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Corporate Transparency Act Essentials: Everything You Need to Know Regarding the Forthcoming Regulations

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In January of 2021 Congress enacted the Corporate Transparency Act (“CTA”), legislation that will create federal reporting requirements for millions of private companies that have never been required to disclose information about company ownership. New rules implementing the CTA will be put in place later in 2022.

If you set up a limited liability company for your small business, your company is now likely considered a “reporting company” that is required to report information to the Financial Crimes Enforcement Network (“FinCEN”), a division of the U.S. Treasury Department. Penalties for non-compliance with the CTA’s reporting requirements can be quite severe, including \$500,000 fines and jail time, so it is paramount that all business owners understand how to properly navigate the CTA and forthcoming regulations.

Congress’ intent behind the legislation is to prevent the use of anonymous shell and front companies for illegal purposes (like money laundering, terrorist financing, tax fraud, etc.) and to align the U.S. with international practice. To accomplish these objectives, the CTA will require certain legal entities to disclose those who control or own at least 25% of the company and those who organize the company. As currently drafted, FinCEN’s CTA regulations will affect an estimated 30 million existing business entities and an additional 3-4 million new entities each year. If you are forming a company to (i) start a new business venture, (ii) operate as a holding company, (iii) acquire the assets of an existing company, or (iv) for any other purpose, there is a good chance that the CTA will impose reporting obligations on the company.

While FinCEN has yet to issue its final ownership reporting rules or set an effective date for the CTA, the proposed rule contains important information for individuals who form, own, or control business entities, including (1) who must comply with the CTA’s reporting requirements, (2) what information must be reported to FinCEN, (3) who may access the information that is collected, (4) deadlines for reporting information to FinCEN, and (5) penalties for non-compliance with the CTA’s reporting requirements.

Who must comply with the CTA’s reporting requirements?

Under the CTA, only “reporting companies” (both domestic and foreign) are required to submit reports containing “beneficial owner” and “company applicant” information to FinCEN. Generally, a “domestic reporting company” is any legal entity that is created by filing a document with a state’s Secretary of State (“SOS”) (or similar office), and a “foreign reporting company” includes entities formed under the

laws of a foreign country that are registered to do business in the U.S. The reporting company definition would include any corporation, limited liability company, limited partnership or other entity that is formed by filing with an SOS.

While these definitions seem all-encompassing, the CTA provides twenty-three (23) specific exemptions from the definition of “reporting company,” generally categorized as (i) “larger” companies that are already subject to significant state or federal regulation (e.g., public companies), (ii) service providers, and (iii) tax-exempt entities. One specific exemption is for entities with an operating presence at a U.S. office with over 20 full-time employees, provided such entity filed federal income tax returns in the U.S. reflecting more than \$5 million in gross receipts or sales.

What information must “reporting companies” report to FinCEN?

FinCEN’s proposed regulations require reporting companies to report information about (i) the entity itself, (ii) the company’s “beneficial owners,” and (iii) the “company applicants.”

To ensure each reporting company can be uniquely identified by FinCEN, a reporting company will be required to report its name, any alternative names through which the company is engaging in business (e.g., d/b/a names), its business street address, its jurisdiction of formation or registration, as well as a Taxpayer Identification Number (“TIN”) or Employer Identification Number (“EIN”).

In addition, a reporting company must report information about every “beneficial owner” and “company applicant.” A beneficial owner is defined as any individual who (i) exercises substantial control over the reporting company, or (ii) owns or controls at least 25% of the ownership interests of the reporting company. Generally, a company applicant is the individual who files to (1) form the entity (in the case of a domestic reporting company) or (2) register the entity to do business in the U.S. (in the case of a foreign reporting company). However, company applicants also include anyone who directs or controls these filings by another. In many cases, a reporting company might have several company applicants. For example, both the attorney who incorporates a company on behalf of a client, and the client individually, would be considered company applicants under FinCEN’s proposed regulations.

Reporting companies must disclose each beneficial owner and company applicant’s full legal name, date of birth, current residential or business street address, and either a unique identifying number from an acceptable identification document (e.g., a passport) or a FinCEN identifier (i.e., a unique identifying number FinCEN will issue to individuals upon request). This information is, of course, a treasure trove for identity thieves. One can only hope that FinCEN will be a more responsible custodian of this information than other federal agencies.

When will reports to FinCEN be due?

The time at which a required report is due depends on (i) when the reporting company was created or registered, and (ii) whether the report is an initial report, an updated report providing new information, or a report correcting erroneous information in a previous report.

Reporting companies created or registered to do business in the U.S. before the effective date of FinCEN’s final reporting regulations will have one year from the effective date to file their initial report with FinCEN. Reporting companies created or registered on or after the effective date of the final regulations will be required to file their initial report with FinCEN within fourteen (14) calendar days of the date on which they are created or registered.

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If there is a change in the information previously reported to FinCEN, reporting companies will have thirty (30) calendar days to file an updated report. Finally, if a reporting company filed information that was inaccurate at the time of filing, the reporting company will have to file a corrected report within fourteen (14) calendar days of the date it knew, or should have known, that the information was inaccurate.

What are the penalties for non-compliance with the CTA's reporting requirements?

Any individual, reporting company, or other entity who "willfully provides, or attempts to provide, false or fraudulent beneficial ownership information to FinCEN" or "willfully fails to report complete or updated beneficial ownership information to FinCEN" may be subject to both civil and criminal penalties. Such penalties for non-compliance include (i) a civil penalty of up to \$500 for each day a violation continues or has not been remedied, and (ii) a fine of up to \$500,000 and up to two (2) years' imprisonment, or both, for criminal violations.

Next Steps

As noted above, FinCEN has yet to issue its final rule regarding the CTA's reporting requirements, but as Congressional pressure mounts to finalize the regulations, Kutak Rock is keeping close tabs on the situation and will continue to monitor any updates regarding the regulations. If you have questions about how, if at all, the CTA will affect your business, or whether you will need to report under the CTA, please contact a member of Kutak Rock's Scottsdale Corporate & Securities Practice Group. You may also visit us at www.kutakrock.com.

