

# Understanding the Corporate Transparency Act: Key Reporting Requirements and Deadlines for High Net Worth Individuals and Businesses

By **Melissa L. Wiley**

Much has been written in recent months alerting small business owners to the impending January 1, 2024 effective date of the Corporate Transparency Act (CTA).<sup>1</sup> But do you know how the new reporting requirements will affect high net worth individuals, their trusts, limited liability partnerships and LLCs, and family offices? Have you already taken steps to ensure compliance with the CTA with minimal disruption to your operations and affected individuals? And do you understand the penalties that could be imposed if you don't comply?

By the federal government's own estimates, the CTA will apply to 32.6 million entities in 2024 and an additional 5 million each year thereafter. The aggregate cost of compliance will be "in the *billions of dollars* on an annual basis."<sup>2</sup> Because most large businesses and highly regulated entities are exempt from the CTA, the bulk of this burden will fall on smaller, privately held business enterprises. With approximately three months to go until the CTA goes into effect, now is the time to make sure that you are ready to comply or thinking about ways to restructure to avoid a reporting obligation.

### What is the CTA?

Enacted by Congress in January 2021 as part of the Anti-Money Laundering Act of 2020, the CTA aims to curtail the use of anonymous shell companies in connection with money laundering and other illegal activity. Specifically, the new law directs the Department of the Treasury's Financial Crimes Enforcement Network

(FinCEN) to create a database of beneficial ownership information that will allow the government to identify the individual owners of all manner of privately held assets.

### Who must report?

"Reporting company" is defined as any corporation, LLC, or "similar entity" that is:

- Created by filing a document with a U.S. state or Indian tribe, or
- Formed in a foreign jurisdiction and registered to do business in the United States through the filing of a document with a U.S. state or Indian Tribe<sup>3</sup>

In most (but not all) states, this includes limited partnerships and may include certain trusts. The key to determining whether an entity must report is whether it was formed (or registered to do business) by the filing of a document with a state or tribal government office. Thus, the determination of which entities must report will necessarily involve a state-by-state analysis.<sup>4</sup>

The CTA provides 23 categories of entities that are exempt from reporting, most of which focus on entities already subject to substantial federal or state oversight (e.g., banks, SEC registrants, insurance companies, public accounting firms, public utilities, and tax-exempt entities). Also exempt from reporting are dormant companies<sup>5</sup> and "large operating companies."<sup>6</sup> The scope of the 23 exemptions is defined in detail in both the statute and the implementing regulations.<sup>7</sup>

<sup>1</sup> P.L. 116-283, sections 6401-03 (Jan. 1, 2021), codified as 31 U.S.C. section 5336.

<sup>2</sup> 87 Fed. Reg. 59549 (emphasis added).

<sup>3</sup> 31 U.S.C. section 5336(a)(11)(A).

<sup>4</sup> For the purposes of the CTA, the term "state" includes Washington, DC, Puerto Rico, the Northern Mariana Islands, American Samoa, Guam, the U.S. Virgin Islands, and "any other commonwealth, territory, or possession of the United States." 31 U.S.C. section 5336(a)(12).

<sup>5</sup> Defined to mean pre-2020 entities with no foreign ownership that are not engaged in active business or holding any assets. 31 C.F.R. 1010.380(c)(2)(xxiii).

<sup>6</sup> Large operating companies must employ more than 20 full-time employees, have an operating presence at a physical office in the U.S. (not shared with any unrelated entity), and must have reported more than \$5 million in gross receipts (or gross sales) on their most recently filed tax return. 31 C.F.R. 1010.380(c)(2)(xxi).

<sup>7</sup> See generally 31 U.S.C. section 5336(a)(11)(B) and 31 C.F.R. 1010.380(c)(2).

Given the specificity of the exemptions, entities will need to perform a careful analysis of the terms of any exemption to be claimed.

### What must be reported?

Each reporting company must report its own name, address, jurisdiction of formation, and taxpayer identification number (e.g., IRS EIN).<sup>8</sup> Reporting companies must also report the name, date of birth, address, and “unique identifying number” for each “beneficial owner” and “company applicant” (as defined below). In addition, an image of the document from which the identifying number was obtained (e.g., driver’s license, state identification, passport) must also be submitted to FinCEN.<sup>9</sup>

Instead of providing the personal information required for each beneficial owner and company applicant, individuals may instead apply for a “FinCEN identifier” from the agency. While the process for obtaining a FinCEN identifier does not yet exist, it is anticipated that individuals will provide their personal information directly to FinCEN, which will then supply the individuals with an identifying number that may be given to reporting companies instead of the individuals’ personal information.<sup>10</sup>

Obtaining a FinCEN identifier will undoubtedly benefit both individuals and reporting companies. On the individual side, it will eliminate the need to disseminate sensitive personal information (including photos of identification) to all of the various entities with which the individual is involved. For reporting companies, if an individual provides a FinCEN identifier, the entity will no longer be responsible for updating that person’s information with FinCEN when, for example, their address changes. Instead, that burden is shifted to the individual, who will need to update their own information directly with FinCEN.

### Who is a beneficial owner?

Most entities will spend the majority of their time and effort on CTA compliance determining who must be reported as a beneficial owner. While the term “beneficial owner” may seem relatively straightforward, the definitions provided in the statute and regulations are anything but.

