

The Corporate Transparency Act

TEXAS TRUST LAW, PLLC

www.TEXASTRUSTLAW.com

- Special thanks to Michael Ripp for helping prepare this presentation.
- Content originally presented on September 19, 2023 to the Austin Tax Study Group.

Outline of Presentation

- Introduction
- Elements of Corporate Transparency Act
- Reporting Companies
 - The Basics
 - Exemptions
- Initial Report
 - Who Reports?
 - Who Is a Beneficial Owner?
 - What to Report?
 - Time to Report
 - Updating Reports
- Penalties
- Miscellaneous
 - Errors
 - Death
 - FinCEN Identifiers

Introduction

Professionals in the Cross-Fire!

- 31 U.S.C. §5336 - Final Rule (31 CFR §1010.380) issued on 9/30/22
- Goal: to enhance laws surrounding money laundering through transparent reporting of beneficial owners
- Use of Information: The information is available to six types of requesters:
 - (1) U.S. (federal) national security/law enforcement agencies in furtherance of such activities;
 - (2) State, local, or tribal law enforcement, if authorized by a court to seek information in a civil or criminal case;
 - (3) Department of Treasury;
 - (4) Financial institutions (with customer consent) to facilitate customer due diligence;
 - (5) Federal and state regulators regulating financial institutions; and
 - (6) Foreign law enforcement agencies who submit qualifying requests.

Elements

- 1) Reporting companies;
- 2) Must file an initial report;
- 3) Within a certain period of time; ***and***
- 4) Update that report periodically.

Reporting Companies: The Basics

- General Rule
 - A domestic reporting company is a:
 - 1) Corporation;
 - 2) LLC; or
 - 3) Similar entity created by filing a document with a secretary of state (SOS) of a U.S. state or Native American Tribe.
 - A foreign reporting company is a:
 - 1) Corporation, LLC, or other entity;
 - 2) Formed under the law of a foreign country; and
 - 3) Registered to do business in any state or tribal jurisdiction by filing a document with a secretary of state or similar office.

Reporting Companies: Exemptions

- 1) Governmental Entities;
- 2) Entities Subject to Government Regulation;
- 3) Tax-Exempt Entities and Entities Assisting Tax-Exempt Entities;
- 4) Large Operating Companies;
- 5) Inactive Entities; and
- 6) Subsidiaries of Certain Entities.

Reporting Companies: Exemptions

- Governmental Entity

- A) Established under the laws of the U.S., a Native American Tribe, or a state or political subdivision thereof; and
- B) Exercises governmental authority on behalf of the U.S., Native American Tribe, state, or subdivision.

Reporting Companies: Exemptions

Entities Subject to Government Regulation

- Securities Reporting Issuer
- Bank
- Credit Union
- Depository Institution Holding Company
- Money Services Business
- Broker or Dealer in Securities
- Securities Exchange or Clearing Agency
- Other Exchange Act Registered Entity
- Investment Company or Investment Advisor
- Venture Capital Fund Advisor
- Insurance Company
- State-Licensed Insurance Producer
- Commodity Exchange Act Registered Entity
- Accounting Firm registered under Sarbanes-Oxley
- Public Utility
- Financial Market Utility
- Pooled Investment Vehicle (RIC or private placement fund)

Reporting Companies: Exemptions

Tax-Exempt Entity

- A company is not a “reporting company” and need not file an initial report if it is either:
 - 1) Described in IRC §501(c) and is exempt from tax under IRC §501(a);
 - **501(a)**: Organizations described in 501(c) are exempt from tax.
 - **501(c)**: Includes traditional charities under 501(c)(3), but also social welfare organizations, labor/agricultural organizations, business leagues, chambers of commerce, professional sports leagues, country clubs, cemeteries, etc.
 - 2) A political organization (as defined in IRC §527(e)(1)) that is exempt from tax under IRC §527(a); *or*
 - Think political parties, PACs, and similar groups.
 - 3) A trust described in IRC §4947(a)(1) or (2).
 - Charitable trusts and split-interest charitable trusts.

