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Understanding the Corporate Transparency Act

If you own or control certain business entities, it's important to understand the operative provisions of this new law

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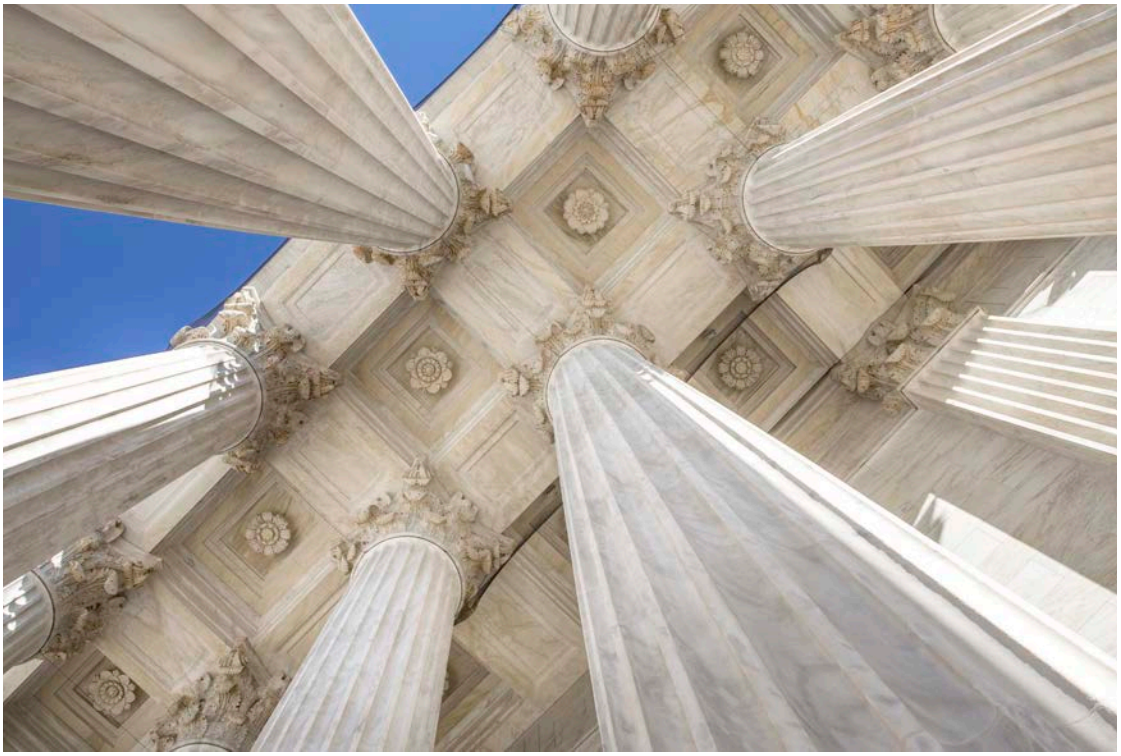
Key Points

- While you may not have heard of the CTA, it is the most significant piece of anti-money laundering legislation since the Patriot Act in 2001 and will impact roughly 36 million existing entities
- All wealth planning and tax professionals, as well as business owners, need to understand the compliance obligations under the CTA in advance of it going into effect in 2024
- Consult with your advisory team to fully prepare for any impact the CTA may have on you or your business entities



Privacy has become a hallmark aspect of business entities in the United States. Corporations, partnerships, limited liability companies (LLCs), and similar entities provide a notable amount of privacy. Wealthy families in search of privacy often use business entities to hold investments, planes, boats, and real estate. This privacy has at times been used for secrecy by those looking to launder money, avoid taxes, and finance illegal activities. In response to these illicit activities, in 2021 Congress enacted the Corporate Transparency Act (CTA). The CTA is the most significant piece of anti-money laundering legislation since the Patriot Act in 2001.

The principal objective of the CTA is to create a national database, overseen by the Financial Crimes Enforcement Network (FinCEN), containing certain identifying information on the individuals who, directly or indirectly, own or control certain types of domestic and foreign entities. Under the CTA and as described in the final regulations, a "Reporting Company" will be required to provide certain identifying information on (i) the entity itself, (ii) its "Beneficial Owners," and (iii) "Company Applicants." The identifying information to be reported on a Reporting Company will include, without limitation, its legal name, any DBAs associated with it (a DBA, or "doing business as," refers to when the company conducts business under a name other than its legal name), identifying tax information, and contact information. The identifying information to be reported on Beneficial Owners and Company Applicants will include, without limitation, legal name, date of birth, a physical contact address, and additional identifying information and documentation.

With the CTA set to go into effect in 2024, it is important to understand the operative provisions of this new law, importantly, how a "Reporting Company," "Beneficial Owner," and "Company Applicant" will each be defined.

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Reporting Companies

Do not be misled by the name, the CTA focuses on more than just corporations. The law's target is any organization serving as a shell company used for illicit purposes.

The CTA applies to corporations, partnerships, LLCs, and other legal entities created by the filing of a document with the Secretary of State or a similar office under the law of a state or Indian tribe. The CTA also applies to foreign legal entities that register to do business in the U.S. by filing registration documents.