The term beneficial owner means an individual who, directly or indirectly:

- Exercises *substantial control* over the entity, or
- *Owns or controls* at least 25 percent of the entity’s ownership interests<sup>11</sup>

Indirect ownership or control may be accomplished through a variety of means, including board representation, control over intermediate entities, control of a majority of the voting rights of a company, or rights associated with financing agreements.<sup>12</sup>

*Substantial control* is defined as having direction or substantial influence over important decisions of the reporting company, including acting as a senior officer (e.g., president, CEO, COO, CFO, general counsel) or having the authority to appoint or remove any senior officer or a majority of the board of directors.<sup>13</sup>

*Ownership* is broadly defined to include not just stock, voting and nonvoting shares, and capital or profits interests but also any interests convertible into one of the above, and any put, call, straddle, or other option.<sup>14</sup>

For trusts, the beneficial owners include (i) the trustee or other individual with the authority to dispose of trust assets; (ii) a beneficiary who is the sole permissible recipient of income and principal or who has the right to demand a distribution of/withdraw substantially all of the trust’s assets; and (iii) grantors/settlers with the right to revoke the trust or withdraw its assets.<sup>15</sup>

### Who is a company applicant?

Company applicants are the individual(s) who:

- Directly file the document that creates or first registers a reporting company with a U.S. state or Indian tribe, and/or
- Are primarily responsible for directing or controlling such filing<sup>16</sup>

This could include, for example, the paralegal who files the required documents with the state of formation, and the lawyer who advised the client to form the entity and instructed the paralegal to make the filing.

Companies need not report more than two company applicants. Further, the company applicant does not need to be reported for entities in existence prior to January 1, 2024.<sup>17</sup>

### When must companies report?

Per the statute and final regulations, entities formed (or registered to do business in the U.S.) *on or after* January 1, 2024, must report to FinCEN within 30 days of formation/registration. However, FinCEN recently published a Notice of Proposed Rulemaking extending the deadline for companies formed/registered in 2024 to 90 days following such action. (The 30-day deadline would continue to apply to companies formed/registered beginning in 2025.)

<sup>8</sup> 31 C.F.R. 1010.380(b)(1)(i).

<sup>9</sup> 31 U.S.C. section 5336(b)(2)(A).

<sup>10</sup> 31 U.S.C. section 5336(b)(3).

<sup>11</sup> 31 C.F.R. 1010.380(d).

<sup>12</sup> 31 C.F.R. 1010.380(d)(1)(ii).

<sup>13</sup> 31 C.F.R. 1010.380(d)(1)(i).

<sup>14</sup> 31 C.F.R. 1010.380(d)(2).

<sup>15</sup> 31 C.F.R. 1010.380(d)(2)(ii)(C).

<sup>16</sup> 31 C.F.R. 1010.380(e)(2).

<sup>17</sup> 31 C.F.R. 1010.380(b)(2)(iv).

Entities formed *before* January 1, 2024, must file an initial report with FinCEN no later than January 1, 2025.<sup>18</sup> Thus, if a new entity is likely to be needed sometime in 2024, forming that entity before the end of 2023 may be advisable to both buy some extra time to report to FinCEN and avoid the company applicant reporting requirement. Conversely, if an entity that would otherwise be reportable is no longer needed, it could make sense to dissolve that entity prior to year-end.

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Updated or corrected reports must be filed within 30 days of a change to previously submitted information or the discovery of an error.<sup>19</sup> An exempt entity that ceases to qualify for exemption must similarly report to FinCEN within 30 days of the triggering change.

Civil penalties of up to \$500 per day may be imposed, but only for willful noncompliance, i.e., intentional behavior. Criminal penalties include fines of up to \$10,000, two years in prison, or both.<sup>20</sup> Keeping a record of an entity's efforts to comply with the requirements of the CTA could be valuable to show that any alleged noncompliance was unintentional.

### **Who has access to CTA data?**

FinCEN may disclose beneficial ownership information for limited, specified uses upon request through (yet to be finalized) protocols. Requests for information may be rejected by FinCEN for any number of reasons, including "other good cause."<sup>21</sup> Permissible recipients include federal agencies (for national security, intelligence, or law enforcement purposes); state, local, and tribal law enforcement agencies (for use in civil or criminal investigations, if authorized by a court); and foreign law enforcement, prosecutors, or judges (only when requested through a U.S. federal agency).<sup>22</sup> Data may also be accessed by employees of the Treasury Department (including the IRS) for "tax administration" purposes.<sup>23</sup>

### **Next steps?**

While FinCEN has released a proposed online reporting form, neither that form nor the proposed FinCEN identifier application form has been finalized.<sup>24</sup> Though some members of Congress have called for FinCEN to postpone the January 1, 2024 effective date of the reporting regime, it does not appear that FinCEN is seriously considering that option at this time.

In light of this, those who oversee compliance for the tens of millions of closely held entities operating in the United States should act now to ensure that they understand the requirements of the CTA, how it applies to the various entities under their purview, how best to streamline the collection of information necessary to comply with the CTA, and how to monitor compliance on an ongoing basis.

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<sup>18</sup> 31 C.F.R. 1010.380(a)(1)

<sup>19</sup> 31 C.F.R. 1010.380(a)(2)-(3).

<sup>20</sup> 31 U.S.C. section 5336(h).

<sup>21</sup> 31 U.S.C. section 5336(c)(6).

<sup>22</sup> 31 U.S.C. section 5336(c)(2).

<sup>23</sup> 31 U.S.C. section 5336(c)(5).

<sup>24</sup> 88 Fed. Reg. 2760 and 88 Fed. Reg. 2764 (both published January 17, 2023).

# Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

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