Reporting Companies: Exemptions

Large Operating Company

- A) Employs over 20 full-time employees in the U.S.;
- B) Has an operating presence at a physical office in the U.S.; ***and***
- C) Filed a tax return for the previous year showing gross receipts of over \$5,000,000 (excluding sales from outside the U.S.).

Reporting Companies: Exemptions

Inactive Entity

- A) In existence before 1/1/2020;
- B) Not actively engaged in business;
- C) Not owned, directly or indirectly, by a foreign person;
- D) No change in ownership in the last 12 months;
- E) Has not sent or received funds over \$1,000 in the last 12 months; ***and***
- F) Does not otherwise hold assets (anywhere in the world) including ownership interests in other companies.

Initial Report: Who Reports?

Must report information on:

- 1) Beneficial owners;
- 2) Company applicants; and
- 3) The reporting company itself.

Who is a Beneficial Owner? – Elements

- Elements: 31 CFR §1010.380(d)
 - An individual;
 - Who directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise;
 - Either:
 - Exercises substantial control over a reporting company; or
 - Owns or controls at least 25% of the ownership interests of a reporting company.

Who is a Beneficial Owner? – Substantial Control

- Per Se Substantial Control
 - Senior Officers – 31 CFR §1010.380(f)(8)
 - President;
 - CEO, CFO, COO;
 - General Counsel; and
 - Other officers regardless of title with similar functions.
 - Authority to appoint/remove any senior officer or a majority of the board of directors.
- Quasi-Facts and Circumstances Control
 - People who directly or substantially influence important decisions regarding:
 - Nature, scope, and attributes of the business;
 - Reorganization, dissolution, or mergers;
 - Major expenditures or investments;
 - Selection or termination of business lines, ventures, or geographic focus;
 - Compensation schemes and incentive programs for senior officers;
 - Entry into or termination of significant contracts; or
 - Amendments to substantial governance documents.
- Catch-All
 - Any other form of substantial control exercised.
 - “Control exercised in new and unique ways can still be substantial.” (Small Entity Compliance Guide, p. 17)

Who is a Beneficial Owner? – Direct or Indirect Substantial Control

- Generally – 31 CFR §1010.380(d)(1)(ii)
 - An individual may directly or indirectly, including as trustee of a trust or similar arrangement, exercise substantial control via:
 - Board representation;
 - Ownership or control of a majority of voting rights or power;
 - Rights associated with any financing arrangement;
 - Control over one or more intermediary entities that separately or collectively exercise such control;
 - Arrangements or financial or business relationships with other individuals; or
 - Any other contract, arrangement, or understanding.

Who is a Beneficial Owner? – At Least 25% Ownership

- What is Ownership?
 - Any equity, stock, or similar arrangement.
 - Any capital or profit interest in the entity.
 - Any instrument convertible (with or without consideration) into any share or instrument described above.
 - Any put, call, straddle, or other option to buy or sell the preceding.
 - “If [the] company has issued any options, privileges, or convertible instruments, assume they have been exercised or converted.” (Small Entity Compliance Guide, p.23)
 - Any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership.

Who is a Beneficial Owner? – At Least 25% Ownership

- Calculation (31 CFR §1010.380(d)(2)(iii) and Small Entity Compliance Guide, p. 23)
- **Stock (C or S Corp. for FIT Purposes)**: An individual's ownership interest is the greater of the two percentages:

$$\frac{\text{Individual's Voting Power \%}}{\text{Total Combined Voting Power of All Classes of Individual's Ownership Interests}} = \frac{\text{Individual's Voting Power \%}}{\text{Total Outstanding Voting Power of All Classes of Ownership Interests Entitled to Vote}}$$

