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Corporate Transparency Act

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Introduction

- The Corporate Transparency Act (CTA), became effective January 1, 2024 (Effective Date)
- Intended to help law enforcement combat illegal activity.
- Reporting Companies must report beneficial ownership information (BOI) to the US Treasury Department's Financial Crimes Enforcement Network (FinCEN).
- The reporting requirements apply to many small companies that have never reported to the federal government (even IRS).
- Penalties for violating the CTA are <u>harsh</u>.

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Overview

This presentation discusses:

- Who must report? (“reporting companies”)
- Who is exempt? (23 Exemptions)
- What information is reported? (BOI)
- Who is a beneficial owner? (owners and controllers)
- When are initial reports due? When to update?
- What are the penalties for violations? (500/10,000/2 years/Double)
- How to comply with the CTA.

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Reporting Companies

Reporting Companies

- Reporting companies can be domestic or foreign entities.
- Domestic reporting companies are
  - corporations, limited liability companies (LLCs), or other entities
  - created by filing a document with a secretary of state (SOS) or similar office under the law of any U.S. state, DC, or any commonwealth, territory, possession or an Indian tribe.
- Foreign reporting companies are non-US entities that are:
  - corporations, limited liability companies (LLCs), or other entities
  - Formed under the law of a foreign country.
  - Registered to do business in any state or tribal jurisdiction by the filing of a document with a SOS or any similar office under the law of a state or Indian tribe.
- Basically, place of organization doesn't matter if you (1) filed creation documents OR registered to do business (2) with a state, territory, possession or Indian tribe.

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Exemptions from the CTA's Reporting Requirements

The CTA excludes 23 categories from the reporting company definition, including:

- Large operating companies.
- Public companies.
- Inactive entities.
- Tax-exempt entities and entities assisting tax-exempt entities.
- Subsidiaries of certain exempt entities.
- Federally registered investment companies or advisers.
- Venture capital fund advisers.
- Certain pooled investment vehicles.
- Insurance companies and producers.
- Public accounting firms.
- Governmental authorities.

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Exemptions from the CTA's Reporting Requirements (cont'd)

The CTA also excludes certain highly regulated entities, including:

- Banks, bank holding companies, and savings and loan holding companies.
- Credit unions.
- Money transmitting businesses and money services businesses.
- Securities brokers or dealers.
- Securities exchange or clearing agencies.
- Other entities registered with the SEC under the Exchange Act.
- Public utilities.
- Financial market utilities.

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Information a Reporting Company Must Report to FinCEN

A reporting company must report information about:

- Itself.
- Beneficial Owners.
- Company Applicants (if created or registered on or after the Effective Date). A company applicant is an individual who either:
  - Directly files the document that creates a domestic reporting company or first registers a foreign reporting company to do business in the US.
  - Is primarily responsible for directing or controlling the filing of the relevant document by another, if more than one individual is involved in the filing.

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Information a Reporting Company Must Report to FinCEN (cont'd)

A reporting company must report the following about itself:

- Full legal name (including trade names and d/b/a names).
- Complete current address.
- Place of creation (domestic) or registration (foreign).
- IRS TIN and/or EIN.

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Information a Reporting Company Must Report to FinCEN (cont'd)

For each beneficial owner and company applicant, a reporting company must report:

- Full legal name.
- Date of birth.
- Complete current address.
- Unique identifying number.
- Image of the document with the unique identifying number.

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Information a Reporting Company Must Report to FinCEN (cont'd)

The unique identifying number must come from one of the following non-expired documents issued to the individual:

- A US passport.
- A state, local, or Indian tribal ID document.
- A state-issued driver's license.
- If an individual does not have one of the above, foreign passport.

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FINCEN ID

- Instead of specific information about each beneficial owner, a reporting company can report an individual's FinCEN ID.
- Since the Effective Date, an individual can obtain a FinCEN ID by giving to FinCEN the same information a reporting company must provide regarding its beneficial owners.
- A reporting company can also obtain a FinCEN ID by checking a box on its BOI report.
- FINCEN ID may be good choice for:
  - Entities with many owners or subsidiaries
  - Individuals who own or control many entities or company applicants

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Beneficial Owners

Beneficial Owners

A beneficial owner is any individual who, directly or indirectly, either:

- Exercises substantial control.
- Owns or controls 25% or more of the ownership interests.

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Substantial Control

Exercising substantial control includes any of the following:

- Serving as a senior officer.
- Authority to appoint or remove either:
  - Any senior officer.
  - A majority of the reporting company's board of directors or similar body.
- Directs, determines, or has substantial influence over important decisions.
- Any other form of substantial control over the reporting company.

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Senior Officers

Senior officers include:

- President.
- Chief financial officer.
- General counsel.
- Chief executive officer.
- Chief operating officer.
- Any officer who performs a similar function.

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Substantial Influence over Important Decisions

Important decisions a reporting company makes include:

- Decisions about the nature and scope of business.
- Selling or leasing principal assets.
- Major expenditures or investments.
- Issuing equity.
- Incurring <u>significant</u> debt.
- Selecting or terminating business lines or ventures, or geographic focus, of the reporting company.

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Substantial Influence over Important Decisions (cont'd)

Important decisions a reporting company makes include:

- Approving operating budget.
- Compensation schemes and incentive programs for senior officers.
- Entering or terminating significant contracts.
- Amending substantial governance documents, policies, or procedures.

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Examples of Substantial Control

Exercising substantial control may include:

- Board representation (being a director by itself is not determinative).
- Owning or controlling a majority of the voting power or voting rights.
- Rights associated with any financing arrangement or interest in the reporting company.

