

Holland & Knight

# CORPORATE TRANSPARENCY ACT

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# OVERVIEW

The Corporate Transparency Act (CTA) entered into force on Jan. 1, 2024. For the first time under federal law, certain entities called "Reporting Companies" are required to report personal identifying information about the individuals who are "Beneficial Owners" and "Company Applicants" of the entity to the Financial Crimes Enforcement Network (FinCEN), a unit of the U.S. Department of the Treasury. FinCEN will maintain information reported on a secure, nonpublic database for use by governmental authorities, certain financial institutions and financial regulators.

Holland & Knight has established a cross-disciplinary task force of veteran lawyers from multiple practice areas – corporate, private equity, venture capital, joint ventures, healthcare, financial services, real estate, white collar defense, private wealth and tax, among others – to counsel companies on how to comply with the CTA. Attorneys on Holland & Knight's CTA Team have closely followed the CTA since its enactment and are familiar with its requirements and ramifications. Below, we provide answers to some basic questions regarding the CTA. Our lawyers stand ready to assist you in determining the specific impact of the CTA on your organizations, as well as actions for you to take to comply.

## HAVE THERE BEEN LEGAL CHALLENGES OR OTHER REQUESTS TO DELAY REPORTING?

On March 1, 2024, the U.S. District Court for the Northern District of Alabama entered a final declaratory judgment in *National Small Business United v. Yellen*, concluding that the CTA exceeds the Constitution's limits on Congress' power. The U.S. Department of Justice (DOJ) appealed the decision. Oral arguments were held before the U.S. Court of Appeals for the Eleventh Circuit on Sept. 27, 2024. We await the decision of the Appeals court. It is likely that whichever party loses will appeal the decision to the U.S. Supreme Court. Also, additional lawsuits challenging the constitutionality of the CTA have also been filed in federal district courts in various jurisdictions across the U.S. However, at this time, there is no indication that a court will invalidate the CTA generally. Furthermore, while impacted parties have requested the Treasury Department and Congress to delay the reporting date for reporting entities formed or registered in years prior to 2024, no action to date has been taken on these requests. So, for the general public, as of now, the reporting obligations of the CTA continue to exist.

## WHY WAS THE CTA ENACTED?

The United States has become the jurisdiction of choice to form shell companies. The CTA was enacted to combat the proliferation of anonymous shell companies used by illicit actors for criminal purposes in the United States and to protect national security, intelligence and law enforcement interests within the United States.

## HOW WILL MY COMPANY BE IMPACTED BY THE CTA?

Millions of legitimate companies and their constituents are within scope of the new legislation and will incur a new and significant administrative burden to comply with the CTA's reporting regime. The CTA is not a "one and done" reporting regime, but requires reporting companies to file updated reports if previously reported information changes. This updating requirement may prove challenging in complex structures.

## WHAT IS A REPORTING COMPANY?

- **DOMESTIC REPORTING COMPANY.** A corporation, limited liability company (LLC) or an entity created by the filing of a document with a secretary of state or any similar office under the laws of a state or an Indian Tribe (including U.S. territories and possessions).

- **FOREIGN REPORTING COMPANY.** A corporation, an LLC or entity formed under the laws of a foreign country that has registered to do business in the U.S. by the filing of a document with a secretary of state or equivalent office under the laws of a state or an Indian tribe (to include U.S. territories and possessions).

## ARE ANY ENTITIES OR ARRANGEMENTS OUT OF SCOPE?

Sole proprietorships, general partnerships, unincorporated associations and common-law trusts are excluded because their creation does not involve the filing a document with a secretary of state or similar office. Also, foreign entities that do not register to do business in a state or with an Indian Tribe likewise are excluded.

## WHICH ENTITIES ARE EXEMPT FROM REPORTING REQUIREMENTS?

There are 23 entity exemptions, including:

- Exemptions for highly regulated entities, such as public companies registered with the U.S. Securities and Exchange Commission (SEC), banks, insurance companies, broker-dealers, registered investment advisers, investment companies and pooled investment vehicles, tax-exempt entities and other entities that are regulated and for which the U.S. government already obtains the requisite information.
- **"Large Operating Companies."** An entity that directly 1) employs more than 20 full-time employees in the U.S., 2) maintains a U.S. operating presence (i.e., a genuine working office; owned or leased) in the U.S. and 3) has filed a federal income tax or information return with the IRS for the previous year demonstrating more than \$5 million in gross receipts from U.S. sources.

