7 Things to Know About the Corporate Transparency Act

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By: Deirdre Wheatley-Liss, CELA*, John Elias, Jennifer Kelliher

Beginning January 1, 2024, U.S. corporate entities will have to comply with new reporting requirements under the Corporate Transparency Act (CTA). The CTA, which was enacted by Congress in 2021 to expand anti-money laundering laws, requires most U.S. corporate entities, as well as foreign entities doing business in the United States, to report certain identifying information about their beneficial owners to U.S. Treasury's Financial Crimes Enforcement Network (FinCEN). Businesses that are subject to the CTA should take steps now to comply with the new reporting requirements.

Porzio's Deirdre Wheatley-Liss, John Elias and Jennifer Kelliher outline 7 keys to understanding the CTA's new compliance requirements and what you need to do to prepare.

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Transcript
Deirdre Wheatley-Liss: Hello there and welcome to Porzio's presentation on the Corporate Transparency Act. Some broad sweeping and transformative legislation that candidly is going to probably impact all of our clients starting in 2024. And we're here to give you a high-level overview of it.

This is the beginning of a webinar series and educational series that we're doing for our clients, so they understand what this law is, how to comply with this law, and importantly, once the government starts enforcing this law, how to deal with any enforcement actions.

So before we go any further, I want to introduce the panelists here for today.

My name is Deirdre Wheatley-Liss. I am a principal in Porzio's Wealth Preservation team. I mostly represent owners of closely held businesses who are the ones that candidly are going to have the highest compliance obligations under this law.

John, can you introduce yourself to our audience, please?

John Elias: Thank you, Deidre. My name is John Elias. I, too am a principal in the Wealth Preservation Group at Porzio.

Like Deirdre, I represent a number of business owners and individuals who may find themselves swept up in this piece of legislation, not knowing that the government considers them a business owner who needs to make these kinds of disclosures.

Deirdre: Absolutely. And Jennifer, could you introduce yourself to our audience here today?

Jennifer Kelliher: Hello everyone. I'm Jennifer Kelliher. I'm an associate at Porzio in the Litigation Practice Group. I primarily represent small to mid-size businesses in litigation-related matters.

Deirdre: Well, thank you. So the Corporate Transparency Act, what we're going be talking about today is a law that is going to touch every single limited liability company, corporation, limited partnership that exists in the United States of America.

Last time I looked, I believe they said there were over 200 million such entities that exist. So this is going to be very broad sweeping and it's going to impact existing entities as well as new entities that may be created. Today's just an introduction.

So what are we going to be talking about here today? The first is why should you care about this? Spoiler alert, there's a $500-a-day penalty, so you're going to want to care. What companies does it apply to, and what people does it apply to? What do you need to report to a federal government database? When do you need to report it? How do you go about reporting to the database? And most importantly, what you should be doing now.

Now we are recording this in December of 2023. As I said, we're going to be having a series of information going forward in terms of what needs to be done.

This isn't something you need to be panicked about over the holidays, but this is something that you need to take seriously and start taking steps on in the first quarter of 2024.

So Jennifer, maybe you could start by telling our audience why you should care about the Corporate Transparency Act.

Jennifer: The Corporate Transparency Act is this sweeping effort to bring transparency to an area where the United States has traditionally been severely lacking, and that is disclosing information about who owns corporations in the United States.

It is part of the federal anti-money laundering efforts, and it goes into effect on January 1, 2024. It will apply to most businesses-- corporations, partnerships, and limited liability companies will now have certain reporting requirements, and there is, as Deirdre indicated, a huge penalty for non-compliance. That's $500 per day.

Deirdre: So John, what are your thoughts on that? I mean, you and I are tax attorneys. We deal with penalties and interest all the time from the tax perspective. This seems very different to me though.

John: I couldn't agree more. Let's start with the basic premise that it applies to all business entities and the onus is on the owner and the owner's advisors to find an exemption if applicable. And if you guess wrong on that exemption, you fall into this $500-a-day penalty category.

