

Are You Ready for the Corporate Transparency Act in 2024?

January 4, 2024

The Corporate Transparency Act (CTA) went into effect January 1, 2024. Under the CTA, all newly created entities are now required to file a report with the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) within 90 days of formation, unless an entity qualifies under one of 23 exemptions. That means, unless an exemption applies, any newly formed LLC, limited partnership, corporation, statutory trust, or other organization that is created by filing with a secretary of state has an additional federal filing requirement. All existing entities formed prior to January 1, 2024, that do not qualify for an exemption have until the end of 2024 to file a Report.

Any entity that is not exempt is called a "Reporting Company." Each Reporting Company is responsible for filing a Report to provide information on itself and on the individuals (i.e., the human beings) who directly or indirectly control or own interests in the entity. These individuals are called the "Beneficial Owners."

This client alert is the first in a series that will cover the CTA. This alert will provide a general overview of the CTA. Subsequent alerts will review the exemptions from the CTA, the current guidance, and uncertainties on identifying the Beneficial Owner, and who has access to the FinCEN database.

Purpose of the CTA

The CTA is designed to be a tool to prevent money laundering and other illicit activities in the U.S.'s financial system that are conducted through the veil of one or more entities. Congress adopted the CTA in 2021 as part of the National Defense Authorization Act. However, its implementation was deferred to allow FinCEN to issue regulations and create an online database for filing Reports.

The goal of the CTA is generally for smaller, non-regulated, or lightly regulated entities to disclose the human beings who control or own such entities to FinCEN.

The Exemptions

The 23 exemptions from FinCEN's Report are focused on entities that are either:

- (a) highly regulated by some government body (SEC, CFTC, OCC, FINRA, insurance, utilities),
- (b) tax-exempt (a 501(c)(3), 501(c)(4) organization), or
- (c) large (i.e., 20 or more employees plus \$5,000,000 of revenue) or public companies.

Subsequent client alerts will explore these exemptions in more detail.

The Report

FinCEN is creating an online database for Reporting Companies to file their Report. Within the Report, the Reporting Company must provide its full legal name, its EIN or other tax identifier, state of formation and current U.S. business address. The Report must list the full names of all Beneficial Owners, including copies of state identification (such as driver's license or passport), SSN, and residential address, subject to a few exceptions. For Beneficial Owners who do not wish to provide this information to a Reporting Company, they can provide the information directly to FinCEN and receive a unique number, referred to as a FinCEN identifying number. The Beneficial Owner can then provide just that FinCEN identifying number to the Reporting Company.

Aside from the initial Report, the Reporting Company must update the Report within 30 days if any of the information in a Report changes, that would include a change of address or updated ID for a Beneficial Owner.

Beneficial Owners

A Beneficial Owner, whose information needs to be disclosed in the Report, is any person (human being) who either:

- directly or indirectly owns more than 25% of the Reporting Company (“Ownership Test”) *or*
- has substantial control over the Reporting Company (“Control Test”).

Ownership of a Reporting Company includes not just stock, memberships, or ownership units, but also indirect forms of ownership, such as convertible notes, puts, calls, and warrants. All of an individual’s direct or indirect ownership will be aggregated for purposes of determining whether he or she has 25%.

For the Control Test, certain senior officers of a Reporting Company (such as CEO, President, general counsel) will automatically be treated as being Beneficial Owners. Individuals who serve on the Board of Directors or have a similar role in a Reporting Company may also be treated as Beneficial Owners depending on the scope of their authority.

Aside from individuals who hold certain key positions, owner(s) of a Reporting Company may be Beneficial Owners under the Control Test because of a right to make or participate in significant decisions, regardless of the percentage of ownership. For example, if an operating agreement for an entity requires unanimous consent (and therefore unanimous participation) of all owners for key or significant decisions regarding the entity, then an owner who otherwise owns 20% of the entity could be a Beneficial Owner under the Control Test, even though she would not be a Beneficial Owner under the Ownership Test.

Depending on the Reporting Company, it may or may not be clear who is a Beneficial Owner. For example, consider a member managed LLC, LLC A, with two individuals who are the only members. In this simple structure, the two individual members will be considered the Beneficial Owners as they own all the membership interests and control the LLC. However, the analysis can quickly become much more complex. For example, LLC B is owned 75% by corporation X and 25% by limited partnership Y, with company Z serving as manager of LLC B. Each layer of entity (corporation X, limited partnership Y and company Z) will need to be analyzed to determine who are, ultimately, the human beings that either own 25% of LLC B, or have substantial control over LLC B.

Future client alerts will analyze both of these tests, Ownership Test and Control Test, including looking at the limited guidance that exists when a trust is an owner of a Reporting Company.

For More Information

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