**Comment:** *This exemption is available to privately held, for-profit entities, whether regulated or not. The tested entity 1) must have filed a federal income tax return demonstrating more than \$5 million in gross receipts from U.S. sources for the prior tax year, 2) must employ more than 20 full-time employees employed in the U.S., and 3) must maintain a genuine working office. Gross receipts can be determined on an aggregated basis if a federal consolidated return is filed, but the employee and office requirements cannot be aggregated. A company may fall within or without this exemption in different periods, depending on its gross receipts and/or the number of employees. This exemption is unavailable to "startups" because these entities would not satisfy the tax return requirement in their year of organization and to single owner LLCs that are disregarded for federal income tax purposes because these entities do not file tax returns.*

- **Subsidiary Exemption.** This exemption applies if one or more exempt entities (other than a pooled investment vehicle and certain other entities) directly or indirectly either wholly own all of the ownership interests of a subsidiary or wholly control all of the ownership interests of a subsidiary.

**Comment:** *This is a most useful exemption for directly or indirectly wholly owned or wholly controlled lower-tier entities of a qualifying exempt entity.*

## WHO IS A BENEFICIAL OWNER?

**GENERAL RULE:** An individual who, directly or indirectly, exercises "Substantial Control" over a Reporting Company or owns or controls at least 25 percent or more of the Ownership Interests of a Reporting Company.

## SUBSTANTIAL CONTROL TEST

### Indicators

#### Senior Officer of the Reporting Company

(President, CEO, COO, CFO, General Counsel or any other officer, regardless of official title, who performs similar functions)

**Appointment or Removal Authority** (of a Senior Officer or majority of Board of Directors of the Reporting Company)

**Important Decision-Maker** over important decisions (e.g., business, finances, structure) of the Reporting Company

**Catch-All: Exercises** any other form of Substantial Control (i.e., does not have the power, but can exert significant influence over important decisions)

#### Comments:

- Equity ownership not necessary.
- Test requires all individuals who exercise Substantial Control over an entity, directly or indirectly, to be identified and reported.
- Directors may exercise Substantial Control, depending on facts, but application unclear.
- If one is not dealing with the 25 percent ownership interest test, then with respect to beneficial owners *in entities that control the reporting company*, the significant control test can be summarized as follows: Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) or directs, determines or has substantial influence over important decisions made by the reporting company (in effect, the individual(s) that "call the shots" over important decisions).

## 25 PERCENT OWNERSHIP TEST

### Three-Part Analysis

**Ownership Interest:** 1) equity, stock, voting rights, 2) capital or profits interests, 3) convertible instrument, 4) options and 5) other ownership mechanisms

**Ownership or Control of Ownership Interest:** Any contract, arrangement, understanding, relationship or otherwise, such as through direct or indirect ownership, debt, joint ownership, nominee, trust, or owning or controlling intermediate entity that owns/controls Reporting Company

**Calculation:** Determine whether an individual directly or indirectly owns or controls 25 percent or more of the ownership interest (by reference to voting power, value, capital and profits interests and treating all options and similar interests as exercised or, if foregoing calculations cannot be performed with certainty, an individual is deemed to hold 25 percent ownership/control provided the individual owns/controls 25 percent or more of any class of ownership interest)

#### Comments:

- This test requires a three-part analysis: 1) determining which ownership interests exist as related to the reporting company, 2) determining the individuals who own or control such ownership interests in the reporting company, and 3) performing the calculation to ascertain the individuals that own or control 25 percent or more of such ownership interests.

**EXCEPTIONS FROM BENEFICIAL OWNER DEFINITION.** 1) minor child, 2) nominee, intermediary, custodian, or agent, 3) employee (other than Senior Officer), 4) inheritor (future interest through a right of inheritance) and 5) creditor.

**Special Rule: Entity Reporting of Beneficial Owner.** If an individual holds a 25 percent or more ownership interest in a reporting company through one or more exempt entities, the reporting company may include the name(s) of the exempt entity or entities in lieu of the personal identifiable information with respect to the individual Beneficial Owner.

# WHO IS A COMPANY APPLICANT?

**DEFINITION:** A Company Applicant is an individual involved with the formation or registration of a Reporting Company.

- **CATEGORY 1:** The individual who directly filed the document that created a Domestic Reporting Company or that first registered a Foreign Reporting Company with a secretary of state or similar office.
- **CATEGORY 2:** The individual who was primarily responsible for directing or controlling the filing of the creation or registration document, if more than one individual was involved in the filing. Consider who makes decisions on the filing of the document, such as the document's content, how it is managed and when and where the filing occurs.

