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Corporate Transparency Act Factsheet

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Introduction

Are you a small business owner? Are you aware of the Corporate Transparency Act (CTA)? If not, it's important that you tune in to the recently imposed requirements set forth by the CTA. On January 1, 2024, a new reporting requirement created by the CTA went into effect that requires millions of small entities to file online reports with the federal government that disclose certain ownership information about those entities. This report is known as a Beneficial Ownership Information (BOI) Report and is filed with the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN). Congress's primary goal in enacting the CTA was to gather information about certain entities, their owners, management, and individuals to fight money laundering, tax fraud, and other illegal financial crimes. The CTA outlined filing requirements including who must file, what information should be reported, and when the information should be filed. Every small business owner should know about this new mandatory reporting requirement because failing to comply with regulations could result in severe penalties. However, recent litigation filed in several federal district courts also raise questions about the whether the CTA is permissible under the United States Constitution.

Background

What is the Corporate Transparency Act?

The CTA was part of a U.S. strategy to expose corruption and financial threats that exploited vulnerabilities in the U.S. financial system that allowed the hiding, laundering, storing, and moving of illicit business profits. Essentially, the CTA aimed to combat illicit activity involving financial crimes by capturing more ownership information for certain U.S. businesses operating in or accessing the U.S. market. Its goal included prioritizing efforts to prevent corruption that occurred as a means of money laundering through anonymous companies in the United States. The efforts were meant to equip law enforcement with the needed information to recognize and disrupt financial anonymity that enabled financial crimes, particularly crimes using shell corporations.

Timeline/Legislative History

Even though the CTA was passed by Congress in 2020, the required regulations became effective on January 1, 2024. The CTA was enacted by Congress in 2021 as part of the Anti-Money Laundering Act of 2020. The CTA was part of the National Defense Authorization Act for Fiscal Year 2021. FinCEN has stated that the CTA will "help to shed light on criminals who evade taxes, hide their illicit wealth, and defraud employees and customers and hurt honest U.S. businesses through their misuse of shell companies." To accomplish this, the CTA provides authorization to FinCEN to share the information collected in a BOI Report with certain government agencies, financial institutions, and financial regulations. In September 2022, FinCEN issued final regulations around reporting requirements (31 C.F.R. § 1010.380), which officially went into effect on January 1, 2024.

General Filing Requirements

Who Must File?

Under the CTA, both businesses and beneficial owners must file. All businesses registered to do business in the United States that meet certain criteria must submit a BOI Report to the FinCEN and provide details that identify individuals associated with the reporting company.

Two types of reporting businesses are categorized under the CTA, domestic and foreign. Domestic reporting business are corporations, limited liability companies (LLCs), and any entities created through documented filings with a secretary of state or similar state law or Indian tribe. This generally includes limited liability partnerships, limited liability limited partnerships, single-member LLCs, business trusts in certain states, and most limited partnerships. single-member LLCs, although disregarded for tax purposes, are still subject to reporting requirements. Foreign reporting businesses are corporations, LLCs, or other entities formed under the law of a foreign country registered to do business in any state or tribal jurisdiction

A beneficial owner under the CTA is an individual that has direct or indirect significant ownership stake in a company. This means the person has "substantial control" on the reporting company's decisions or operations, owns at least 25% of the company's shares, or has a similar level of control over the company's equity. The CTA defines "substantial control" as any individual that is a senior officer with authority to appoint or remove certain officers or a majority of directors or similar body, is an important decision maker, or has any other form of substantial control. This is a very broad definition of "substantial control," and an individual should lean towards a default assumption of a beneficial owner if they exhibit control over business decisions. It is important to note that beneficial owners do not include minors, individuals acting on behalf of others, an employee that is not a senior officer, individuals with future interests in the business, or creditors of reporting companies.

What Information Must Be Filed?

The CTA requires certain requirements for BOI Report information for both businesses and beneficial owners. The details within those requirements vary based on the date the business was established. Businesses must include: (1) full legal name, (2) any trade or "doing business as" names, (3) complete current street address of the principal place of business, (4) jurisdiction of formation, and (5) taxpayer identification number.

Beneficial Owners must include: (1) full legal name, (2) date of birth, (3) complete current residential street address (except in the case of a company applicant who forms or registers an entity in the course of the company applicant's business, who has to provide the street address of the business), (4) unique identifying number and the issuing jurisdiction from either a current (i) U.S. passport, (ii) state or local ID document, (iii) driver's license, or (iv) if the individual has none of those, a foreign passport, and (5) an image of the document from which the unique identifying number was obtained.

