



International Update

The Corporate Transparency Act: By failing to prepare, you're preparing to fail

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The goal of this article is to educate the reader on the key provisions of the Corporate Transparency Act, 31 USC § 5336 (2021) (CTA), the steps you can take to prepare your company for these new reporting requirements, and additional considerations that may govern compliance and the future implementation of and amendments to the CTA.

Overview

The Corporate Transparency Act, 31 USC § 5336 (2021) (CTA) is a United States law that was enacted on 1 January 2021 (and effective as of 1 January 2024) with bipartisan support, that aims to combat money laundering and other illicit activities (eg, OFAC violations, terrorism funding, human drug trafficking and securities fraud) by certain domestic and foreign entities registered to do business in the United States. The CTA requires 'Company Applicants' of 'Reporting Companies' to disclose their 'Beneficial Owners' to the United States Government, with such information to be stored in the 'Beneficial Ownership Secure System' database (Database) and managed by The Financial Crimes Enforcement Network (FinCEN), a bureau of the United States Department of Treasury. The information housed in the Database may be freely shared with, inter alia, local, state, federal, foreign security, intelligence, law enforcement agencies and regulators in their efforts to uncover and prosecute illicit activities which may be concealed by entities which, to date, have not been subject to such reporting requirements. Such information may also be shared with financial institutions as part of their 'Know Your Customer' due diligence if, and only if, such Reporting Company consents to the dissemination of the same in its reporting to FinCEN.

Beginning 1 January 2024, any entity that meets the definition of a 'Reporting Company' must file its initial report by 1 January 2025 (if such entity was formed prior to 1 January 2024) (Pre-Existing Entity) or within 90 days of such entity's formation (if such entity is formed on or after 1 January 2024) (New Entity). If applicable changes to the ownership and/or control of a Reporting Company occur following that entity's initial report, such entity's Company Applicant(s) must file an amendment with FinCEN within 30 days of such change to the extent its initial report becomes inaccurate as a result thereof. Penalties against Company Applicants and Reporting Companies for non-compliance with the CTA (eg, providing knowingly false or misleading information or a failure to timely file an initial report or any required amendments thereto) include civil penalties not to

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exceed \$500 for each day that the violation continues or has not been remedied (capped at \$10,000) and/or a criminal penalty of imprisonment (up to 2 years).

The time is now to start preparing your company for any reporting requirements it may face and to begin incorporating language into a commercial joint venture or other entity agreements, loan documents and other commercial agreements to govern the prompt and accurate reporting of your partners, customers and counterparties.

Key Provisions

The CTA defines ‘Company Applicant’ as: (a) the individual who is responsible for filing the documents that create the entity or, in the case of a foreign entity qualified to do business in the United States, the individual who directly files the document that first registers the foreign reporting company to conduct business in a state; and/or (b) the individual who is primarily responsible for directing or controlling the filing of the relevant formation or registration document by another. Special attention should be given by in-house legal departments, law firms and third-party servicers who may meet the definition of a ‘Company Applicant’ having previously assisted in the formation of Pre-Existing Entities and who may be asked by clients to form New Entities. Of note, the CTA does not require the disclosure of Company Applicants for Pre-Existing Entities, but it is unclear whether the civil and/or criminal penalties promulgated under the CTA will be enforced against such individuals for failure to comply.

The CTA defines a ‘Reporting Company’ as:

any corporation, limited liability company, or other similar entity created by filing a document with the secretary of state or similar office in any state or territory or with a federally recognized Indian Tribe, or formed under the laws of a foreign country and registered to do business in the United States.

For domestic entities, depending on the state of formation, some limited partnerships and business trusts may not qualify as a ‘Reporting Company’ if those entities are not created by the filing of a document with the secretary of state or similar office, so Company Applicants should be mindful of the applicable state laws governing such entity’s formation in determining whether to report. Additionally, there are 23 exceptions to the definition of a ‘Reporting Company’, which include entities that are already subject to strict reporting requirements (eg, certain publicly traded companies, non-profit companies, large operating companies and financial institutions). FinCEN estimates that nearly 32 million businesses will be required to report in 2024 and approximately 5 million new businesses per year thereafter.

The CTA defines ‘Beneficial Owner’ as ‘any individual who, directly or indirectly, (a) exercises substantial control over the entity (e.g., Manager, President, CEO, COO, CFO, GC), or (b) owns or controls at least 25 percent equity in the entity’. Again, there are several exceptions to the definition of Beneficial Owner, which include minors, custodians and certain employees and creditors. The full legal name, domicile addresses, date of birth and

unique identification numbers (eg, driver's license number and/or passport numbers) of each Beneficial Owner must be disclosed as part of the reporting.