OR

$$\frac{\text{Individual's Ownership Interest Value \%}}{\text{Total Combined Value of Individual's Ownership Interests}} = \frac{\text{Individual's Ownership Interest Value \%}}{\text{Total Outstanding Value of All Classes of Ownership Interests}}$$

- **Capital or Profit Interests (Partnership for FIT Purposes)**:

$$\frac{\text{Individual's Capital and Profits Interest \%}}{\text{Individual's Capital and Profit Interests}} = \frac{\text{Individual's Capital and Profits Interest \%}}{\text{Total Outstanding Capital and Profit Interests}}$$

Who is a Beneficial Owner? – Ownership or Control via Contract

- An individual can directly or indirectly “own or control” an ownership interest via any contract, arrangement, etc., including:
 - Joint ownership; and
 - Via another individual acting as a nominee, intermediary, or agent of such person.
- What about trusts?
 - “Owns and controls” includes:
 - As the trustee of a trust with the power to dispose of trust assets;
 - As the beneficiary of a trust if the beneficiary:
 - is the sole permissible recipient of income and principal from the trust; or
 - has a right to demand a distribution of or withdraw substantially all of the trust assets; or
 - As the grantor/settlor of a trust who has the power to revoke the trust or withdraw trust assets.

Who Is a Beneficial Owner? – Exceptions

- Exceptions:
 - 1) Minor Children;
 - 2) Nominee, Intermediary, Custodian, or Agent;
 - 3) Employees;
 - 4) Inheritors;
 - 5) Creditors; and
 - 6) Ownership by Exempt Entities**
- Ownership by Minors
 - Only a parent or legal guardian's information needs to be reported.
 - Must clearly indicate that this is the case.
 - **But Note: 31 CFR § 1010.380(a)(1)(iv):** Upon attaining the age of majority, the company must report the child-owner's information within 30 days.

