii) directs, determines, or has substantial influence over important decisions made by the Reporting Company. Thus, senior officers and other individuals with control over the company are beneficial owners under the CTA, even if they have no equity interest in the company.

In addition, individuals may exercise control directly or indirectly, through board representation, ownership, rights associated with financing arrangements, or control over intermediary entities that separately or collectively exercise substantial control.

CTA regulations provide a much more expansive definition of "substantial control" than in the traditional tax sense, so many companies may need to seek legal guidance to ultimately determine who are deemed beneficial owners within their organization.

Phase-in of reporting requirements

As currently promulgated, the CTA's reporting requirements will be phased-in in two stages:

- All **new** Reporting Companies — those formed (or, in the case of non-U.S. companies, registered) on or after January 1, 2024 — must report required information **within 30 days** after their formation or registration.
- All **existing** Reporting Companies — those formed or registered before January 1, 2024 — must report required information **no later than** January 1, 2025.

Penalties for noncompliance

Penalties for willfully violating CTA reporting requirements include (1) civil penalties of up to $500 per day that a violation is not remedied, (2) a criminal fine of up to $10,000, and/or (3) imprisonment of up to two years. A safe harbor from the penalty is available to Reporting Companies that file corrected reports with FinCEN no later than 90 days after submission of an inaccurate report (31 U.S.C. 5336(h)(3)(C)).[1]

Considerations for entities as they begin to prepare for the CTA

With the CTA introducing a new and expansive reporting regime, now is the time for entities to assess the new rules' implications on their organizations. As entities begin this evaluation, the following, although not meant to be all inclusive, should be considered:

- Is the entity subject to the CTA or does it qualify for exemptions?
- If the company is **not** exempt, how should it calculate percentages of "ownership interests" to determine whether any owners meet the 25%-ownership threshold? In many companies with simple capital structures, the answer will be obvious. It may be much less obvious, however, for companies with complicated capital structures (given the expansive definition of "ownership interest"), or companies in which some ownership interests are held indirectly — for example, through upper-tier investment entities, holding companies, or trusts.

- How should a company begin to assess and determine each person who exercises "substantial control" over it? There may well be multiple people who qualify, given the expansiveness (and vagueness) of the "substantial control" definition.
- What new processes and procedures should a company put in place to monitor future changes in its beneficial owners and reportable changes on existing beneficial owners that will require timely updated reports to FinCEN? Note that the types of information that must be provided to FinCEN (**and kept current**) for these beneficial owners include the owner's legal name, residential address, date of birth, and unique identifier numbers from a non-expired passport, driver's license, or state identification card (including an image of the unique-identifier documentation).
- **Caution:** Keeping current with the information that needs to be provided to FinCEN will be a significant trap for Reporting Companies, as they will need to rely on beneficial owners to timely update them on reportable changes to their information (e.g., ownership changes, moves, marriages, divorces, etc.). Reporting Companies must file updated or corrected reports within **30 days** of reportable changes or discovery of inaccurate information in previously filed reports. As a result, a company's operative documents may need to be revised to include provisions related to the CTA such as representations, covenants, indemnifications, and consent clauses. For example, the operating agreement may require:
    - A representation by each shareholder, member or partner, as applicable, that it will be in compliance with or exempt from the CTA;
    - A covenant by each shareholder, member or partner, as applicable, requiring continued compliance with and disclosure under the CTA or to provide evidence of exemption from its requirements;
    - An indemnification by each shareholder, member or partner, as applicable, to the company and its other shareholders, members or partners, as applicable, for its

failure to comply with the CTA or for providing false information; and

- A consent by each disclosing party for the company to disclose identifying information to FinCEN, to the extent required by law.