CLIENT ALERTS

New Entity Ownership Reporting Requirements Introduced by the Corporate Transparency Act

2.16.2021

The National Defense Authorization Act of 2021 (the "Defense Authorization Act"), enacted by Congress on January 1, 2021, provides significant changes to U.S. anti-money laundering policies. The Defense Authorization Act includes the Anti-Money Laundering Act of 2020 (the "AMLA") and the Corporate Transparency Act (the "CTA"), the latter being the focus of this Client Alert. The CTA targets the anonymity of certain U.S. and foreign entities and sets a Federal standard with regard to ownership information required to be disclosed when incorporating or organizing an affected business entity. Among the reasons cited by Congress for the CTA is the illicit activity conducted through entities formed and structured to evade detection.

This requirement changes somewhat the regulatory regime applicable to business formation. Historically, creation of businesses (such as incorporation of a corporation or formation of an LLC or partnership) has been a matter of state law. The Federal government has been involved in regulating public companies with registered securities. Reports of beneficial ownership of public company securities must be filed with the SEC by certain insiders or significant owners on Forms 3, 4 and 5 under Section 16 of the Securities Exchange Act, and concentration of shares in excess of certain thresholds must be reported on Schedule 13D or 13G under Section 13 of that Act. There has been no Federal requirement for disclosure of ownership of non-registered companies, and states generally do not require disclosure of owners' identities.

What Companies Are Covered?

The CTA applies to "reporting entities," which are defined to include a corporation, limited liability company (LLC), or similar entity that is either:

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- created by the filing of a document with the secretary of state or a similar office under the laws of a State or Indian Tribe, or
- formed under the laws of a foreign country and registered to do business in the U.S. by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe.

Are There Exemptions?

The CTA specifically excludes 24 types of entities from the need to file reports. These exclusions generally cover entities otherwise subject to governmental oversight or that fall under broad threshold-based exclusion. Examples of excluded entities that are otherwise subject to governmental oversight include issuers of securities subject to the Securities Exchange Act, a bank subject to the Bank Holding Company Act of 1956, and a U.S. insurance company subject to supervision by the insurance commissioner of a State. Examples of threshold-based exclusions include (i) an entity that employs more than 20 employees on a full-time basis in the U.S., reported over $5M in gross receipts or sales in the aggregate on its federal tax return filed in the previous year, and has an operating presence at a physical office within the U.S., and (ii) a corporation, LLC or similar entity that has been in existence for more than one year, has no active business, assets or foreign ownership, and within the preceding 12-month period has not experienced an ownership change or sent or received funds greater than $1,000. Unless an entity falls within one of the 24 exclusions, it has an obligation to report its beneficial ownership.

The term “State” is broadly defined by the CTA to include any state of the U.S., Washington D.C., Puerto Rico, and any other commonwealth, territory or possession of the U.S. Further guidance is expected to clarify other entities subject to these rules (see the term “or similar entity”), such as whether trusts or partnerships would be considered a Reporting Entity.

What Information Must Be Reported?

Reporting entities must include the following information about their Beneficial Owners:

- full legal name;
- date of birth;
- current residential or business address; and
- a unique identifier from an acceptable document or a FinCEN identifier assigned to a person pursuant to the CTA. Acceptable identification documents include a non-expired (a) U.S. passport, (b) identification document issued by a State, local government, or Indian Tribe for the purpose of identifying that individual, (c) driver’s license issued by a State, or (d) a foreign passport, if the individual does not have a document described in (a)-(c).

Who Is a Beneficial Owner Covered by the Requirement?

A Beneficial Owner is defined in the CTA as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, owns or controls 25% or more of the ownership interest of the entity or exercises substantial control over the entity (the "Control Tests"). A Beneficial Owner does not include: (i) a minor child whose parent or guardian reported information required by the CTA, (ii) nominees, intermediaries, custodians, or agents acting on behalf of another individual, (iii) an employee whose control of an entity is derived solely from the employment status of the person, (iv) an individual whose only interest in the entity is through a right of inheritance, or (v) a creditor of an entity that does not meet the Control Tests.

Where and When Are Reports Filed?

The CTA requires reporting entities to submit a report to the Financial Crimes Enforcement Network (commonly referred to as "FinCEN"), a bureau of the U.S. Treasury Department. One of FinCEN's primary responsibilities is to combat money laundering. FinCEN is tasked with maintaining the reported information and setting up a registry to collect it.

A Reporting Entity must submit a report to FinCEN by certain deadlines. The due date for the report is based on the effective date of regulations that must be promulgated by the Treasury within one year from the enactment of the CTA (i.e., by January 1, 2022). Entities formed or registered before the effective date of the regulations prescribed by the CTA must submit their initial FinCEN report within two years from the effective date. Entities formed after the effective date must contemporaneously submit the FinCEN report at the time of formation or registration. Reporting entities have an ongoing obligation to update their FinCEN report in the event any information previously reported has changed. Such updated information must be submitted to FinCEN within one year from the date on which there is a change.

Penalties

A reporting violation may result in a civil penalty of up to a $500 fine for each day of noncompliance, with a max fine of $10,000, imprisonment for up to two years, or both.

For questions about the entity reporting requirements, Corporate Transparency Act, or National Defense Authorization Act of 2021, please contact the authors of this alert or any member of Butzel Long's Business Practice Group.

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