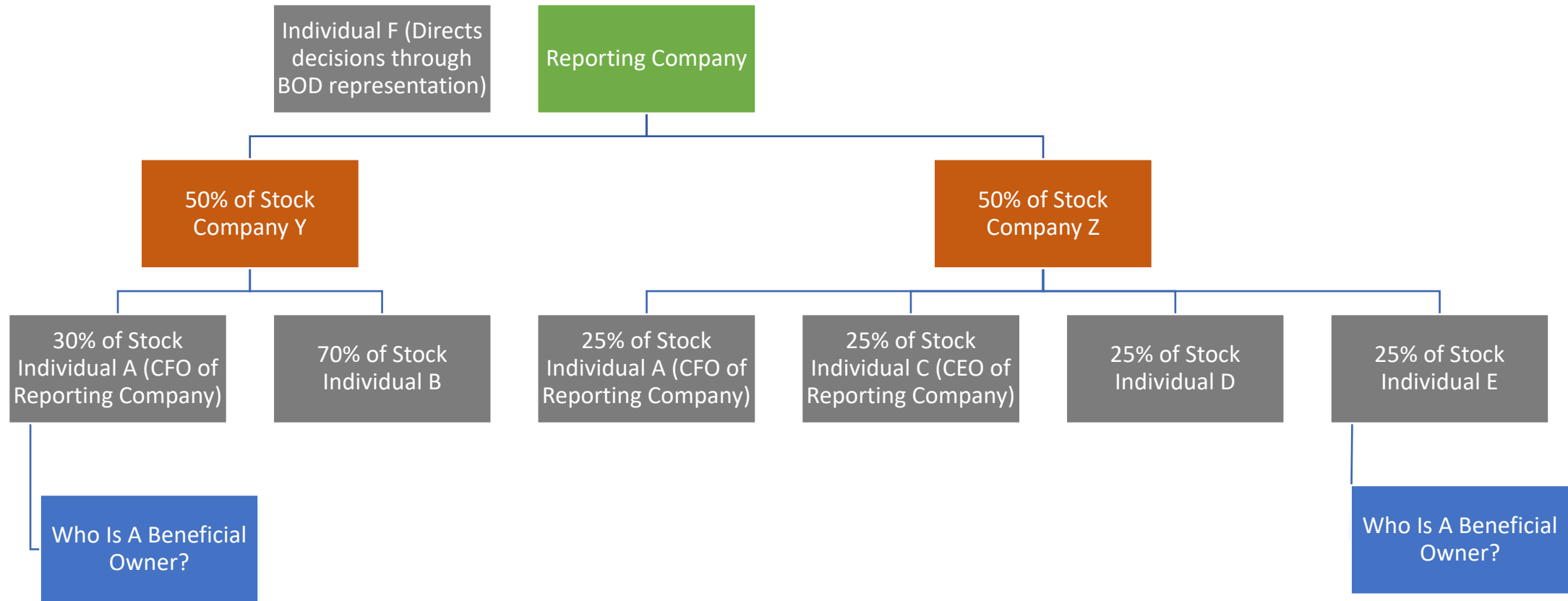
Who is a Beneficial Owner? – Exceptions

- Nominee, Intermediary, Custodian, or Agent
 - Merely acts on behalf of an actual beneficial owner in their capacity as a nominee, intermediary, custodian, or agent.
 - “Individuals who perform ordinary advisory or other contractual services (such as tax professionals) likely qualify for this exception.” (Small Entity Compliance Guide, p. 29)
- Employees
 - Subject to the will and control of the employer in what and how to do work and subject to dismissal from work;
 - Individual’s substantial control over or economic benefits from the company are derived solely from their employment status as an employee; **and**
 - Individual is not a senior officer.
- Inheritor
 - The individual’s only interest is a future interest through a right of inheritance.
 - **But Note**: Once they actually inherit the interest, this no longer applies (more below).
- Creditors
 - Stake in the company solely through rights or interests for the payment of a predetermined sum of money.

Who is a Beneficial Owner? – Exceptions

- Ownership by Exempt Entities**
 - **31 CFR §1010.380(b)(2)(i)**: Only report the name of an exempt entity-owner if:
 - An entity is exempt from reporting (see above exemptions);
 - An individual owns at least 25% of that exempt entity; **and**
 - That exempt entity owns a reporting company.
 - **Exception**: Foreign pooled investment funds.
 - Foreign pooled investment funds must report the individual with control or with the greatest authority over strategic management (31 CFR §1010.380(b)(2)(iii)).

Example



Example - Answers

- **Individual A**: Yes
 - Senior Officer *and* owns 27.5% of Reporting Company.
 - 15% of Company Y + 12.5% of Company Z = 27.5% of Reporting Company
- **Individual B**: Yes
 - Owns 35% of Reporting Company.
- **Individual C**: Yes
 - Senior Officer.
 - Only owns 12.5% of Reporting Company.
- **Individual D**: No
 - Only owns 12.5% of Reporting Company.
- **Individual E**: No
 - Only owns 12.5% of Reporting Company.
- **Individual F**: Yes
 - On the board of directors and makes important decisions, exercising substantial control.

Initial Report: What to Report?

Beneficial Owner Information

- Legal name;
- Date of birth;
- Current residential address;
- A unique identifying number from either:
 - Non-expired passport;
 - Non-expired driver's license;
 - Non-expired state-issued ID; or
 - Non-expired passport issued by a foreign government to the individual, if preceding are unavailable.
- Image of the above document.

Initial Report: What to Report?

Company Applicant Information

- Definition
 - Two individuals can qualify as a company applicant :
 - 1) One who directly files the document that creates or first registers a reporting company; *and*
 - 2) One who is primarily responsible for directing or controlling the filing of the relevant document.
 - Companies or legal entities cannot be company applicants.
- **Effect**: Company applicant must report the same info as a beneficial owner.
- **Exceptions**:
 - 1) **Business Address**: Can use business address instead of applicant's residential address.
 - 2) **More Than One Applicant**: **31 CFR §1010.380(e)**: if more than one person is involved, each company applicant must be reported.
 - "Each reporting company . . . Will have to identify and report to FinCEN at least one company applicant, but at most two [company applicants]." (Small Entity Compliance Guide, p. 34)
 - 3) **Entities Formed Prior to 2024**: **31 CFR §1010.380(b)(2)(iv)**: Need not provide information about the company organizer/applicant, but the company must indicate on its initial report that it was formed prior to 2024.
 - 4) **FinCEN Identifiers** (see below)

Initial Report: What to Report?

