

The Corporate
Transparency Act:
What Every
~~Business~~ Attorney
Needs to Know

Chernoff's Lawyers in Limine
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Today's Presentation

- Why
- What
- Who
- Where
- How
- When
- As a lawyer, what do I need to do???

The WHY

- Congress has found that the U.S. lags behind other developed nations in its safeguards against the flow of illicit funds that are directed toward:
 - human and drug trafficking
 - terrorism
 - organized crime
 - money laundering
 - securities fraud
- The goal:
 - enhance national security
 - prevent bad actors from hiding assets in the U.S.

The WHAT

- The Corporate Transparency Act (CTA) is a bipartisan law enacted by Congress on January 1, 2021
 - Part of the National Defense Authorization Act (NDAA) which is a series of federal laws related to the US Department of Defense
 - Amends the Anti-Money Laundering Act (AMLA) of 2020
 - 31 C.F.R. § 1010.380
- CTA aims to eliminate the secrecy behind the ownership of anonymous shell companies by requiring all registered entities to file certain information with the US Department of Treasury's Financial Crimes Enforcement Network (FinCEN)
- The feds want to know WHO is running the entity

The WHO - #1

Reporting Company

- Domestic - a corporation, LLC, or any entity created by the filing of a document with a secretary of state or any similar office under the law of a state or Indian tribe.
 - May include any foreign entity authorized to transact business in a state other than its state of domicile.
- Foreign - a corporation, LLC, or other entity formed under the law of a foreign country that is registered to do business in any state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office.

Reporting Companies

23 types of entities are exempt

- Those that are already subject to substantial federal and/or state regulation or already have to provide their beneficial ownership information to a governmental authority, and
- Entities for which collecting information would neither serve the public interest nor be highly useful in national security, intelligence, and law enforcement agency efforts

Exemption Categories

- **Large operating companies that:**
 - **employ more than 20 full time employees in the United States**
 - **have an operating presence at a physical office within the United States, and**
 - **filed a Federal income tax or information return in the United States for the previous year demonstrating more than \$5,000,000 in gross receipts or sales**
- Domestic governmental authorities
- Securities issuers, brokers, dealers registered with the SEC
- Registered investment companies and advisers
- Banks, federal or state credit unions, registered money transmitting businesses
- Insurance companies and insurance producers
- Public accounting firms registered under the Sarbanes Oxley Act of 2002
- Public utilities
- **Tax-exempt Section 501(c) corporations, political organizations, charitable trusts or split interest trusts exempt from tax and the entities that provide assistance to such tax-exempt entities**
- Subsidiaries of certain exempt entities
- **Inactive businesses**

Inactive Entities

Any entity that:

- A. was in existence on or before January 1, 2020, and
- B. is not engaged in active business, and
- C. is not owned by a foreign person, whether directly or indirectly, wholly or partially, and
- D. has not experienced any change in ownership in the preceding 12-month period, and
- E. has not sent or received any funds in an amount greater than \$1,000, either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding 12-month period, and
- F. does not otherwise hold any kind or type of assets, whether in the United States or abroad, including any ownership interest in any corporation, limited liability company, or other similar entity.

Terminated Entities

- Not required to file:
 - An entity fully terminated prior to January 1, 2024
- Required to file:
 - Any legal entity in existence for any time in 2024, and
 - was terminated BEFORE December 31, 2024
 - Unless – an exemption category applies
- After initial report filed, no requirement for an entity to file that it has terminated

Tax-Exempt Entities

- Newly formed nonprofits may not be exempt from CTA filing until receipt of IRS tax-exempt determination letter, which may take up to a few years
- These entities must file pursuant to the appropriate deadline, but then can file an amendment once they are tax-exempt
- No further amendments will be required