How is Information Filed?

All BOI Reports are filed electronically. As of January 1, 2024, FinCEN will accept all BOI Reports. FinCEN Identifier Numbers are available and can be obtained at or after the time an initial BOI Report is filed. A FinCEN Identifier is unique to the company or beneficial owner. A FinCEN Identifier Number can also be used to submit any updated information to an initial BOI Report.

Further, a "company applicant" is the individual that directly files the BOI Report and is responsible for the process of filing, if there is more than one individual assisting in the filing process. For a foreign business, this is also the individual that directly filed the required documentation for the business to officially be registered in the United States. A company applicant is not the same as a beneficial owner, but a company applicant can be a beneficial owner.

When Information Must Be Filed?

The CTA sets several important filing deadlines for companies and beneficials owners that must be followed. Any company that is created or registered after January 1, 2024, must file a BOI report. Any companies created or registered before January 1, 2024, are required to report only beneficial owners.

A company created before January 1, 2024, must file its initial BOI report by January 1, 2025. A company created after January 1, 2024, but before January 1, 2025, must file a BOI report within 90 calendar days of the date when it received actual or public notice that it was an effective company. A company created after January 1, 2025, must file a BOI Report within 30 calendar days of the date when it received actual or public notice that it was an effective company

Once a company files its initial BOI Report, all subsequent changes to the company must be reported. The reporting company or beneficial owner must file an updated report within 30 calendar days after the date when the changed occurred. Changes could include a change in beneficial owners (including a transfer of rights via a death of a beneficial owner) or a new awareness of an exception. If a BOI Report was filed inaccurately, a corrected report must be filed within 30 calendar days after the company is aware of, or has a reason to know of, the incorrect information.

Exemptions to Filing

There are certain entities that are exempt from filing. Most of the exemptions are for entities that are already heavily regulated under other areas by state or federal laws. It is important to understand whether or not your business qualifies for an exemption to understand how to comply with the CTA.

Twenty-three categories of companies are exempted from filing beneficial ownership reports under the CTA. Exempt entities include securities issuers, domestic governmental authorities, banks, insurance companies, public utilities, public accounting firms, credit unions, tax-exempt entities, state-licensed producers, among others. Certain "inactive entities" that were in existence before January 1, 2020, are also exempt.

A "large operating company" is also exempt under the CTA. A "large operating company" is defined as a business that: (1) employees over 20 full-time employees within the United States, (2) has a physical operating presence within the United States, and (3) filed a federal income tax or information return within the United States in the previous year that showed over $5 million in gross receipts or sales.

A full list of the twenty-three exempted categories can be found at [31 CFR § 1010.380(c)(2).]

Examples

Say that in 2019, Sam and Sally formed S&S Farms, LLC, a business entity to manage their farming operations. They own S&S in equal 50% shares, are the only business officers of the company, and have no additional employees. Under the CTA, Sam and Sally are both beneficial owners of S&S. Therefore, they must file a BOI Report by January 1, 2025, because the LLC was formed before January 1, 2024.

In another example, Ned and Nita formed N&N, Farms, LLC on February 1, 2024. They also created the business entity to manage their farming operations. Nita owns 75% of N&N and Ned owns 25%, but have 2 full-time employees. Under the CTA, Ned and Nita are also beneficial owners of N&N. While the addition of employees and share percentage does not change Ned and Nita's reporting requirements, the creation of N&N does. Because N&N was formed after January 1, 2024, Ned and Nita have 90 days from February 1, 2024, to file their BOI Report. Therefore, N&N must file their BOI Report by May 1, 2024.

Impact

What are the Penalties for Failing to Comply?
Noncompliance with the CTA's reporting requirements can result in significant penalties and the possibility of imprisonment. Even willfully providing incorrect or fraudulent information comes with penalties. Therefore, understanding the penalties associated with noncompliance is crucial.

Generally, penalties apply to any violations of the CTA's reporting obligations, but fines increase in severity when they are done willfully or intentionally. Fines range anywhere from $500 per day up to $10,000 and imprisonment of up to two years. This means that reporting failures can accumulate each day that the required information is not reported, and starts out with civil fines but could end up with criminal fines. Businesses must be aware of the various penalties associated with noncompliance or providing inaccurate or misleading information to the FinCEN.