Now, there may be some opportunities to reduce or avoid, but I think all business owners have to understand the default position is the owner must report and we'll explain what, who needs to report, and what needs to be disclosed. And that failure to report results in this $ 500-a-day penalty.

I am unaware of anything remotely similar to this in the Internal Revenue Code that would impose such draconian penalties for noncompliance. So this is a new one and we can, given the nature of what they're trying to find out, we can rest assured the feds are going to be pretty aggressive in enforcing this legislation and by extension imposing these penalties.

Deirdre: Yeah, so this is really, I'm going to say that it's a game changer. And you know, one of the reasons is that it's very different in Europe. In Europe, there's been this know your client, know your customer concept, probably for decades now.

So if you're going to open up a bank account or you're going to get or retain an attorney, they always peel back the onion to find out who is the human being behind it.

Now, the United States' history has been very, very different. We proudly and intentionally create corporate structures to create privacy for people's business operations, and that is no longer going to be the case.

One of the things we'll be talking about in a future webinar is how that trust potentially can be used to avoid the compliance obligations here and can have other tax benefits.

But Jennifer, before we get to this, let's talk about what companies the CTA applies to. And in doing that, John teed up that unless you find an exemption, it applies, I think for this audience that large business exemption is the one that's probably going to be the most relevant.

Jennifer: The rules were written very broadly to include as many companies as possible, and they delineate only 23 exemptions. And the way that the rules are written is that most companies will end up being a reporting company. It will apply to all corporations, partnerships, and limited liability companies.

Of those 23 exemptions, the bulk of them are for institutions that are already heavily regulated and already have reporting requirements. So those are going to be your bank institutions, insurance companies, things of that nature. One of the other exemptions that will most be at play is going to be this large business exemption. But there are strict criteria that a company needs to meet in order to qualify for this particular exemption.

The first of which is that have to employ more than 20 employees on a full-time basis in the United States. They also need to have tax returns from the year prior that reflect more than five million in gross receipts of sales. They need to have a physical presence in the United States in order to qualify for that large business exemption.

Deirdre: All righty. So, John, let me ask you a question about this because we have spent our careers creating parent-subsidiary structures for clients for tax reasons. And really importantly, because we want to not cross-collateralize liabilities of different operations.

So let's say that we have a parent, that parent has two entities, one's an operating entity. That operating entity has 25 employees and $10 million in revenue.

And then we have a real estate entity, which is another child subsidiary. And that one has another $10 million in revenue. So I've got $20 million of revenue and I've got a subsidiary that's employing 25 people. Does the parent meet the large business exemption in that situation?

John: The parent does not. The operating entity does. And the other child, the real estate entity does not either. These are “ands,” and while you can aggregate revenue, you cannot aggregate employees.

So each of those three entities from the perspective of the employee headcount will be analyzed separately. And the exemption is only available if that specific entity has $20 million, excuse me, 20 employees regardless of the level of revenue it realizes on an annual basis.

Deirdre: So John, I just want to jump at your word aggregate because I did a little bit of math here for our audience. So let's say that you're non-compliant for one month, that's a $15,000 penalty.

One other thing that I want to point out is inactive entities with no assets are an exemption. It's not inactive entities, it's inactive entities with no assets. So think about maybe a limited liability company that has a bank account with a thousand dollars in it, or alternatively, you have a limited partnership that owns undeveloped land. You're not making any money off that property at all. They do not qualify for an exemption. It, this is not a tax code item where we're looking for income to

be generated. This is an entity structure item. So one idea might be to restructure some of those inactive entities into a trust or other ownership format so that you don't have the cost of these compliance reporting obligations for an entity that's not generating any income at all in terms of what it's doing.

So now that we've talked about the companies that the CTA applies to Jennifer, what about the people it applies to? Because again, the goal of this as an anti-money laundering law is to get to the human beings behind the entity. So who are the human beings they're looking for?

