

Corporate Transparency Act

Little known to CPAs, attorneys, and business owners, the Corporate Transparency Act (“CTA”) was enacted in 2021, requiring most businesses in the U.S. to disclose beneficial owner information. The purpose of the CTA is simple – to combat dirty money. Whether money laundering, financing of terrorism, or other illicit activities, the newly required disclosure of the ultimate beneficial owners (“UBOs”) of most domestic entities aims to quell these issues. Administered by the Financial Crimes Enforcement Network (“FinCEN”), which also requires U.S. persons to disclose their ownership of certain foreign bank accounts via the Foreign Bank Account Report (“FBAR”), FinCEN is taking aim at opaque shell companies by bringing their owners to light.

The U.S. has been graded poorly by the Foreign Action Task Force (“FATF”), which was established by the Organization for Economic Cooperation and Development (“OECD”) to measure countries’ disclosure of beneficial ownership information for entities formed within their jurisdictions. The OECD encourages market-based democratic governments to collect and compare such data to analyze the efficacy of economic, social, and environmental policies. The FATF and OECD have concluded that the less transparent a country is regarding beneficial owner information, the more likely criminal activities such as money laundering or financing of other illicit activities may occur. Accordingly, the CTA is the U.S. latest effort to promote transparency by U.S. businesses to halt the flow of tainted money.

The CTA was passed on January 1, 2021, as a piece of the National Defense Authorization Act, and represents a paradigm shift in the Bank Secrecy Act and other related anti-money laundering legislation. FinCEN aims to develop a standardized reporting system for companies formed in the U.S. and the disclosure of their beneficial owners. FinCEN is the U.S. Treasury’s Bureau that collects financial data and analyzes transactions to combat money laundering, terrorist financing, and other financial crimes. Tax practitioners must be keenly aware of the new reporting requirements or run the risk of exposing their clients to significant civil and even criminal penalties.

Reporting Requirements of the CTA

The CTA mandates “reporting companies” to file reports with FinCEN disclosing their beneficial owners and information about company applicants. Companies formed through a U.S. state filing or companies formed in a foreign country but registered to do business in the U.S. are subject to these reporting requirements. Simply put, if a company is formed by filing a document in applicable state jurisdictions, it is subject to these new reporting requirements. Whether an LLC, corporation, partnership, or trust, each state requires a filing with the applicable state agency to form a company.

Certain exceptions preclude a company from filing such information with FinCEN. Examples of entities exempt from the reporting requirements include revocable living trusts, sole proprietorships, and general partnerships. Also exempt are certain highly regulated entities such as banks, federal and state credit unions, government entities, publicly traded companies, PCAOB-registered accounting firms, insurance companies, 501(c)3 tax-exempt entities, and tax-exempt political organizations. Companies with more than 20 U.S. full-time employees, exceeding \$5 million in gross receipts or sales on their prior year federal income tax returns, are also exempt from reporting.

Beneficial Owners and Company Applicants

Once established that an entity is a reporting corporation, tax practitioners must analyze company records to determine beneficial owners who exceed a percentage of ownership or control. The company must report such information to FinCEN once the threshold is met. A beneficial owner is defined as:

- ✓ Persons with substantial control;
- ✓ Persons owning 25% or more of a company, either directly or indirectly; and
- ✓ Company applicants.

The term owner is broadly defined by the CTA, and includes companies with tiered ownership. If a parent company owns a reporting company, the reporting company must “look through” the parent company to disclose the person who owns the company. For purposes of the CTA, the beneficial owner must be a natural person or human being.

The term “substantial control” is qualitative facts and circumstances based analysis. A person may exhibit substantial control if they can merge or dissolve the company, control major expenditures, direct its service lines, determine compensation, or enter the company into contracts. A person with the ability to do such things on the company’s behalf will be deemed a beneficial owner even if the person doesn’t have an ownership interest. Included in this category are officers and directors of a reporting company.

Alternatively, parties who either 25% of the reporting company, either directly or indirectly, are also subject to these reporting requirements. This includes joint ownership, direct ownership of stock, or ownership of a membership interest.

Finally, those who filed the formation documents within the company’s jurisdiction to establish the entity are also treated as beneficial owners. Anyone who has signed a certificate of formation or incorporation, or another similar document is deemed a beneficial owner.

What and When to File

The FinCEN BOI report requires a company to disclose the following:

- ✓ Legal name and jurisdiction of the beneficial owners;
- ✓ Date of birth;
- ✓ Street address for beneficial owners and business address for company applicants;
- ✓ Unique identifying number (e.g., Driver’s License or Passport Number); and
- ✓ A picture of the identification.

While these disclosures are substantial, there is no requirement for reporting companies to disclose financial information or the company’s business purpose. Companies formed after January 1, 2024, have 30 days from the effective date of formation to file a BOI report with FINCEN. Reporting companies existing prior to January 1, 2024, must file the Report by January 1, 2025.



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Failure to File Penalties

Failure to file a BOI Report or filing fraudulent beneficial owner information can result in significant penalties. If FinCEN can prove fraudulent information was willingly filed, rather than a good faith error, the company can receive penalties of \$500 per day up to \$10,000 and its shareholders up to two years of imprisonment. If an error is made due to reasonable cause, rather than willful negligence, the penalties may be waived.

Potential Criminal penalties for the misuse or unauthorized disclosure of beneficial ownership include fines up to \$250,000 and imprisonment not to exceed 5 years, or both.

Key Points Summarized

- 1. Broadly defined “reporting companies” are required to file a BOI Report;**
- 2. Beneficial owners of reporting companies must file a BOI Report;**
- 3. Specific information required in these reports may be difficult to obtain;**
- 4. Penalties may be imposed only for willful violations;**
- 5. Tight deadline for required disclosures (only 30 days for new companies, one year for existing); and**
- 6. Compliance with the CTA and monitoring for updates is extremely important.**