A full list of exceptions to the definitions of Reporting Companies and Beneficial Owners can be found on FinCEN's website, along with a handbook containing illustrative examples.

How to Prepare

If your entity will qualify as a Reporting Company, it is imperative that you begin (a) identifying your Company Applicant and Beneficial Owners; (b) familiarizing yourself with the reporting process; and (c) creating internal processes to track such information and ensure timely and accurate initial and/or amended reporting. Importantly, if your entity structure involves several control parties, owners or layers of indirect owners which are beyond your immediate control, special attention should be given to obtaining certified records from such members and intermediaries as to their corporate structure to ensure accurate reporting of all Beneficial Owners. Moreover, governing language should be added to joint venture documents for New Entities that requires each member and intermediary thereof to certify as to any individual who may meet the definition of Beneficial Owner and to promptly report any changes to the ownership or control of such parties so that the Company Applicant can timely amend any prior reporting. Lastly, business owners should consult with their accountants and attorneys on whether they intend to implement new client engagement terms which may restrict or entirely prohibit such service professionals from handling formation documents for new entities to avoid the risk of being deemed a Company Applicant and assuming the responsibilities (and potential liability) that results therefrom.

FinCEN has acknowledged in a recent amendment to the CTA published 30 November 2023 that many businesses may struggle to meet the reporting requirement deadlines of the initial CTA and has consequently extended the reporting period to 90 days following formation for New Entities formed between 1 January 2024 and 31 December 2024 (from the 30-day deadline under the original CTA); provided, however, that New Entities formed on or after 1 January 2025 will remain subject to the initial 30-day reporting deadline. Since the CTA directs FinCEN to 'promulgate regulations that achieve the objectives of the statute, while minimizing burdens on reporting companies to the greatest extent practicable' while creating a Database that is 'highly useful' in facilitating national security, intelligence and law enforcement activities, further amendments will likely continue into 2024 to address public concerns. For example, several recent comment submissions received by FinCEN have proffered aligning reporting deadlines with tax return deadlines or providing extension rights for initial submittals, and others have emphasised the value in postponing compliance deadlines of the CTA so as to not overwhelm the Database with submittals, to allow accountants and attorneys time to digest the new rules and properly counsel clients, to provide additional time for FinCEN to react to public comment and promulgate further guidance on compliance.

If you are a financial institution, you may want to consider (a) modifying your term sheets, commitment letters; and loan documents to require your borrower(s) and guarantor(s) to comply with the CTA and to include covenants that such entities shall provide their consent to release their reporting to you; (b) being mindful of any changes to the CTA that will expand your statutory 'Know Your Customer' requirements; and (c) requiring existing borrower(s) and guarantor(s) to provide their consent to enable you to access their reporting on a go-forward basis.

The Future of the CTA

As the CTA rolls into effect, the hope is that a more transparent business environment in the United States will deter bad actors and lead to a more stable and welcoming small business economy. On the ownership side, partners should now be empowered to obtain detailed records of their counterparts and their affiliates, which will, in turn, lead to greater clarity regarding the ownership structure and identity of key individuals. On the creditor side, it is expected that FinCEN will modify the 'Customer Due Diligence Rule', which requires financial institutions to conduct due diligence on the identity of Beneficial Owners to require financial institutions to meet certain new 'Know Your Customer' requirements of the CTA in an effort to expand the reach of the CTA. It is not out of the realm of possibility that challenges may be brought against FinCEN and the CTA based upon the potential financial burdens associated with compliance (including, without limitation, the internal processes and procedures above, the negotiation of new language into joint venture or other entity agreements, loan agreements, other commercial agreements and a potential shift by accountants and attorneys away from their prior roles as facilitators of company formations). If advanced, these challenges will likely stem from interpretation of the CTA's compliance with the US Federal Register No 12866 of 30 September 1993, 'Presidential Documents', US Federal Register No 13563 of 18 January 2011, 'Presidential Documents' and US Federal Register No 14094 of 6 April 2023, 'Modernizing Regulatory Review', Regulatory Flexibility Act, 5 USC § 601 (1980), Unfunded Mandates Reform Act, 2 USC § 1501 (1995) and Paperwork Reduction Act, 44 USC § 3501 (1980), which, collectively, require the CTA to not amount to 'significant regulatory action' which increases the financial burden of such Reporting Companies. For all of these reasons, small business owners should stay apprised of any upcoming congressional hearings, FinCEN press releases, amendments, rulings and related briefings.