In the introductory preamble to the CTA, FinCEN states, ""intends to prioritize education and outreach to ensure that all reporting companies and individuals are aware of and on notice regarding their reporting obligations." The regulations state that an individual willfully (meaning, purposely) fails to report if they cause the reporting failure or is a senior officer of the business at the time of the reporting failure.

The CTA does include a safe harbor provision that applies to businesses that discover an inaccuracy within their BOI Report and subsequently file a corrected BOI report within 90 days of that initial filed BOI Report. However, the safe harbor does not apply if at the time of the submitted BOI Report, the individual submitting the BOI Report "acts for the purpose of evading the reporting requirements . . . and has actual knowledge that the any information contained in the report is inaccurate."

Challenges to Implementing the CTA
All businesses may opt to file their own BOI Reports, and the CTA allows businesses to do so. However, the complexities within the reporting requirements might make the filing process complicated and unfamiliar for business. Therefore, consulting a knowledgeable advisor, such as an attorney or accountant, is something a business should consider. This is particularly so when filing an initial BOI Report, when considering the penalties for filing incorrect or fraudulent information.

However, it is also important to remember that not all accountants or attorneys will offer assistance in filing a BOI Report, so taking time to find the right professional will be important. Because the reporting requirements under the CTA are relatively new, choosing a professional service to help in filing a BOI Report should be done with care. In the tax and accounting profession, some companies will not take on business clients needing assistance in filing a BOI Report due to potential insurance policy limitations that may not cover an error or omission in filing. If a professional service does claim to have specialty in BOI Report filing, businesses should ensure they choose a service with proper expertise and reasonable fees.

One of the most important things businesses should do is avoid procrastination. Because of the tight deadlines for reporting information, delaying compliance is not an option. If a business has not taken action to start filing a BOI Report, it should start thinking about the reporting process. It is also recommended that businesses consider amending their bylaws or corporate governance documents to make BOI Report filing mandatory. Having clear internal guidance documents around BOI Report can help make the reporting process, and its required compliance, smoother. Businesses should also consider how reporting may affect material transactions, for example, how individuals with substantial control of the business conduct operations or make operational decisions for the business.

The CTA imposes significant burdens on small businesses. Although the CTA is intended to detect, expose, and prevent financial crimes that operate via shell entities, the required information included within the BOI Report can be cumbersome for small businesses to collect. Because of this, more general clarity and precision with the respect to these requirements will be needed in the future to reduce the burden on reporting companies and applicants to increase compliance and create more value for the information collected.

Recent Litigation

Recently, a federal district court in Alabama ruled that the CTA was unconstitutional. On March 1, 2024, the U.S. District Court for the District of Alabama released a 53-page opinion in the case of National Small Business Association v. Yellen (Case No. 5:22-cv-01448). The National Small Business United brought the suit, arguing that the CTA goes beyond Congressional authority to act as laid out in the Constitution. Judge Liles C. Burke found the argument persuasive and determined that Congress surpassed constitutional boundaries when it enacted the CTA. The Court permanently enjoined the government from enforcing the CTA against the National Small Business Association and its members. An appeal of this decision is pending, with oral arguments scheduled for September 27, 2024.

Since then, several other cases have been filed in district courts throughout the country, although no other courts have issued rulings based on those filings. The newer cases contain requests for injunctions against enforcement against anyone subject to its provisions, unlike the NSBU case, where the request was limited solely to the plaintiffs.

Conclusion

Overall, the CTA is a significant requirement for business operation within the United States. It represents the first attempt at cataloging national corporate database that tracks ownership of businesses within the United States. Because of this, the default assumption of any business or business owner should be that of compliance BOI Reporting. Overall, the CTA can seem incredibly complicated, and potentially even a bit scary. But with informed awareness and proper compliance, the CTA can seem less intimidating. An attorney can also assist any businesses concerned about how to most effectively and accurately comply with the CTA.

Resources

Final Rule CTA Reporting Requirements – Federal Register
Small Entities Must File New Beneficial Ownership Information Reports in 2024 – Iowa State University
Beneficial Ownership Information Reporting Frequently Asked Questions – Financial Crimes Enforcement Network
US Beneficial Ownership Information Registry Now Accepting Reports – Financial Crimes Enforcement Network
Small Entity Compliance Guide – Financial Crimes Enforcement Network
An Introduction to Beneficial Ownership Information Reporting – Financial Crimes Enforcement Network