Information to be Reported

1. Full name of the Reporting Company
2. Any trade name or “doing business as” name of the Reporting Company
3. Business street address of the Reporting Company
4. State or Tribal jurisdiction of formation of the Reporting Company (or for a foreign Reporting Company, the state or Tribal jurisdiction where such company first registers), and
5. IRS TIN of the Reporting Company (or, where a Reporting Company has not yet been issued a TIN, either a Dun & Bradstreet Data Universal Numbering System (DUNS) Number or a Legal Entity Identifier (LEI))

**Most small companies fall firmly
within the requirements of the
Corporate Transparency Act**

The WHO - #2

Beneficial Owner

- Any individual who, directly or indirectly, either
 - exercises **substantial control** over a reporting company, OR
 - owns or controls **at least 25 percent of the ownership** interests of a reporting company
- No obligation for the Beneficial Owner to report WHY they are a Beneficial Owner
- The rule defines the terms “substantial control” and “ownership interest” in detail

Substantial Control

- Three specific indicators of “substantial control”:
 - senior officer
 - authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of directors (or similar body)
 - direction, determination, or decision of, or substantial influence over, important matters affecting a Reporting Company
- An individual can exercise substantial control directly or indirectly through a variety of means
- It is possible that not all board members exercise substantial control

25% Ownership

- An individual's total ownership interest as compared to the outstanding ownership interests of the Reporting Company
- Rule includes a catch-all provision to include any other instrument, contract, arrangement, understanding, relationship, or other mechanism used to establish ownership.

Calculating Ownership Interest

- Calculated at present time
- Options treated as exercised
- Capital or profits interest: calculated as a % of total outstanding company capital/profits interest
- Stock % calculated based on the greater of:
 - (1) owner's total combined voting power as a % of outstanding voting power of all classes; or
 - (2) owner's total combined value of ownership interests as a % of total outstanding value of all classes
- If unable to calculate: any individual who owns or controls at least 25% of any class of ownership interest is deemed a beneficial owner for purposes of the CTA

Trust as Owner of Entity

If a trust is a member of an entity, Beneficial Owners of the entity may be:

- a **trustee** that has the authority to control/dispose of trust assets
- a **beneficiary** who has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or
- a **grantor** that has the right to revoke the trust or otherwise withdraw the assets of the trust.

The determination for the above is:

- Who exercises substantial control over the reporting company
- Who owns/controls at least 25% of ownership interests in the trust

*Family revocable trusts are not Reporting Companies, but business trusts may be

Community Property

Q: If one spouse has an ownership interest in a reporting company, is the other spouse also considered a beneficial owner if the reporting company is created or registered in a community property state?

A: Possibly. Whether State community property laws affect a beneficial ownership determination will depend upon the specific consequences of applying applicable State law.

If, applying community property State law, both spouses own or control at least 25 percent of the ownership interests of a reporting company, then both spouses should be reported to FinCEN as beneficial owners unless an exception applies.

Ownership Dispute

Q: What should a reporting company report if its ownership is in dispute or the subject of active litigation?

A: If an initial BOI report has not been filed, a person authorized by the company should report:

- all individuals who exercise substantial control over the company, and
- all individuals who own or control, or have a claim to ownership or control of, at least 25 percent ownership interests.

The reporting company must file an updated BOI report within 30 calendar days of resolution of the litigation if ownership has changed.

Exclusions

1. Minor child, provided that a parent or guardian's information is reported
2. Individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual
3. Individual acting solely as an employee of a Reporting Company in specified circumstances (senior officers not excluded)
4. Individual whose only interest in a Reporting Company is a future interest through a right of inheritance
5. Creditor of a Reporting Company

The WHO - #3

Company Applicant

Defined as:

- the individual who directly files the document to create or register the Reporting Company, and
- the individual who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing
- Limited to two (2) Company Applicants
- Company Applicants may be employed by a business formation service or law firm
- Not retroactive - existing entities formed or registered before January 1, 2024 are not required to report Company Applicant information

The WHO - #3

Company Applicant

Test:

1. What individual directed the filing of the formation document?
2. What individual pushed the button to file?

Lawyers, paralegals, business consultants, etc. included

Ultimately, under the test, it's the lawyer, not the paralegal, who is the company applicant (together with the actual filer, i.e., the third-party service provider)

Information to be Reported

- For Beneficial Owners and Company Applicants:
 1. Name
 2. Birthdate
 3. Address
 4. A unique identifying number and issuing jurisdiction from an acceptable identification document
 5. Image of such document
- Company Applicant's address can be a business address
- Beneficial Owner information must be updated as appropriate
- No obligation to update Company Applicant's information, provided it was correct at the time of filing

Information to be Reported

If the name on the identification document of a beneficial owner or company applicant does not match their current full legal name or address, an individual should file:

- the individual's current full legal name or address; and
 - an acceptable identifying document that includes the non-current information
- A beneficial owner or company applicant should file an update once the new identifying document that includes the updated information is obtained

Statutory Agents

- The CTA imposes no obligations on Statutory Agents or law firms (unless they also act as the Company Applicant or are a Beneficial Owner)

The Challenge

- Identifying which clients fit the definition of **Reporting Company**
- Identifying **Company Applicant**
- Who is a **Beneficial Owner**:
 - Identifying everyone with a **25%+ ownership**
 - Determining everyone with **Substantial Control**

The WHERE

- A Reporting Company is one that is registered with a secretary of state or any similar office under the law of a state
- In Arizona, any entity registered with the Corporation Commission or AZ SOS, unless exempt per the rules

The HOW

- BOSS – the Beneficial Owner Secure System
 - FinCEN’s national database that will receive, store, and maintain all information required by the CTA
 - BOI reports will be submitted via online form
- BOSS will be secured to a Federal Information Security Management Act “High” compliance level, the highest information security protection level under the Act

The WHEN - Filing

- Entities already formed before January 1, 2024
 - Must register in BOSS before January 1, 2025
- Entities formed after Jan. 1, 2024 and before Jan. 1, 2025
 - Must register in BOSS within 90 days of the date of formation
- Entities formed on or after January 1, 2025
 - Must register in BOSS within 30 days of the date of formation
- Correction of Errors
 - Must file corrections within 30 days of when the Reporting Company became aware or had reason to know of the inaccuracy of information in earlier reports
 - Safe harbor available to Reporting Company if voluntarily corrected reports are filed no later than 90 days after submission of an inaccurate report

The WHEN - Updates

- Changes to Reporting Company/Beneficial Owner info
 - Must file changes within 30 days of change
 - Address changes
 - Ownership changes
 - New form of unique identification or new piece of documentation
 - If entity newly qualifies for an exemption
 - Domestication from one jurisdiction to another
 - Corporate conversion – must file:
 - updated BOI report for converting entity
 - new BOI report for new/converted entity

FinCEN Identifier

- For a Beneficial Owner, Company Applicant, or Reporting Company
 - Submitted to FinCEN via a web-based application
- Can then be used in lieu of entering the required information for each Reporting Company
- Helpful if:
 - an individual is a Beneficial Owner of multiple entities
 - a Company Applicant files on behalf of multiple entities
 - a law firm employee is filing on behalf of clients

Who can Access the Information?

- Not publicly available
- BOI will be available on request only by
 1. federal law enforcement agency
 2. state, local, or tribal law enforcement agency (if authorized by a court order)
 3. federal agency on behalf of a foreign country (if the request is pursuant to an international agreement)
 4. financial institution for customer due diligence purposes and if authorized by the reporting company

Penalties for Non-Compliance

The rule specifies penalties for persons who “willfully provide, or attempt to provide, false or fraudulent Beneficial Ownership information” or “willfully fail to report complete or updated Beneficial Ownership information”

- Civil penalties of up to \$500 for each day a violation continues or has not been remedied. (Adjusts for inflation – today is \$591)
- Criminal penalties of fines up to \$10,000, imprisonment for up to two years, or both.
- Methods of enforcement of CTA have not been specified

So Who is Liable?

