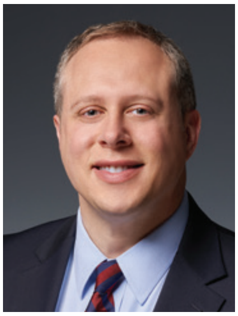
VANTAGE POINT

Experts weigh in on industry issues



LOUIS P. ALEXANDER, JR.

THOMAS A. GATTOZZI

Impacts of the Corporate Transparency Act

In January of 2021, Congress passed the Corporate Transparency Act (CTA) imposing new reporting requirements for all entities formed or registered to do business in the United States.

While the CTA was intended to strengthen anti-money laundering laws and make it more difficult to commit financial crimes or avoid taxes in the United States, the breadth of the CTA will impose significant burdens on small businesses in the form of additional administrative work, compulsory disclosure and loss of anonymity, and compliance costs. Such burdens will be felt in the real estate industry since forming new entities to take title to real estate is common practice and often a requirement in connection with financing.

Reporting companies; beneficial owners

The CTA broadly defines "reporting company" to include any corporation, limited liability company, or other similar entity created by filing a document with the secretary of state or similar office in any state or territory or with a federally recognized Indian Tribe, or formed under the laws of a foreign country and registered to do business in the United States. While the CTA does not specifically mention limited partnerships in the definition of *reporting company*, owners of limited partnerships should expect the obligation to comply with the CTA unless excused by the final implementing regulations.

The CTA does provide exceptions to the reporting requirement for certain types of entities, but these exceptions will not apply to small businesses. Publicly traded companies, investment vehicles operated by investment advisors, nonprofits, government entities and "public utilities" are not required to report under the CTA. In addition, entities engaged in certain heavily regulated industries, in which the existing regulations already require reporting of beneficial ownership (e.g., banks, domestic credit unions, securities issuers, money transmitting businesses, registered investment advisors, insurance companies) are excepted from the reporting requirements. Exceptions also apply to "large operating companies" that (1) employ more than 20 employees; (2) filed in the previous year a tax return demonstrating more than $5 million in gross receipts or sales; and (3) have an operating presence at a physical office within the United States. Entities that are subsidiaries of these excluded companies are also exempted from these reporting requirements.

The CTA defines a "beneficial owner" of an entity as any individual who, directly or indirectly, (1) exercises substantial control over the entity or (2) owns or controls not less than 25% equity in the entity. The CTA does not define the term "substantial control," so the forthcoming regulations are expected to clarify its meaning. The CTA expressly excludes certain individuals from the definition of beneficial ownership, including (1) a minor child (as long as the child's parent's or guardian's information is reported); (2) an individual acting as an intermediary or agent on behalf of another; (3) a person whose control over a reporting company derives solely from their employment; (4) an individual whose only interest in a reporting company is through a right of inheritance; or (5) a creditor of a reporting company (unless they qualify as a "beneficial owner" through substantial control or equity ownership).

Proposed regulations concerning beneficial ownership reporting

On December 7, 2021, FinCEN issued a Notice of Proposed Rulemaking (NPRM) setting forth proposed regulations with respect to beneficial ownership information reporting. Those proposed regulations were not scheduled to take effect until after the comment period expired on February 7, 2022. However, the proposed regulations provided a clearer understanding of what constitutes beneficial ownership and what information must be disclosed in a beneficial ownership information (BOI) report.

The proposed regulations provide three specific indicators of "substantial control":

1. Service as a senior officer of a reporting company
2. Authority over the appointment or removal of any officer or dominant majority of the board of directors (or similar body) of a reporting company
3. Direction, determination or decision of, or substantial influence over, important matters of a reporting company, including, for example, the sale, lease or transfer of any principal assets of the company, the entry into or termination of significant contracts, major expenditures and investments by the company, and compensation schemes for senior officers.

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According to the NPRM, each of these indicators "supports the basic goal of requiring a reporting company to identify the individuals who stand behind the reporting company and direct its actions." In addition, the proposed regulations include a broad, catch-all provision defining "substantial control" to include "[a]ny other form of substantial control over the reporting company," thereby clarifying that "substantial control can take additional forms not specifically listed" in the regulations and to prevent individuals from evading identification by "hiding behind formalisms." Furthermore, the NPRM clarifies that there can be more than one person who exercises "substantial control" over a reporting company, and the rule will require the identity of each person to be disclosed.

Similarly, the proposed regulations take a broad view of what constitutes an "ownership interest," which includes both equity in the reporting company and other types of interests (such as capital or profit interests, convertible instruments, warrants or rights, or other options or privileges to acquire equity, capital or other interests). The proposed regulations remind reporting companies that entities can be owned or controlled directly, indirectly or "through a variety of means" (e.g., a trust agreement), further revealing the breadth of FinCEN's definition of "ownership interest."

Reporting requirements

The CTA requires a reporting company to make reports and disclosures to FinCEN. In each report, the reporting company must disclose (1) each beneficial owner's name, (2) date of birth, (3) residential or business address, and (4) a unique identifying number from an acceptable identification document, such as a driver's license, passport or other government-issued identification document or a FinCEN identifier.

Once the CTA implementing regulations become effective, all new reporting companies will be required to report their beneficial owners' information at the time of formation of the entity. All existing entities will be required to report their beneficial owners' information within two years of the effective date of the implementing regulations. Further, a reporting company must report updated information within one year of any change in its beneficial ownership.

Use of information

FinCEN will be responsible for secure storage of all information collected from reporting companies pursuant to the CTA. The FinCEN database will not be publicly accessible; rather, beneficial ownership information will be available upon request only by (1) a federal law enforcement agency; (2) a state, local or tribal law enforcement agency, if authorized by court order; (3) a federal agency on behalf of a foreign country, if the request is pursuant to an international agreement; or (4) a financial institution for customer due diligence purposes and if authorized by the reporting company.

A reporting company that willfully provides false information or fails to report complete information to FinCEN can face fines up to $10,000 and imprisonment for up to two years. The CTA contains a safe harbor provision from such liability for submission of false information if the person submitting the report voluntarily corrects it within 90 days.

Penalties

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While the intent of the CTA is to strengthen existing laws to detect and prevent money laundering, the CTA brings about significant new compliance obligations for small businesses. It is recommended that small businesses contact an attorney to evaluate its reporting obligations. P

Louis P. Alexander Jr. is an attorney in Brouse McDowell's Business Transactions & Corporate Counseling and Real Estate Practices. He counsels clients on real estate, corporate law, mergers and acquisitions, contract drafting and negotiation, and business transactions. Thomas A. Gattozzi is co-chair of the firm's Real Estate Practice Group. His practice includes all areas of commercial real estate and general corporate law and he has developed a specific focus in retail development matters, including drafting and negotiating leases, purchase agreements, easements and subordination, non-disturbance and attornment agreements. Contact Brouse McDowell's Real Estate Practice Group or Business Transactions & Corporate Counseling Group at 330.535.5711 for more information regarding the Corporate Transparency Act.