

The Corporate Transparency Act: What You Need to Know Pending FinCen Regulations

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In an effort to combat money laundering, tax fraud, and other similar financial crimes, Congress recently passed the Corporate Transparency Act (CTA) as part of the National Defense Authorization Act. The CTA requires certain private companies to report the information of their beneficial owners and controlling parties to the U.S. Treasury's Financial Crimes Enforcement Network (FinCen). While compliance with the CTA requirements will not commence until FinCen regulations are effective, which are set to be promulgated by no later than January 1, 2022, given the potentially significant effects of the CTA on many private businesses, now is the time to begin considering how best to ensure your company's compliance with the CTA.

Key Provisions of the CTA:

Who Must Report. The CTA will require entities formed in the United States or foreign entities qualified to do business in the United States to identify and report certain information on their beneficial owners to FinCen. This information will include the name, business or residential address, date of birth, and a U.S. driver's license or a U.S. or foreign passport number. However, certain entities like publicly traded entities or those subject to reporting requirements with other regulatory bodies such as the Securities and Exchange Commission are exempted. More importantly, entities with more than 20 full-time employees, \$5 million in gross receipts or sales in the aggregate, and a physical presence in the United States are also exempt from the CTA.

Who Is a Beneficial Owner. Under the CTA, a beneficial owner is a person who exercises substantial control over an entity or owns 25% or more of the entity. The language of the CTA excludes, among others, employees who exercise substantial control over an entity solely as a result of that individual's status as an employee. It also generally excludes creditor(s) of an entity unless the creditor otherwise meets the definition of a "beneficial owner."

Who Is an Applicant. The CTA also requires reporting companies to provide the name, business or residential address, date of birth, and identification document of applicants to FinCen. An applicant is a person who files an application to form an entity in the United States or to qualify a foreign entity to do business in the United States. Is an applicant a lawyer, paralegal, or service agency that files the entity formation documents, or is this intended to cover only the person who signed the application (i.e., the representative of the client such as an officer or agent)? The implementing regulations should clarify this.

When Will the CTA Take Effect. The CTA will not require compliance with its terms until the implementing regulations go into effect. Under the CTA, the regulations are required to be promulgated by January 1, 2022. The CTA as presently enacted will require all entities, whether formed before or after the effective date of the CTA, to report beneficial owner information according to the following time frames:

1. **Entities Formed After the FinCen Regulations Are in Effect.** Reporting companies formed after the effective date of the regulations have to report the relevant information at the time of their formation.
2. **Entities Formed Before the FinCen Regulations Are in Effect.** Reporting companies existing before the regulations are effective have two years from the effective date of the regulations to comply with the reporting requirements.
3. **Changes in Information.** Reporting companies have up to one year to provide any changes to the previously reported information to FinCen.

What Are the Penalties for Noncompliance. The CTA includes significant penalties for willfully (i) failing to report the required information or (ii) providing inaccurate information. The penalties include a civil penalty of up to \$500 for each day the violation continues, and a fine of \$10,000 and/or imprisonment for up to two years.

Who Has Access to the FinCen Reports. The CTA provides that the information in the reports submitted to FinCen will not be publicly available but may be accessed by Treasury Department employees and certain other federal regulatory agencies. Similarly, the CTA lists a number of avenues under which FinCen may disclose the reported information to financial institutions for due diligence requirements with the consent of the reporting entity.

Things to Consider Pending the FinCen Regulations:

The FinCen regulations will hopefully fill in the blanks on some of the open questions the CTA does not currently address, including providing a more precise definition of control in relation to who is a beneficial owner; the administrative requirements for tracking down information for older companies; what requirements might be applicable to exempt companies to confirm the exemption; and the scope of the safe harbor provision for companies that inadvertently (rather than willfully) fail to comply with the reporting requirements. However, rather than taking a “wait-and-see” approach pending the promulgation of the FinCen regulations, companies can start considering certain measures in preparation for compliance, including:

First, developing procedures for collecting relevant information and protecting it appropriately. This ensures that the information is readily available when compliance kicks in; and

Second, incorporating language in bylaws, operating agreements, shareholder agreements, limited partnership agreements, and the like obligating members, shareholders, and general and limited partners to provide information (and update it) and consent to its disclosure as necessary to comply with the CTA.

Carlton Fields will continue to monitor closely the developments of the FinCen regulations as they are released for public comment and will continue to provide updates on any major changes that may emerge.

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