Reporting Company Information

- Legal name and any assumed name or d/b/a;
- Physical street address of principal place of business;
- State (or other jurisdiction) of formation;
- For a foreign reporting company, the state or tribal jurisdiction where it first registered to do business; and
- Its U.S. TIN or, if none, its foreign TIN and issuing jurisdiction.

Time To File

- Entities Created Before 01/01/2024
 - Reporting Companies must report by 01/01/2025.
- Entities Created On or After 01/01/2024
 - Must file an initial report within 30 days from the earlier of:
 - Date it received notice from the SOS that it is registered to do business in the state; or
 - Date which SOS provides public notice of such (via publicly available registry).
- Transition to Non-Exempt Entity
 - **31 CFR §1010.380(a)(1)(iv)**: Any entity that was exempt but no longer qualifies for any exemption must file an initial report within 30 days of failing to meet that exemption.

Updating Reports

- General Rule
 - No annual filing is required.
 - If there is a change in any of the information, the reporting company must file an updated report within 30 days.
 - **Reminder**: This includes changes to:
 - Name;
 - Address; or
 - Unique identifying number.
 - **New Image**: “If a beneficial owner obtained a new [identifying document] that includes the changed name, address, or identifying number,” the reporting company must file an updated report with the new image. (Small Entity Compliance Guide, p. 45)
- Transition to Exempt Entity from Non-Exempt Entity
 - **31 CFR §1010.380(a)(2)(ii)**: Company must file an updated report stating that it is now an exempt entity.
- Death
 - Requires an updated report (more later).

Penalties

- What is a violation?
 - It is a violation to ***willfully***:
 - File or attempt to file a report with false or fraudulent information; or
 - Fail to complete or update a report.
- Who is responsible?
 - A person is responsible for failing to file a report if:
 - The company was a reporting company;
 - The reporting company fails to file a report; and
 - The person either causes the failure or is a senior officer of the entity at the time of the failure (strict liability?).
- Consequences (31 USCA §5336(h)(3)(A))
 - \$591/day civil fine (adjusted for inflation); and
 - May be fined not more than \$10,000, imprisoned for up to 2 years, or both.
 - **Question**: Is the civil fine unlimited or does this cap the civil fine?

Example

- Client A is a CFO of a Reporting Company. Client A moves on November 15, 2025, but fails to notify the Reporting Company until April 15, 2026. What penalty could this result in?

Example (With Answer)

- Client A is a CFO of a Reporting Company. Client A moves on November 15, 2025, but fails to notify the Reporting Company until April 15, 2026. What penalty could this result in?
 - \$60,000 civil fine.
 - \$10,000 criminal penalty.
 - Up to two years in prison.

Penalties (Continued)

- Unauthorized Disclosure of Information
 - 31 U.S.C. §5336(c)(4): Unauthorized disclosure or use of information is subject to criminal fines and civil penalties under (h)(3)(B).
 - 31 U.S.C. §5336(h)(3)(B):
 - Civil penalty of \$591/day (adjusted for inflation) that the violation continues or has not been remedied; **and**
 - Either:
 - Fined not more than \$250,000, imprisoned up to 5 years, or both; **or**
 - If done in conjunction with another crime involving more than \$100,000 over a 12-month period, then fined not more than \$500,000, imprisoned up to 10 years, or both.

