BELLNUNNALLY

NEED TO KNOW COMPLIANCE REQUIREMENTS FOR CORPORATE TRANSPARENCY ACT

April 15, 2024

Entities are now required to report certain management and beneficial ownership information to the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the U.S. Department of the Treasury. These reporting requirements, created under the Corporate Transparency Act ("CTA"), became effective as of Jan. 1, 2024 for newly formed entities and will begin on Jan. 1, 2025 for pre-existing entities.

Entities Subject to the CTA Reporting Requirements

All entities formed in the U.S., or foreign entities that register to do business in the U.S., after Jan. 1, 2024 are deemed to be "Reporting Companies," and will be required to comply with the CTA filing requirements unless they otherwise qualify for an exemption. One key exemption provides that large operating companies with: (i) a physical office in the U.S.; (ii) 20 or more full time U.S. employees; and (iii) more than $5 million in gross revenue on the prior year's tax return, excluding any gross receipts from sources outside the U.S., are exempt from the CTA disclosure requirements.

Information That Must Be Reported

Reporting Companies must provide FinCEN with the following identifying information (the "Information"):

- The Reporting Company's
    1. full legal name;
    2. trade names and DBA names;
    3. business address;
    4. jurisdiction of formation; and

5. federal tax identification number.

- Each beneficial owner's (as defined below) and company applicant's:

    1. full legal name;
    2. date of birth;
    3. current residential or, in certain cases, business street address;
    4. identification number from of an identification document (i.e., a driver's license or passport); and
    5. photocopy of such identification document.

Beneficial owners and company applicants may obtain a FinCEN identifier number by providing their Information to FinCEN and the identifier number may be used on multiple required Reporting Company disclosure as necessary.

FinCEN will maintain this information in a secure database that is not publicly available. However, the information will be available by request to certain law enforcement agencies. If authorized by the Reporting Company, financial institutions may also have access for customer due diligence purposes.

Beneficial Owners and Company Applicants

A "beneficial owner" is any natural person who, directly or indirectly:

owns or controls, directly or indirectly (through one or more entities, proxies or voting agreements), at least 25% of the Reporting Company's ownership interests (including, but not limited to, traditional stock or equity interests, options, profits interests, convertible notes and warrants); or

exercises "substantial control" over the Reporting Company, including an individual who:

- serves as a senior officer of the Reporting Company (CEO, CFO, COO, general counsel or any other officer, regardless of official title);
- has authority over the appointment or removal of any senior officer or a majority of the board or other governing body of the Reporting Company;
- directs, determines or has substantial influence over important Reporting Company decisions; or
- has any other form of substantial control over the Reporting Company.

Please note an individual can be classified as a beneficial owner even if such individual has no traditional ownership interest in the Reporting Company. Additionally, other entities cannot be listed as beneficial owners. Thus, Reporting Companies may need to review a complex capital structure to determine the ultimate ownership by natural persons. In addition, proxies, veto rights, and voting agreements or arrangements need to be reviewed to determine whether any one or more individuals can exercise substantial control through such proxies, veto rights or voting agreements.

There are certain instances in which an individual who would otherwise be a beneficial owner of a Reporting Company qualifies for an exception. For example, if a minor is a beneficial owner of a Reporting Company, the information of the parent or guardian of the minor child is reported instead. However, when the child reaches the age of majority, and continues to have at least a 25% beneficial ownership stake in the Reporting Company, the former child will need to report.

A Reporting Company must also provide information for company applicants ("Applicant"). An Applicant is any individual who: (i) files an application to form an entity in the U.S.; (ii) registers or files an application for a foreign entity to do business in the U.S.; or (iii) is primarily responsible for directing or controlling the filing by another individual, when more than one individual is involved in the filing. An example of an Applicant would be an attorney who prepares and files a certificate of formation with the Texas Secretary of State. Notably, entities formed prior to Jan. 1, 2024 will not need to provide the information for their applicants.

Reporting Due Dates; Penalties

For all existing Reporting Companies (those formed or registered before Jan. 1, 2024), the Information must be reported no later than Jan. 1, 2025. For all new Reporting Companies (those formed or registered on or after Jan. 1, 2024 but before Jan. 1, 2025), the Information must be reported within 90 days after formation. Reporting Companies formed on or after Jan. 1, 2025, have 30 days to report the information after formation. If your entity is required to file a report, it must do so electronically through a secure filing system available here.

A Reporting Company must rely on its beneficial owners to timely update it on reportable changes to their information (e.g., ownership changes, name changes or address changes). If the information relating to a beneficial owner or Reporting Company previously reported to FinCEN changes, or when the beneficial owner or Reporting Company discovers that reported information is inaccurate, the beneficial owner or Reporting Company must update or correct the reported Information within 30 days from the date of the change and/or from the date when the Reporting Company knows (or has reason to know) of the inaccuracy.

Noncompliance with the CTA's reporting requirements include: (i) civil penalties of up to $500 per day; (ii) a criminal fine of up to $10,000; and/or (iii) imprisonment of up to two years.

Constitutional Challenges

As of the end of March, two constitutional challenges have been made against the CTA. The first challenge, decided on March 1, ruled that the CTA was unenforceable for exceeding Congress's constitutional authority. However, the court limited its ruling to the plaintiffs in that case. The U.S. Justice Department, on behalf of the U.S. Department of the Treasury, quickly filed a Notice of Appeal. The second challenge remains undecided.

However, if the appellate courts decide that the CTA is unconstitutional, it is expected that Congress will likely re-tool the CTA to satisfy any constitutional challenges.

Immediate Next Steps

Now is the time to take the following actions:

- Determine whether your entity is deemed to be a Reporting Company or whether an exemption is available.
- If your entity is a Reporting Company, identify the beneficial owners and obtain and report the required information.
- Review your entity's organizational documents and procedures to determine the changes necessary for CTA compliance (e.g., a Reporting Company's organizational documents may need to be updated to include representations, covenants, indemnifications and consent clauses to ensure compliance by the beneficial owners).

Ensuring your entity complies with the CTA may be initially time-consuming for many entities.

If you have any corporate formation needs or need assistance to properly address any considerations for complying with the CTA with regard to your existing corporate entities, please contact one of our corporate attorneys.

Related Practices

Corporate and Securities

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