The Corporate Transparency Act: What Practitioners Need to Know

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The Corporate Transparency Act, Title LXIV, Pub. L. No. 116-283 (2021) ("CTA"), enacted by Congress on January 1, 2021, established new beneficial ownership disclosure and reporting requirements for both newly formed and existing companies. The legislation requires that certain U.S. companies, referred to as reporting companies, submit a report to the Financial Crimes Enforcement Network ("FinCEN") of the Treasury Department. The report must identify both the applicant forming the company and the beneficial owners of the company. The implications of the CTA are far-reaching and unprecedented. This is the first time that the federal government has inserted itself into the state entity formation process. Historically, business formation and reporting has occurred at the state level. As a result of the CTA, companies will now be required to make both federal and state filings, and the federal government will maintain information in a federal database. While supporters of the CTA have praised its enactment as an important and vital step by the U.S. in the battle against corruption, tax evasion, organized crime, money laundering, and terrorist financing, the CTA has also caused apprehension among lawyers, incorporators, and advisors who are understandably concerned about the legal, ethical, and administrative implications of its passage and implementation. This article will provide some background on the passage and the policy basis for the CTA. It will summarize which companies and intermediaries have to report beneficial ownership information, what information is required, penalties for non-compliance, who will have access to the information, and the timeline for implementation. Finally, this article will highlight issues that remain to be resolved by Treasury Department Regulations and other important considerations for lawyers.

The CTA was the result of a years-long effort by a coalition of Democrats, Republicans, national security experts, law enforcement officials, anti-corruption groups, human rights advocates, financial institutions, the banking industry, business groups, and NGOs that all supported efforts to make it harder for criminals to use anonymous shell companies to launder money, evade taxes, and engage in criminal conduct. Its passage was also the result of serious international pressure on the U.S. by foreign countries and international organizations to comply with global standards for anti-money laundering and counter-terrorism financing. The U.S. had become a notoriously financially secretive jurisdiction, and the international community had taken notice. Critics of the U.S. argued that the lack of transparency and the tolerance of anonymous shell companies attracted criminal behavior and allowed foreign bad actors to launder money through the U.S. financial system. The Financial Action Task Force ("FATF"), a global intergovernmental organization that seeks to combat criminal behavior that threatens the integrity of international financial systems, repeatedly evaluated the U.S. as having the lowest grade possible in its compliance with FATF recommendations. This low rating had become a source of embarrassment to the U.S., specifically to Congress and the Treasury Department. The lack of transparency regarding beneficial ownership information exposed a vulnerability in the U.S. legal and financial systems that legislators were eager to address. Between 2008 and 2019, Congress unsuccessfully introduced many bills that aimed to resolve the perceived (and real) abuse of corporations and LLCs. Even while these domestic legislative efforts to increase transparency failed, during this time the U.S. took on a leadership role on the international stage in tackling transparency

issues. The Obama Administration encouraged the adoption of sweeping new disclosure requirements (for example, the Foreign Account Tax Compliance Act or FATCA) to be imposed on offshore banks with U.S. customers that conducted business in the U.S., requiring such banks to identify U.S. customers and the nature and extent of their offshore assets. Many foreign countries, including the G20, ultimately and enthusiastically joined in the effort to require increased disclosure as a means to combat cross-border financial crimes and terrorist activity, and to encourage international cooperation and the sharing of information. Meanwhile, on the domestic front, support for increased disclosure requirements grew. The banking industry in the U.S., having realized that domestic legislation would help banks identify the owners behind business accounts, began to support domestic legislation aimed at increased transparency. Law enforcement officials argued that gaining access to beneficial ownership information and the establishment of a federal database would help them combat criminal activity. And in 2016, regulatory pressure increased when the Treasury Department issued geographical targeting orders requiring that title insurance companies in certain geographic areas collect and report information about individuals involved in residential real estate transactions. Finally, in late 2020, bipartisan efforts succeeded, and the CTA was included within the National Defense Authorization Act ("NDAA") for Fiscal Year 2021. Congress passed the NDAA in December 2020; President Trump vetoed it on December 23, 2020; and Congress overrode the veto on January 1, 2021.

So what does the CTA do? The CTA requires that "reporting companies" file with FinCEN personal identification information on their "beneficial owners" at the time of a company's formation and requires that such information be updated upon any change in beneficial ownership. Importantly for legal practitioners, while the CTA was enacted in early 2021, it has a prospective effective date. Companies are not required to report the necessary information until Treasury promulgates its Regulations, which it will do by January 1, 2022.

A "reporting company" is defined to include any corporation, limited liability company, or other similar entity that is created by the filing of a document with the secretary of state or similar office or formed under the law of a foreign country and registered to do business in the U.S. by the filing of a document with the secretary of state or similar office. Of course there is some uncertainty as to what qualifies as a "similar entity," and the forthcoming Regulations hopefully will provide clarity. The CTA contains a number of exceptions from the definition of a "reporting company." Specifically excluded are banks, publicly traded companies, insurance companies, tax-exempt organizations, certain registered investment companies and investment advisors, any entity that employs more than 20 people and has at least $5 million in annual revenue and a physical presence in the U.S., and certain registered public accounting firms. Note that there is no exception for law firms. Essentially the CTA targets smaller companies that might act as shell companies in illicit schemes.