Jennifer: So if you are a reporting company that does not qualify for an exemption, you need to report certain information regarding two categories of people. The first is a beneficial owner and the second is a company applicant.

The company applicant. The definition is a little bit more straightforward than the beneficial owner. A company applicant is going to be anyone who files or directs another to file an application that forms the business. It's also going to be an individual who registers or directs another to register the business.

The definition of a beneficial owner is a little bit more broad, and that's going to be the area where a lot of these companies are going to struggle in determining who constitutes a beneficial owner. There are two ways in which a person can be considered a beneficial owner. The first is that they exercise substantial control over the entity or that they own or control more than 25% of the ownership interest in that entity. The way these rules are drafted is they are very fact-intensive as to what constitutes substantial control and the various ways in which you can calculate who owns or controls more than 25% of the ownership interest.

Deirdre: Absolutely. So, Jennifer, I mean this is a constantly changing area. You know, we have guidance on beneficial owners. Do you recall when that came out? The most recent guidance on beneficial owners? I think it was earlier this month and it was like a couple of hundred pages long. So I tee that up because we're going to be talking about this at another webinar and it might Jennifer even be more than one. There's a lot of detail behind this beneficial owner concept.

Jennifer: Correct. That is a very lengthy discussion and it's because it is so fact-intensive the way that the rules are written in order to determine who meets that definition.

Deirdre: Yeah. So right now in terms of who an applicant would be. John, I'm going to give you a couple of examples. somebody goes online and they form a limited liability company with the state of New Jersey. Who's, who's the applicant?

John: The applicant is that person who just completed and hit the send button on their computer.

Deirdre: Okay, so let's say that they asked their accountant to form it and their accountant asked their legal assistant to do it. Who's the applicant?

John: Now we've got three people in that chain. We've got the applicant, the business owner who hired his accountant to register him, and the accountant who has his assistant or junior staff member to do it. All three of those people are going to be, are going to fall within this definition of applicant and must register accordingly.

Deirdre: Yeah, so just interestingly, I have a couple of attorneys that I've spoken to recently. They are no longer going to be forming entities because they do not want to be applicants.

I will let you know that at Porzio all of our attorneys and our team members will all be filing to be applicants so that we can continue to assist our clients who are forming new business entity organizations.

And before I bounce off of beneficial owners because it is really relevant how complex this is. So John, if I were to say, what does exercise substantial control mean? You're a lawyer, what do you think? That's a clear term, right? That's like reasonable, right?

John: That that is a loaded, that is a loaded concept, right? You, to Jennifer's point from a moment ago, we've got these fact-sensitive analyses that are being addressed almost on a weekly basis in these new regulations. And at some point, substantial control is going to be one of those hot-button issues.

Somebody who sits atop the pyramid of a corporate structure obviously exercises substantial control, but need not be an owner of the entity yet has to be the person who's the subject of this disclosure. And it's going to be a highly, as Jennifer said, factually sensitive analysis to determine who has substantial control and what constitutes substantial control.

Deirdre: I mean, this is legal analysis. So we've been looking at this, you know, since the beginning of the year, at least in terms of what it is, you know, Jennifer, I mean, is there even, is, is there, is there just a checklist and to say, okay, this is going to be the beneficial owner that somebody can go through, or is this the kind of thing that lawyers, because it's dealing with laws, are really going to have to give opinions on?

Jennifer: For a majority of the companies, it is going to require the input of a lawyer to determine whether or not any of those factors that would render someone having substantial control over the company does or does not apply.

Deirdre: Hence why we're going to be having another whole different webinar on that issue. So the next point that we wanted to get to is what do you need to report?

And this is really going to be shocking for people, okay? Privacy is something that's pretty important for people here in the United States. You know, we set up, there are states right now as an example that you can set up an entity and it's entirely shielded who the ownership of that entity is. That is no longer going to be the case. So going back to anyone, as Jennifer said, who is either an applicant or is a beneficial owner, Jennifer, can you talk about what information these individuals are going to have to report to the federal government?

