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TAX ALERT – JULY 26, 2023

Corporate Transparency Act – Implementation is Fast Approaching

The Corporate Transparency Act (the **"CTA"**) is fast approaching implementation. On March 24, 2023, FINCEN (US Treasury Department, Financial Crimes Enforcement Network) published its first set of guidance material intended to aid the public in understanding the upcoming beneficial ownership requirements taking effect on January 1, 2024.

The first set of guidance includes: (i) "Beneficial Ownership - Frequently Asked Questions" (**"FAQ"**) containing, in particular, illustrative examples of who is, and who is not, a "beneficial owner" under the CTA; (ii) one pagers on key filing dates and key questions; and (iii) introductory and information videos about the reporting requirements.

We issued a tax alert on February 23, 2021, regarding the enactment of the CTA. This tax alert is intended as an update.

Background

The CTA was enacted to combat terrorism, money laundering and serious tax fraud. It requires the disclosure of identifying information (including drivers licenses or passports) to FINCEN concerning beneficial owners of certain US corporations, limited liability companies and business trusts (each a "reporting company"). The Act is generally effective January 1, 2024.

The CTA was enacted as part of the Anti-Money Laundering Act of 2020. The first set of implementing Regulations under the CTA were proposed in December 2021 and finalized in September 2022.

In December 2022, FINCEN published a second set of proposed, implementing Regulations governing the disclosure, access and safeguarding of beneficial ownership information.

A third set of implementing Regulations, governing customer due diligence and especially relevant to financial institutions, should be published by January 1, 2025.

Key Filing Dates – One Pager

The "Key Filing Dates - One Pager" identifies key filing dates under the Act and Regulations. New reporting companies created or registered to do business in the US on or after January 1, 2024, must be reported within 30 calendar days of receiving actual or public notice that the creation or registration is effective.

Key Filing Dates – One Pager (Cont.)

Existing reporting companies created or registered to do business in the US prior to January 1, 2024, must issue reports by January 1, 2025. Note that the Beneficial Owner Information system is not yet up and running.

In addition, updated reports are due within 30 calendar days after a change to previously reported information about the reporting company itself or its beneficial owners. Corrected reports are due within 30 calendar days after the reporting company becomes aware of or has reason to know of an inaccuracy.

Key Questions – One Pager

The "Key Questions – One Pager" provides useful information, particularly regarding the definition of "reporting company." For instance, a key factor in determining whether a company will have to report is whether it has to file a document with a state's secretary of state or a similar office to create the company. Thus, not only are US corporations and limited liability companies and business trusts required to report but also other entities that are required to register with a state secretary of state must report (e.g., limited partnerships in a number of relevant states).

In addition, any entity formed under the law of a foreign country and registered to do business in any US state by the filing of a document with a secretary of state (or similar office) must report.

There are 23 separate exemptions from the definition of reporting company. Many regulated companies (including publicly traded companies) and larger entities are excluded. Larger entities include those employing more than 20 full-time employees in the US, have an operating presence at a physical office in the US, and demonstrate more than $5 million in gross receipts or sales on their Federal income tax return (excluding foreign receipts/sales).

Beneficial Ownership FAQ

Reporting corporations must file a report with FINCEN, providing identifying information about the corporation's "beneficial owners." A beneficial owner is an individual who, directly or indirectly (i) exercises "substantial control" over the reporting company or (ii) owns or controls at least 25% of its ownership interests.

Under the final Regulations, whether an individual has "substantial control" over a reporting company depends on the power he or she may exercise over a reporting company. For example, an individual will have substantial control of a reporting company if he or she can direct, determine, or exercise substantial influence over "important decisions" the reporting company makes (including the appointment or removal of any senior officer or majority of the board of directors).

Beneficial Ownership FAQ (Cont.)

The Regulations contains a lengthy illustrative list of "important decisions" (e.g., sale, lease, mortgage or transfer of principal assets; reorganizations, dissolutions or mergers; major expenditures or investments, issuance of any equity or significant debt, or operating budget approval; selection or termination of business lines or ventures or geographic focus, compensation schemes and incentives programs for senior officers; entry into or termination or fulfilment or nonfulfillment of significant contracts; or amendment of substantial governance documents).

In addition, any senior officer is deemed to have substantial control over a reporting company. A "senior officer" is defined as "any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function." Missing from the final regulations are "corporate secretary" and "treasurer."

Other rights or responsibilities may also constitute substantial control. This provision, which is vague and potentially circular, aims to recognize that control exercised in novel and less conventional ways nevertheless can be "substantial."

Further, a reporting company organized on or after January 1, 2024, is also required to report its "company applicants" as well as its beneficial owners. A company applicant is (i) the individual who directly files the document that creates, or first registers, the reporting company and (ii) the individual who is primarily responsible for directly controlling the filing of the relevant document. Thus, the company applicant reporting is intended to report up to 2 persons.

A. The Beneficial Ownership FAQ provides three illustrative examples of "beneficial owner" summarized below:

Example 1: *The reporting company is a limited liability company (LLC). Mr. A is the sole owner and president of the company and makes important decisions for the company. No one else owns or controls ownership interests in the company or exercises substantial control over the company.*

Mr. A is a beneficial owner in two different ways. First, he exercises substantial control over the company because he is a senior officer of the company (the president). Second, he is also a beneficial owner because he owns 25% or more of the reporting company's ownership interests.

Example 2: *The reporting company is a corporation. The company's total outstanding ownership interests are shares of stock. Three people (individuals A, B, and C) own 50%, 40%, and 10% of the stock, respectively, and one other person (individual D) acts as the president for the company but does not own any stock.*

Beneficial Ownership FAQ (Cont.)

A and B are beneficial owners because they each own at least 25% of the company's ownership interests. D is a beneficial owner because he is a senior officer of the company (the president). C is not a beneficial owner because he satisfies neither the ownership test (he owns only 10% of the company stock) nor the substantial control test (he is not a company officer).

Example 3*: The reporting company is a corporation owned by four individuals (A-D) who each own 25% of the company's ownership interests (e.g., shares of stock). Four other individuals (E-H) serve as the reporting company's CEO, CFO, COO, and general counsel, respectively, none of whom hold any of the company's ownership interests.*

Each of the 8 individuals are beneficial owners. Individuals A-D each satisfy the ownership test (each owns at least 25% of the company stock). Individuals E-H each satisfy the substantial control test (each is a senior officer of the company).

B. The Beneficial Ownership FAQ provides two illustrative examples of "company applicant" summarized below:

Example 1*: Individual A is creating a new company. He prepares the necessary documents to create the company and files them with the relevant state office, either in person or using a self-service online portal. No one else is involved in preparing, directing, or making the filing.*

A is a company applicant because he directly filed the document that created the company. State employees who receive and process the company creation and formation document are not company applicants.

Example 2*: Individual A is creating a company. Individual A prepares the necessary documents to create the company and directs Individual B to file the documents with the relevant state office. Individual B then directly files the documents that create the company.*

A and B are both company applicants. B is a company applicant because he directly filed the documents, and A is a company applicant because she was primarily responsible for directing or controlling the filing. A and B would be company applicants even if, for instance, B was A's spouse, business partner, attorney or accountant.

Going Forward

A major criticism of the Regulations is that the "substantial control" standard is too ambiguous and open-ended. The above are some basic examples of who is a "beneficial owner" and "company applicant." We expect that FINCEN will provide additional guidance in the future.

This content is for general information purposes only and does not constitute tax advice.

If you have any questions or would like additional information on the topics covered in this alert, please contact your engagement partner.

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