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Examples of Substantial Control (cont'd)

Exercising substantial control may also include:

- Control over one or more intermediary entities that separately or collectively exercise substantial control over the reporting company.
- Financial or business arrangements, formal or informal, with other individuals or entities acting as nominees.
- Any other contract, arrangement, understanding, relationship, or exercise of control.

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Ownership Interests

Ownership interests include:

- Any equity, stock, or similar instrument.
- Any preorganization certificate or subscription.
- Any transferable share of, or voting trust certificate or certificate of deposit for, an equity security.
- An interest in a joint venture.
- A certificate of interest in a business trust.

- *Regardless of whether the interest is transferable, classified as stock or similar, or confers voting power or rights*.

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Ownership Interests (cont'd)

Ownership interests also include:

- Capital or profits interest.
- Convertible instrument, with or without consideration, into any ownership interest or any future on such an instrument, whether treated as debt or not.
- Warrant or right to purchase, sell, or subscribe to shares or other interests above.
- Put, call, straddle, or other option to buy or sell an interest, unless the option is held by a third party and not known to the reporting company.
- Any instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership.

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Ownership Interests (cont'd)

An individual may directly or indirectly own or control an ownership interest through:

- Any contract, arrangement, understanding, relationship, or otherwise, including joint ownership.
- A nominee, intermediary, custodian, or agent.
- Ownership or control of one or more intermediary entities.

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Calculating Total Ownership Interests

To calculate if an individual has 25% ownership interest:

- An individual's total ownership interests, directly or indirectly owned or controlled, are calculated:
  - As a percentage of the total outstanding ownership interests of the reporting company.
  - At the time of the report, with any options or similar interests being treated as exercised (i.e., fully diluted).
- If capital or profits interests are issued, the individual's ownership interests are their capital and profits interests over the combined total outstanding capital and profits interests.

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Calculating Total Ownership Interests (cont'd)

- For corporations, entities treated as corporations for tax purposes, and other reporting companies that issue shares of stock, total ownership equals *the greater of* the total combined:
  - (individual’s voting power of all classes)/(total voting power of all classes)
  - (individual’s value of all classes)/(total value of all classes)
- If total ownership can’t be calculated with reasonable certainty, owning or controlling 25% or more of *any class or type* of ownership interest is substantial.

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Individuals Exempt as Beneficial Owners

Five kinds individuals are excluded as beneficial owners:

1. Minor children (…until majority)
2. Heirs (…until inheritance)
3. Certain employees who are not senior officers.
4. "*Mere*" creditors of a reporting company.
5. Nominee, intermediary, custodian, agent on another's behalf.

Note these limitations!

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Determining Beneficial Owners

- An individual may indirectly own or control an ownership interest in a reporting company through one or more intermediaries.
- A reporting company with one or more entities as owners or in management (LP with LLC acting as general partner) may need those entities to provide the required personal information of all the individuals who are their direct and indirect owners.
- Reporting companies should:
  - Obtain beneficial owners' required personal information.
  - Be notified of changes to that personal information.
  - Update its agreements to define and allocate responsibility for updating information and requiring FinCEN IDs.

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Obtaining Beneficial Ownership Information and Being Notified of Changes

- A reporting company must determine how it will get information from appropriate individuals and implement appropriate policies and procedures.
- Beneficial owners need to provide information and updates with enough time to review and report when necessary.
- These obligations may be contained in agreements:
  - The reporting company's governing documents (Bylaws, shareholder, operating, partnership agreements).
  - Company policies.
  - Investment, warrant, employment, equity incentive, or other agreement.

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Deadlines

When a Reporting Company Must File Its Initial Report

A reporting company created or registered:

- Before the Effective Date has until January 1, 2025, to initially file.
- In 2024 must initially file *within 90 days*.
- In 2025 (or later) must initially file *within 30 days* of the earlier of:
  - Actual notice that creation or registration is effective.
  - A SOS or similar office first provides public notice by SOS or similar office.

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Reporting Changes

A reporting company has 30 days to report any changes to information in its BOI report regarding itself or its beneficial owners. For example:

- The reporting company changes its name or address or becomes exempt.
- A beneficial owner transfers their interest or there is a change to their address or unique identifying number.

- Correct any inaccuracies in its BOI report if it becomes aware or has reason to know of the inaccuracy.
- Note that 2024 new entities have 90 days, while changes require reports within 30. I believe that a change of business ownership before filing will not accelerate the reporting obligation.

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30 DAY SAFE HARBOR

If a reporting company with reason to believe its report contains inaccurate information (1) files a corrected report within 30 days of becoming aware or having reason to know of the inaccuracy, and (2) the inaccuracy:

- Is corrected within 90 days of filing the inaccurate report.
- Was not made to evade reporting requirements.
- Was not known to the person filing the report at the time it was submitted.

- Don't do nothing!

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Penalties for Reporting Violations

- There are civil and criminal penalties for violating the CTA. Fines up to $10,000, imprisonment for up to two years, or both.
- Any person who willfully:
  - Provides or attemps to provide false or fraudulent BOI.
  - Fails to report complete or updated BOI to FinCEN.
- Penalties may also apply to individuals or entities who:
  - Cause a reporting company not to report.
  - Are senior officers of a reporting company at the time of violation.

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…Any Good News?

On the Brightside

Silver linings:

- Tax savings, reorganizations, reconciliations, clean up.
- FinCEN IDs will reduce headaches.
- Compliance is doable once systems in place.
- Coincidence: I do this stuff!

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Questions

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