Jennifer: There are four main things that a company applicant or a beneficial owner will need to report. The first is your full legal name. The second is your date of birth. The third is your residential or business street address as of the date of the report. That last part is very important because if there is a change in address that would trigger a requirement within 30 days to update that information. And then the fourth is going to be an identifying number. Now this is going to be something like a passport or a driver's license number. But recently they've created an option that you can apply for what's called a FinCEN identifier, which is a number that will be specific to you and that you can use in connection with all of your reporting requirements to the extent that there are people who are going to be filing multiple reports. The fifth aspect isn't really information, but rather it's a document you need to provide a picture of your passport or some other form of identification.

Deirdre: And of course, people love sending their driver's licenses, you know, through email. That's always a good thing.

John, let me ask you a question. I mean, you've been forming companies for clients for quite some time now. You know, and to be clear, the reporting company is the one that needs to report this information, but they have to gather the information from the individuals.

So John, how comfortable do you think people are going to feel about giving this information to somebody that maybe they have a 30% passive investment in as an example?

John: Yeah, I mean these are the real-world implications of what's going on right now. And why this has become such a, as you suggested several times, Deirdre, such a sea change, for the American business community to be at, be exposed to this kind of disclosure. And again, you keep coming back to this fundamental concept that the failure to make a full and complete disclosure of all the items Jennifer just identified for each applicant and beneficial owner results in a $500-a-day penalty. And that's going to force the hand, I think of that reluctant 30% owner to come forward and have to make a clean,

complete showing of all this data and have it reported to the federal government and ideally stored in a secure database that's limited to this very narrow purpose.

Deirdre: So, let's just say from a practical perspective, your owner, in my example, lives off the grid in Bali. They have a wonderful place, right? And you can't get the information for them for a good 90-day period. I did the math for you, that's a $45,000 penalty for one quarter. And here's the thing, there is not a single operating agreement or shareholder agreement in existence that required that information to be provided at the inception. because we didn't know that we needed it. And there's not anyone that has this ongoing, you have an obligation to provide this and if you don't X, Y, Z is going to happen. So I think it's going to be very challenging, potentially, to get some of that information because I know, and I'm sure many of our clients who are listening to this right now are not super comfortable about the idea of doing this, notwithstanding that it, that it's the law.

Jennifer, we talked about, you know, this law is coming into effect on January first of next year. Can you talk about when people are going to need to report? This is not something that you have to do on January 3rd, but when do you need to do it?

Jennifer: So if you're a company that's already in existence, meaning that you were created or registered before January 1, 2024, you have one year to file your initial reports. If you are a new entity, as in one that is being created after January 1, 2024, you have 90 days, upon receiving notification that your company has been created or registered to file your initial reports.

Now that 90-day period is going to be shortened to 30 days for new entities that are created January 1, 2025, and after.

Deirdre: Okay? And again, getting it wrong, because I'm doing the math here for you, $90,000 if for half a year you didn't know that you had to do this and you were late for doing it. We're going to have a whole another seminar on when you have to update your reporting because that's a whole different section of things Jennifer alluded to. What if there's a change of address? What if somebody passes away? What if there's a change of ownership? We're going to have a whole different discussion around that right now. We want to just get, if you're a reporting company, you have to report is what we're trying to focus on.

And the last one I want to talk about is how you need to report, and Jennifer, when we're talking about this, interestingly enough FinCEN actually issued guidance yesterday on some of the, on the entity, the database that's being reported to.

So maybe you could talk about how it is that you need to report as well as, because they've been getting a lot of pushback about, hey, we've got a lot of personal and sensitive information in a federal database, and not at all being rude to the federal government, but those databases have previously been hacked, that has historically happened. So Jennifer, what is it that needs to be reported and what kind, what have they sort of been taken about? Who has access to that information?

Jennifer: So FinCEN just yesterday released about 147 pages of guidelines as to what the actual reporting is going to look like. And surprisingly, even though these regulations are set to go into effect in just two weeks, they were pretty non-specific as to what it actually looks like. Instead, their focus was on who can access it and what type of requirements they need to meet in order to access it.