**Comment:** A Reporting Company formed on or after Jan. 1, 2024 (but not before), is required to report at least one Company Applicant **and at most two**.

# WHAT ARE THE REPORTING OBLIGATIONS OF A REPORTING COMPANY TO FINCEN?

REPORTING COMPANY CREATED/REGISTERED BEFORE JAN. 1, 2024	REPORTING COMPANY CREATED/REGISTERED ON OR AFTER JAN. 1, 2024
<p><b>Provide information about:</b></p> <ul style="list-style-type: none"><li>• Itself</li><li>• Beneficial Owners</li><li>• But not Company Applicants</li></ul>	<p><b>Provide information about:</b></p> <ul style="list-style-type: none"><li>• Itself</li><li>• Beneficial Owners</li><li>• Company Applicants</li></ul>

## INITIAL REPORT INFORMATION ITEMS FOR REPORTING COMPANY, BENEFICIAL OWNER AND COMPANY APPLICANT

- **Reporting Company.** Full legal name, trade name or doing business as (DBA), current address (principal place of business in U.S., or primary U.S. location if the company's principal place of business is not in the U.S.), jurisdiction of formation and, for a foreign company, state/Tribal jurisdiction of first registration, tax ID number or, for a foreign company, foreign tax ID (if no U.S. ID).
- **Beneficial Owner.** Full legal name, date of birth, residential address, unique ID number and issuing jurisdiction, and an image of one of the following nonexpired documents: U.S. passport, state driver's license, or ID issued by a state or local government or an Indian tribe; if a foreign individual does not have any of the foregoing, then a foreign passport. (No other forms of ID are permissible.) (**Comment:** A Beneficial Owner can submit a FinCEN Identifier in lieu of providing foregoing information.)
- **Company Applicant.** Same information as for a Beneficial Owner but may use business address if an individual is in the business of forming or registering companies (or, in lieu thereof, a FinCEN Identifier).
- **FinCEN Identifier.** A unique ID number issued by FinCEN to an individual upon request, which is used by a Reporting Company in lieu of a Beneficial Owner's or a Company Applicant's personal identifiable information (PII). Note, individuals with FinCEN Identifiers are required to update FinCEN of any change in PII within 30 calendar days after a change occurs.

## DUE DATE

REPORTING COMPANY FORMED/REGISTERED PRIOR TO JAN. 1, 2024	No later than Jan. 1, 2025
REPORTING COMPANY FORMED/REGISTERED IN 2024	Within <b>90 days</b> of the earlier of 1) actual notice of creation/registration or 2) public notice of creation/registration
REPORTING COMPANY FORMED/REGISTERED IN 2025 AND THEREAFTER	Within <b>30 days</b> of the earlier of 1) actual notice of creation/registration or 2) public notice of creation/registration

**Updated Report.** Within 30 calendar days after a change of previously reported information for Reporting Company or Beneficial Owner occurs.

**Corrected Report.** Within 30 calendar days after Reporting Company became aware or has reason to know of any inaccuracy.

**Where to Send.** File electronically with FinCEN on their secure filing system. See FinCEN's Beneficial Ownership Information (BOI) website ([www.fincen.gov/boi](http://www.fincen.gov/boi)).

## ARE THERE PENALTIES FOR NONCOMPLIANCE?

Yes. Both civil and criminal penalties for 1) the willful failure to report, 2) the willful failure to update BOI and 3) willful failure to correct inaccurate BOI.

- **Civil Penalties.** \$591 (\$500, increased by inflation) per day in civil monetary penalties (no maximum amount).
- **Criminal Penalties.** \$10,000 fine, imprisonment for no more than two years, or both.

***Comment:** Penalties may apply to Reporting Company, as well as to an individual who caused a failure to correctly, timely and properly report or was a Senior Officer at the time of a failure.*

## NEXT STEPS

Please reach out to our team or your Holland & Knight contact if you have questions about the CTA. Although Holland & Knight will not prepare or file reports with FinCEN or monitor your business or activity to determine the need for updated or corrected reports, we can provide referrals for third-party vendors who can assist with data collection/retention/alerts and report filings with FinCEN. Holland & Knight will provide advice related to CTA compliance only when explicitly requested to do so.

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