The information that must be reported to FinCEN must identify each beneficial owner of the reporting company and each applicant with respect to that reporting company. A "beneficial owner" is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise exercises substantial control over an entity or owns or controls at least 25% of the ownership interests of an entity. Again, there is some uncertainty in these definitions that will need to be clarified in the Regulations. There are five exclusions from the definition of beneficial owners,

including: (i) a minor child (the information of a parent or guardian must be reported instead); (ii) a person acting as a nominee, intermediary, custodian or agent on behalf of another individual; (iii) a person acting solely as an employee; (iv) a person whose only interest in an entity is through a right of inheritance; and (v) a creditor of a reporting company. An "applicant" means an individual who files an application to form a corporation, LLC or other similar entity, or registers or files an application to register a corporation, LLC or other similar entity formed under the laws of a foreign country to do business in the U.S.

The information that must be reported includes the full legal name, date of birth, current residential or business street address, and unique identifying number from an acceptable document (such as a passport number or driver's license) for each beneficial owner and/or an applicant. Importantly, no financial information or details about business purposes or methods of operation are required. This reported information will be maintained in a federal, private, secure database. The information will be confidential and will not be available to the public. Information may only be disclosed to federal and state law enforcement agencies under certain circumstances for national security, intelligence, or law enforcement purposes. Foreign law enforcement may also request information through the appropriate channels. Financial institutions, with the reporting company's consent, will be able to access the database for customer due diligence/know-your-customer requirements imposed by state and federal laws. The Treasury Department may obtain access to beneficial ownership information for tax administrative purposes.

Newly formed entities must submit the beneficial ownership disclosure at the time of formation. Existing entities must file a beneficial ownership disclosure within two years of the effective date of the adoption of the Regulations. A reporting company must also provide updated information to FinCEN within one year upon a change in beneficial ownership. In addition, these reporting deadlines are subject to modification, and the Treasury Department may change, by regulation, the timing for reporting updates no later than two years after the enactment of the CTA.

The CTA imposes both civil and criminal penalties for compliance violations. Any party that fails to comply with reporting requirements or willfully discloses false or fraudulent information will be liable for fines of not more than $500 for each day that the violation continues, not to exceed $10,000, or 2 years of imprisonment, or both. Any party that unlawfully discloses beneficial ownership information or unlawfully uses such information will be liable for fines of not more than $500 for each day that the violation continues, not to exceed $250,000, or 5 years of imprisonment, or both. There is a safe harbor for individuals who believe that a submitted report contains inaccurate information and voluntarily and promptly submit a corrected information report.

So what are the implications for lawyers? The CTA has dramatic consequences for lawyers who assist clients with the formation of entities. Nearly two million corporations and LLCs are created every year, and lawyers oftentimes act as incorporators for these entities with the state corporation commission. When a lawyer assists a client with this administrative task, is the lawyer the "applicant" for purposes of the CTA, which would then create an obligation to file the report and report his or her personal information? Hopefully the forthcoming Regulations will answer this important question.

Lawyers advising clients on the creation of new entities certainly should inform clients about the CTA's new reporting requirements. Another important question is whether lawyers who assisted clients with forming companies in the past have a present obligation to contact those old clients to inform them about the CTA's requirements, or whether the lawyers themselves have an obligation to file the reports for those existing companies. Certainly lawyers who draft Operating Agreements and Shareholders Agreements should consider whether language should be added to those agreements obligating members and shareholders to comply with the CTA, outlining who has the compliance obligation, and specifying the ramifications for failure to comply. Lawyers who advise clients on matters related to money laundering, privacy issues, and responding to investigations and subpoenas will need to understand the CTA. Real estate lawyers and practitioners advising foreign and domestic investors, landlords, tenants, and lenders must consider how these new reporting obligations may impact real estate transactions and contracts. Understandably, the CTA has caused much anxiety for lawyers whose practices are affected, and practitioners are eagerly awaiting the forthcoming Regulations which will hopefully clear up the existing ambiguities.

Undoubtedly the CTA's attempt to crack down on the use of anonymous shell corporations will have many positive repercussions. These new disclosure requirements discourage money laundering, terrorist financial transfers, criminal activity, and tax evasion. Cooperation and coordinated efforts between the federal government, state governments, and foreign governments to accomplish these shared goals is commendable. And from an international perspective, the passage of the CTA helps to restore confidence in the integrity of the U.S. legal and financial systems which have suffered in recent years. With the CTA's passage comes much uncertainty, administrative hassle, and cost of compliance. Lawyers who assist clients with the creation of corporations and LLCs and who advise clients on related corporate matters must understand the new disclosure requirements imposed by the CTA.