But generally speaking, knowing that this is still being developed as we are talking here today it's going to be reported into the FinCEN database. As of now, the system is not available. People cannot look at it. People cannot start completing their applications, but it is going to be a secure mechanism. And those new rules really set forth what those security methods are going to look like.

Deirdre: So I have to say, John, the idea that they call this BOSS – Beneficial Ownership Secure System – we're tax attorneys, we have to give acronyms to everything.

John: If there's an acronym, it must be serious.

Deirdre: It must be serious in terms of what it and what it is that we're doing.

So here's one of the challenges that we've had. We've been trying to prep all year long to get our clients ready to be able to upload to this database.

We don't have the database information yet. So again, this is really something that's going to have to be focused on in the first quarter in terms of what it is that people are doing. And what I want to talk about now is sort of how we get prepared to be doing this. Uploading the issue isn't, you know, necessarily even the difficulties of getting the information and then pushing send, but it's that analysis of do you need to report and then who needs to report on it that we need to be talking about.

Jennifer, we have just sort of some practical tips that the three of us have pow-wowed on that we're going to be having our clients again work on in the first quarter. Can you sort of go through this so people can get an idea of, you know, what they need to do and maybe who they need to task to get some of this prepared?

Jennifer: So we don't know what the form looks like and we don't know what the actual process of reporting will look like, but what we do know is the type of information that is going to be reported.

So to get ahead of the problem, what we can start doing now is, generally speaking, collect all of the information that you need. So the first thing you're going to want to do is prepare ownership cables for all entities. So for all of your entities, what you want to go through is each individual and determine whether or not they were a company applicant or that they qualify as a beneficial owner, either by way of exercising substantial control or by the percentage of their ownership interests. Again, this will more likely than not require the assistance of a lawyer to look at your business structure to determine whether or not an individual in your company meets that definition.

Once you've identified those people, then you need to start gathering their information. Their information is going to be their name, their address, as well as their date of birth. And then you also need to figure out whether or not your company is even exempt from the regulations. Are you a reporting company? If you're a reporting company, do you meet any of the exemptions?

Deirdre: John, you know, one of the things that we have on here is, you know, we had talked about sort of the legal analysis about who the beneficial owners are. Before I ask you a question on that, Jennifer, one thing that came to mind, you need to securely gather this information because this is what's called personally identifiable information, and the leak of that information,

I'm just speaking for New Jersey right now, which is actually potentially a violation of the New Jersey Privacy Act, which falls under the New Jersey Consumer Protection Statute, which means that you can actually get sued if this data is misplaced in transit.

One of the things we have here at Porzio is we have designed a secure upload system so that we can assist clients with gathering the information that then is going to be reported to the BOSS. Isn't that a lovely word to be able to use?

John, you represent a lot of entities, right? Do all your clients always know exactly who owns how much of the entity and who's in control of it?

John: No, dear God, and, unfortunately, oftentimes you have through no fault of ours conflicting information. Sometimes you have an operating agreement that's inconsistent with a tax return so you're never quite sure who owns what without a fair amount of due diligence. And for people to think that this is easy enough to gather on short notice, they're deluding themselves. It's not going to be that quick because you don't want to commit a foot fault that traps you into this penalty

that is so significant. Again, it comes back to using your trusted advisors, your attorneys, to start with this idea of who owns what and then going through the decision tree to determine who on that chain is an individual whose information must be disclosed to FinCEN.

Deirdre: Yeah, so always trying to look for the silver lining. I do think that there are some opportunities here. Okay, if your corporate structure is a mess, it's a mess and it's going to have to be dealt with at some point in time. Either Jennifer, you might be dealing with it in a litigation kind of situation, or we might be dealing with it in a business sale, or an estate administration type of situation.