There are 23 exemptions from the definition of a Reporting Company. Generally speaking, these exemptions only exist because such exempt entities are already the subject of regulations that require the reporting of similar information. Here is a short list of exemptions:

- Large operating companies located in the U.S. (at least 20 employees and $5 million of revenue)
- Issuers of securities registered with the Securities and Exchange Commission
- FDIC insured banks, credit unions, and deposit institution holding companies
- Commodity Exchange Act registered entities
- Registered investment companies or investment advisers, broker-dealers, and registered venture capital fund advisers
- Insurance companies
- Public accounting firms
- Regulated public utilities
- Tax-exempt organizations
- Inactive companies

Note: Generally, a trust will not be deemed to be a Reporting Company under the CTA. However, in many cases, a trust will be a Beneficial Owner of a Reporting Company and, therefore, certain information relating to the trust will need to be reported to FinCEN.

Examples of a Reporting Company:

- The LLC you established to hold rental property
- An LLC without employees established by a family to hold various financial assets and business interests for estate planning purposes
- An operating S Corporation with 10 employees

Beneficial Owners

A Beneficial Owner of a Reporting Company is defined as any individual who, directly or indirectly, exercises substantial control over a Reporting Company, or owns or controls not less than twenty-five percent of the ownership interests of a Reporting Company.

An individual can exercise "substantial control" over a Reporting Company based upon a variety of facts and circumstances. Some examples include, without limitation, an individual who:

- Serves as a senior officer, or exercises the authority or performs the functions of a senior officer of the Reporting Company
- Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) of the Reporting Company
- Directs, determines, or has substantial influence over important matters made by the Reporting Company
- Has "any other form of substantial control" over the Reporting Company

For purposes of determining if an individual owns or controls not less than a 25% ownership interest, the term "ownership interest" is defined broadly and the final regulations of the CTA provide important guidelines on how to determine if an interest rises to the level of a Beneficial Owner.

Note: According to the regulations, under certain circumstances a trustee of a trust may be considered to exercise substantial control over a Reporting Company. Further, with regard to a trust that holds an ownership interest in a Reporting Company, multiple individuals may be deemed to own or control the same interest (trustees, grantors, beneficiaries, etc.).

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As you can see, the definition of a Beneficial Owner is broad and is subject to interpretation.

Examples of Beneficial Owner:

- LLC is owned 50% by husband and 50% by wife. Husband and wife will both be deemed Beneficial Owners
- John Smith is the president of ABC Corporation, a small family business with 15 employees and generating $3,000,000 in revenue per year. The 100% owner of the Corporation is his father, George Smith. Who will be deemed a Beneficial Owner? Answer: John Smith (as officer) and George Smith (as owner).

Company Applicants

A Company Applicant is defined as any individual who files the document with an applicable agency that creates a domestic Reporting Company or who first registers a foreign Reporting Company with an applicable agency.

Example of a Company Applicant: A lawyer and his/her paralegal—in the case the lawyer forms the entity and directs the paralegal to file.

Deadlines

Reporting Companies created before January 1, 2024, must report the necessary information with FinCEN no later than January 1, 2025. Reporting Companies formed on or after January 1, 2024, must report the necessary information with FinCEN within 30 days.

Note: This is not an annual filing requirement, but an "as needed" filing requirement. Generally, updates to FinCEN must be reported within 30 days of a change to the information submitted.

Penalties

There are both financial and criminal penalties associated with non-compliance of the CTA, therefore, this new law must be understood and followed by those with reporting obligations.

How to prepare

While you may not have heard of the CTA, it will impact roughly 36 million existing entities. All wealth planning and tax professionals, as well as business owners, need to understand the compliance obligations under the CTA in advance of 2024. Additionally, you might consider the following action items:

- Begin gathering information sooner rather than later. Recall that you will need physical addresses and certain identifying documentation for all Beneficial Owners of a Reporting Company
- Determine who will handle reporting both initially and on an ongoing basis
- Attorneys and others that anticipate being deemed a Company Applicant may consider obtaining a FinCEN identification number, which may be reported in place of identifying information to the Reporting Company
- Attorneys and other advisors should consider notifying clients about new reporting obligations
- Do you have unnecessary legal entities? If so, now may be the time to dissolve them to ensure those entities do not trigger a filing requirement under the CTA
- Is there an opportunity to restructure existing entities?
  - For business owners having multiple entities, is there an opportunity to restructure in a way to limit reporting requirements?
  - Does an entity have deemed Beneficial Owners who would be unwilling or hesitant to share personal information with the Reporting Company or with FinCEN? If so, you may want to reconsider the roles of these deemed Beneficial Owners in advance of the filing deadline.

Stay tuned

FinCEN has indicated that they will do a public campaign as we get closer to 2024 to inform the general public of the new filing requirements under the CTA. In addition, we anticipate that the forms and the electronic filing system used to report the necessary information to FinCEN will be released later this year.

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As part of the Wilmington Trust Emerald Family Office & Advisory® team, Kerry is responsible for providing strategic and holistic wealth planning advice to high-net-worth individuals, entrepreneurs, executives, and their families by reviewing and illustrating their current plans, highlighting potential deficiencies, and modeling effective tax and estate planning strategies. In addition, Kerry advises on all areas of estate and trust administration and charitable planning.

Kerry holds her LL.M. in taxation with a concentration in estate planning from Boston University School of Law, her JD from UMass Dartmouth School of Law, her master's degree from Bridgewater State University, and her bachelor's degree from Bridgewater State College. Kerry is a member of the Boston Bar Association (BBA) and the New Hampshire Bar Association. Currently, she is the co-chair of the Estate Planning Committee under the T&E Section of the BBA where she is a regular speaker.