Who is liable for ensuring the accuracy and completeness of the data?

- A “person” = a Reporting Company, an individual and any other entity.
- Both individuals and entities may be liable for willfully failing to report complete or update beneficial ownership information
- Individuals can be held liable if they either cause the failure or are a senior officer at the company at the time of the failure

So Who is Liable?

- An inadvertent mistake by a Reporting Company acting in good faith after diligent inquiry would not constitute a willfully false or fraudulent violation
- But how “diligent” must the “inquiry” be to constitute “good faith” by the person submitting the report?

Third-party Service Providers

- Reporting companies may use third-party service providers to submit beneficial ownership information reports.
- Third-party service providers will have the ability to submit the reports via FinCEN's BOI E-Filing website or an Application Programming Interface (API).
- Reporting Company must obtain FinCEN's acknowledgement of submission success or failure from the third-party service provider.

Considerations for Attorneys

- As Reporting Companies, law firms must report their Beneficial Owner information:
 - Determine who is a Beneficial Owner (consider ownership and control)
 - Collect personal information
 - Ensure changes are filed within 30 days

Considerations for Attorneys

- As counsel for clients, will the law firm or its employees:
 - serve as the Company Applicant for new entities registering on or after January 1, 2024 by filing Articles with the AZ Corp. Comm.?
 - Get FinCEN identifiers for its clients?
 - Complete BOI filings?
- Is the firm able to keep all Beneficial Owner personal information secure?

Considerations for Attorneys

- Consider amending engagement letter to:
 - Impose obligation on clients to provide complete and accurate ownership information
 - Disclaim firm's obligation to independently verify any information from client
 - Secure indemnification for penalties if client provides false information
- Consider firm's obligation if it discovers that client has provided false information - might the firm be required to breach its obligation of confidentiality?

Considerations for Clients

- Adopt compliance policy or process
- Appoint compliance officer to track Beneficial Owner information and changes
- Amend bylaws and operating agreements to:
 - require persons who could be considered Beneficial Owners to provide the required information to the company
 - Limit confidentiality that the entity owes to its owners and employees
- Include obligation in C-level employment contracts
- Take steps to identify all Beneficial Owners, if there have been changes over time

Sample LLC Operating Agmt Provision

The Members intend for the Company to comply with its obligations under the Corporate Transparency Act of 2020 (as amended, the “CTA”) and with the regulations (the “CTA Regulations”) promulgated by the Financial Crimes Enforcement Network (“FinCEN”) thereunder. Accordingly, the parties appoint the Person set forth on Schedule 1 to this Agreement to serve as the Company’s “CTA Compliance Officer” and authorize the CTA Compliance Officer to cause the Company to perform its obligations under the CTA and the CTA Regulations, including, without limitation, by causing the Company to file any beneficial ownership report that may be required thereunder. The Members also agree:

CTA Data. Each Member who owns any economic interest in the Company will provide to the CTA Compliance Officer such Member’s (the following collectively referred to as the “CTA Data”): (i) full legal name; (ii) date of birth; (iii) residential street address; and (iv) a unique identifying number from an acceptable identification document (i.e., a non-expired U.S. passport or driver’s license) and an image of the same document, which includes a photograph of the individual in sufficient quality to be legible or recognizable.

Indirect Ownership. With respect to any Member that is not a natural Person, the Member shall provide CTA Data for each natural Person (as applicable, an “Indirect Owner”) who owns, indirectly or beneficially, any economic interest in the Company through such Member.