Miscellaneous – Errors

- Errors must be corrected within 30 days of you becoming aware or had reason to be aware of an error.
- **Safe Harbor**: 31 U.S.C. §5336(h)(3)(C): the person submitting incorrect information meets this safe harbor and avoids criminal and civil penalties if:
 - 1) The person submits a report;
 - 2) The report contains corrected information;
 - 3) The corrected report is submitted not later than 90 days after the date on which the person submitted the report originally;
 - 4) The person was not acting to evade the reporting requirements; ***and***
 - 5) The person did not have actual knowledge that information contained in the original report was inaccurate.

Miscellaneous – Death

- General Rule
 - **31 CFR §1010.380(a)(1)(iii)**: If a person is a beneficial owner of a reporting company (whether individually, via trust or other property interests subject to transfers on death), you must report a change when:
 - The estate of a deceased beneficial owner is “settled” either via:
 - Operation of intestacy laws of the jurisdiction; or
 - Through a testamentary disposition.
 - **Question**: When is an estate settled in Texas? Upon the closing of the estate?

Miscellaneous – FinCEN Identifiers

- FinCEN Identifiers
 - 31 CFR §1010.380(b)(4)
 - What
 - If a person has a “FinCEN identifier” and provides that information to a reporting company, the company need only report that number.
 - How
 - **Individual**: Submit an application to FinCEN containing required information (no application available yet)
 - **Reporting Company**: Submit an application with FinCEN at or after the time an entity submits an initial report.
 - Changes in Information
 - Must report to FinCEN within 30 days.
- Shifting Reporting to Beneficial Owner
 - By having a beneficial owner obtain a FinCEN identifier, it is possible to shift the reporting and updating burden (for the beneficial owner’s information) to the beneficial owner, meaning that a change in a beneficial owner’s information would not obligate the reporting company to file an updated report.
 - **31 CFR §1010.380(b)(4)(iii)(A)**: “Any individual that has obtained a FinCEN identifier shall update or correct any information previously submitted to FinCEN in an application for such FinCEN identifier . . . (1) If there is a change with respect to the required information . . . , the individual shall file an updated application reflecting such change within 30 calendar days. . . .”
 - **But Note**: Conversion to a FinCEN identifier constitutes a change to an initial report and requires an update by the reporting company.

Updates

- Go to <https://www.fincen.gov/boi> for any updates from FinCEN, itself.

Conclusion

- Professionals, from CPAs, to insurance professionals, to attorneys, *will* be called on to administer the Corporate Transparency Act.
- All professionals should consider alerting their clients to this new law.
- All professionals should consider sending a blanket letter to their clients informing them of the reporting requirements and a client's role in updating information.

Exhibit A – CTA Cheat Sheet

- The Corporate Transparency Act (the “CTA”) is a new federal compliance law for state created entities (i.e., “entities” filed with a Secretary of State). In attempts to combat shell companies and money laundering the Department of Treasury introduced the CTA on January 1, 2021.
- The CTA contains stringent federal reporting requirements which are accompanied by civil and criminal penalties.
 - Who must report?
 - Applicants (filers) of all entities (e.g., our firm, employee, BUT maybe YOU if you filed the entity yourself)
 - All with substantial control over an entity
 - All with 25% or more ownership of an entity (may apply to Trust ownership)
 - What to report?
 - Entity name, certificate of filing, address, TIN/EIN
 - Individual’s name, birthdate, residence address
 - Copy of individual’s passport, driver’s license, or state ID card
 - Option for FinCEN Identifier
 - Changes to above after initial filing (e.g., including married name change)
 - When to report?
 - Newly formed entities within 30 days of formation, January 1, 2024 forward
 - Previously formed entities by January 1, 2025
 - 30 days after any reporting information changes (e.g., change in ownership, address)
 - How enforced?
 - Civil penalties - \$591 per day (adjusted for inflation) of noncompliance
 - Criminal penalties - \$10,000 and up to 2 years imprisonment
 - Applies to individuals and possibly to the entity itself
- The CTA will be enforced beginning on January 1, 2024 – which will be here sooner than you think!