Look, the penalty, I did the math for the year, it's $182,000. If you are a reporting company that has to comply, you're going to have to comply with this. But potentially at the same time you're doing that, there's an opportunity to clean up, to simplify your corporate structure, to be able to you know, get rid of people that maybe they're not really contributing to the business. They're the ones that don't want to report anything. Well, maybe we find a way that they're no longer involved in the business, or as we said, we look at something, you know, utilizing trust or something along those lines.

So, you know, at this point, and we haven't meant to scare you. This is meant to be educational, but it's a big deal and that's why we really, you know, we're focusing on the downside because we want to encourage people to know that this is serious. This is not a check-the-box; candidly in my career, this is an entirely new analysis type of thing that has to be done.

So what is it that we can be doing here at Porzio? So Jennifer, can you sort of share some of the things that we've discussed about how we're planning on supporting our clients going forward?

Jennifer: What we did today was a very, very high-level brief overview of the Corporate Transparency Act. There are separate discussions that need to be had on additional topics, including who constitutes a beneficial owner, what is a reporting company, what are those exemptions, and how a company can be structured to potentially avoid those reporting requirements. Those will be future webinars that we will be providing.

We are also getting ahead of the curve and figuring out the best ways that our clients can gather the information that they need to be in compliance with the regulations. Again, if you're an existing corporation, you have until January 1, 2024 to report, but it is going to take a significant amount of time to gather that information so companies need to start getting ahead of the issue.

Deirdre: Absolutely. And Jennifer, I'm just going to correct you. You said January 1, 2024, it's January 1, 2025 for those that have existing companies.

Jennifer: Correct.

Deirdre: So the other thing that we have here is, again, we're going be offering compliance services around that, but this video is going out to our clients right now, right? So, John, an existing client of yours has a question about this. What does, what should they be doing?

John: Pick up the phone and call.

Deirdre: Yeah, send an email, smoke signals, carrier pigeon. We're here to talk about it.

John: Your preferred choice of communication and quick. We can't afford to get too far behind the eight ball on this because as we all know, time flies even when you're not having fun. We'll be looking at this issue in the fourth quarter and people will still be hard-pressed to come up with some of this fundamental information to make a complete and comprehensive disclosure. I guess part of this process from our perspective as we get into forming new entities in 2024, we're going to take a very, very different approach to the information that we're going to request of our clients. Because as

you said, when we started this, one of the virtues of organizing for example, an LLC in New Jersey, was getting away with the disclosure of so little information in that initial filing that it took almost no thought to do it.

All you really asked about was what name you want to use and what you want is a registered office. Now we have to dig a lot deeper into all of that because that new entity has only 90 days to submit all that information. So we need to be at the forefront of reminding clients as they form these new entities that the degree of disclosure that we will need to keep everybody compliant is much greater than anything we've seen before.

Deirdre: It is, but we're here to support you. We're here to help you. We are going to have, you know John, you use the mom and pop. That's relatively straightforward and then we're going to have more those who have a more complicated situation. And part of it might be candidly uncomplicating part of your situation.

From a timeframe perspective, we're suggesting using the first quarter to gather all of this information. For many of you, you're going to go into tax filing at the end of the first quarter, either for March or at the beginning of the second quarter for your income taxes. Personally, right after that is the ideal time to turn to this. You've already been focused on compliance within your business organization. We can get all of this information up to date and it creates enough time that if you want to be able to make changes, you have an opportunity to do so.

The one thing I want to leave you with though, is if you create an entity after January 1, 2024, Jennifer, how long do you have to do the reporting in that situation?

Jennifer: You have 90 days.

Deirdre: John, is there an extension for the 90 days?

John: There is no extension. The 90 days is already an extension from what had originally been proposed as a 30-day requirement.

Deirdre: And Jennifer, if you do not file with that new entity that you created within 90 days, how much is it going to cost you?

Jennifer: $500 a day.

Deirdre: All right, with that sunny news, we're going to say goodbye and we look forward to seeing you at our next webinar. Thank you.

John: Thank you all.

Jennifer: Thank you.