Substantial Control Data. Each Member will also provide to the CTA Compliance Officer any information or documents (collectively, the “Substantial Control Data”) that may be required to determine whether such Member or any Indirect Owner has “substantial control” over the Company, including, without limitation, by (i) serving as a senior officer, (ii) having authority over the appointment or removal of any senior officer or a majority or dominant minority of a board (or similar body), (iii) having any direction, determination, or decision-making power or substantial influence over important matters affecting the Company, including, but not limited to: (1) nature, scope, and attributes of the business of the Company, including the sale, lease, mortgage, or other Transfer of any Property; (2) reorganization, dissolution, or merger; (3) major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget; (4) the selection or termination of business lines or ventures, or geographic focus; (5) compensation schemes and incentive programs for senior officers; and (6) the entry into or termination, or the fulfillment or nonfulfillment of significant contracts; (7) amendments of any substantial governance documents and significant policies or procedures.

Duty to Promptly Report. Each Member and Indirect Owner will promptly notify the CTA Compliance Officer in writing of any change in CTA Data or Substantial Control Data previously provided by such Member or Indirect Owner to the CTA Compliance Officer after such change occurs (but in any event, no more than five (5) calendar days after such change occurs).

Indemnity. Each Member shall indemnify and defend the Company against any third-party claim, loss, or expense, incurred by the Company as a result of (a) any inaccuracy in any CTA Data or Substantial Control Data provided by such Member or any Indirect Owner, or (b) any failure of such Member to provide amended CTA Data or Substantial Control Data to the CTA Compliance Officer within the required time period above. The failure of a Member to provide CTA Data or Substantial Control Data to the Company is a material breach of this Agreement.

Sample Executive Employment Agmt Provision

Employee acknowledges that Employer may be a “reporting company,” as that term is defined in the Corporate Transparency Act of 2020 (31 U.S.C. § 5336), as amended, including the rules and regulations promulgated by the Financial Crimes Enforcement Network (“FinCEN”) of the U.S. Department of Treasury thereunder (the “CTA”). Employee acknowledges that the Employer may be required to report certain beneficial ownership information (“BOI”) regarding the Employee as a result of Employee being deemed a “beneficial owner” through the Employee’s “senior officer” position in which the Employee exercises “substantial control” over the Employer pursuant to, and within the meaning of the CTA. Employee, therefore, covenants and agrees to supply the Employer with any requested BOI, as well as any subsequent changes to such information, to permit the Employer to satisfy its obligations under the CTA. Employee represents and warrants that Employee shall supply and update any requested BOI to the Employer within three (3) business days of such a request. Employee also represents and warrants that such information will be true, correct, and complete. Employee may, but is not required to, apply for a FinCEN identifier (which can be obtained here: <https://fincenid.fincen.gov/landing>), which may be supplied to the Employer in lieu of providing BOI, provided the Employee understands he is responsible for updating FinCEN within the time period required under the CTA in the event of any changes to the BOI provided to FinCEN in connection with obtaining the FinCEN identifier. For more information about the CTA and BOI reporting requirements, FinCEN has provided Frequently Asked Questions and other resources on its website here: <https://www.fincen.gov/boi>. Employee shall indemnify and defend the Employer against any third-party claim, loss, or expense incurred by the Employer as a result of (i) any inaccuracy in any BOI provided by the Employee to the Employer or FinCEN (through a FinCEN identifier the Employee may obtain), or (ii) any failure of Employee to provide amended BOI to the Employer or FinCEN (through a FinCEN identifier the Employee may obtain) within the time period required by this Section or the CTA. Employee’s failure to provide BOI is a material breach of this Agreement.

Resources

- The Corporate Transparency Act:
 - <https://www.congress.gov/bill/116th-congress/house-bill/2513/text>
- FinCEN BOI Main page: <https://www.fincen.gov/boi>
- FinCEN FAQ: <https://www.fincen.gov/boi-faqs>
- FinCEN – Small Entity Compliance Guide
 - https://www.fincen.gov/sites/default/files/shared/BOI_Small_Compliance_Guide.v1.1-FINAL.pdf
- FinCEN - Beneficial Ownership Information Reporting Rule Fact Sheet
 - <https://www.fincen.gov/beneficial-ownership-information-reporting-rule-fact-sheet>

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