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Reporting Obligations of Small Private Companies Regarding Beneficial Owners Under the Corporate Transparency Act

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EXECUTIVE SUMMARY

The United States Senate and the House of Representatives voted to override the President's veto of the National Defense Authorization Act ("NDAA") on January 1, 2021 and December 28, 2020, respectively, resulting in the NDAA becoming effective law as of January 1, 2021. Within the NDAA was included the Corporate Transparency Act ("CTA") that became law upon the effective date of the NDAA. The CTA represents a substantial change in the transparency obligations for private companies, as the CTA will impose reporting obligations regarding beneficial ownership information for "reporting companies," which are primarily small-scale private companies with an operating presence in the U.S. As discussed below, although reporting companies will not be subject to these obligations until a later date, existing or newly formed reporting companies must be prepared to meet these obligations in the near future.

Under the CTA, a "reporting company" must disclose to the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") and then update certain information pertaining to its "beneficial owners." Required beneficial owner information to be reported is "(i) full legal name, (ii) date of birth, (iii) current, as of the date on which the report is delivered, residential or business street address, and (iv) unique identifying number from an acceptable identification document" such as a driver's license or passport.[1] It is important to note that such information will not be publicly available[2] and unauthorized disclosure of such information will subject the discloser to severe penalties.[3]

A reporting company is defined as "any corporation, limited liability company or similar entity that is (i) created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe; or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe."[4] However, not all U.S. entities or foreign entities doing business in the U.S. are subject to the CTA. Rather, the

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reporting obligations under the CTA are directed toward smaller companies. Specifically, the CTA exempts from its reporting obligations any company that has more than 20 employees in the U.S. on a full-time basis, had more than $5 million in gross receipts in sales in the previous year, and has an operating presence at a physical office in the U.S.[5] Furthermore, the CTA exempts numerous types of entities that are already required to disclose their beneficial ownership information publicly or to federal agencies, such as public companies and financial entities (including banks, insurance companies, investment companies and the like).[6]

The term "beneficial owner" is defined broadly as "any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise – (i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests of the entity."[7] As with the definition of "reporting company," there are exceptions to the definition of "beneficial owner." Among other categories, the exceptions of note are an employee of a company (whose control over or economic benefits from such entity is derived solely from the employment status of such person), an individual whose only interest in a company is through a right of inheritance and a creditor of a company.[8] Even with such exceptions, the definition "beneficial owner" could be construed very broadly and, as a result, we anticipate that the regulations to be adopted by FinCEN ("Regulations") will further clarify this definition. Such Regulations are expected to be adopted by no later than January 1, 2022.

With respect to timing, reporting companies that existed prior to the effective date of the Regulations will be required to report necessary information no later than 2 years after such effective date.[9] Reporting companies that have been formed or registered after the effective date of the Regulations, on the other hand, will be required to report necessary information at the time of formation or registration.[10] Changes to reported information must be reported within one year of the occurrence of such change.[11]

Finally, as currently written, the CTA not only applies to domestic private companies, but also to any small-scale U.S. subsidiary of a foreign company. Absent further exceptions applicable to such foreign companies, identifying "beneficial owners" of such foreign companies may be complicated. As a result, any U.S. subsidiary of a foreign company, when the U.S. subsidiary meets the definition of "reporting company," must be prepared to identify and report its "beneficial owners." Of course, gathering the necessary information may require complex analysis of the upstream, overseas ownership structure.

We will update you when the Regulations are issued.

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[1] NDAA § 6403 (adding 31 USC § 5336(b)(2)(A)).

[2] NDAA § 6403 (adding 31 USC § 5336(c)(2)(A)).

[3] NDAA § 6403 (adding 31 USC § 5336(h)(3)(B)).

[4] NDAA § 6403 (adding 31 USC § 5336(a)(11)(A)).

[5] NDAA § 6403 (adding 31 USC § 5336(a)(11)(B)).

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[6] *Id*.

[7] NDAA § 6403 (adding 31 USC § 5336(a)(3)(A)).

[8] NDAA § 6403 (adding 31 USC § 5336(a)(3)(A)).

[9] NDAA § 6403 (adding 31 USC § 5336(b)(1)(B)).

[10] NDAA § 6403 (adding 31 USC § 5336(b)(1)(C)).

[11] NDAA § 6403 (adding 31 USC § 5336(b)(1)(D)).

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