

How to Stop Worrying about the new FinCEN Reporting Rules

2024 stands to give an unwanted education in new compliance obligations and lost privacy for most of those who own (or plan to own) privately held corporations, limited liability companies, and limited partnerships.

Starting in 2024, all business entities will need to determine the applicability of the Corporate Transparency Act (the “CTA”). If applicable, companies will need to collect and report information about certain owners and decision makers to the Financial Crimes Enforcement Network, a Bureau of the US Department of Treasury (“FinCEN”). Failure to report, or failure to report accurately, could lead to both criminal and civil penalties.

What is the Corporate Transparency Act?

The CTA was included in the Anti-Money Laundering Act of 2020 which was enacted into law as part of the National Defense Authorization Act of 2021. Congress gave FinCEN very wide latitude in implementing the CTA. The CTA’s beneficial owner information reporting regime will begin January 1, 2024.

Congress passed the CTA to give law enforcement additional tools to combat the use of so-called “shell companies” engaged in illicit activities (including money laundering, drug dealing, and terrorist financing). While it sounds odd, several states in the US are viewed as privacy “havens” when it comes to the formation of business entities. For example, an LLC can be formed in Delaware completely anonymously. This is not the case in most international jurisdictions, including those viewed as “haven” countries.

Criminals and others involved in illicit activities worldwide have used anonymous US LLCs to launder and move money. For this reason, Congress created a new reporting regime under the CTA to allow law enforcement to go “under the hood” on otherwise opaque entities.

What are the reporting requirements of the Corporate Transparency Act?

It’s relatively easy to summarize the basic gist of the CTA. The Federal Government now requires business entities formed or registered to do business in the US to report on their existence and provide some information about their owners and decision makers.

Implementing this through a set of clear legal requirements is much more difficult. The CTA has given rise to not only the statutory language enacted into law in 2021, but a variety of regulations and other guidance published by FinCEN, assuredly with more to come.

The bottom line for most private clients is that if they either (1) own, or (2) control, directly or indirectly, a corporation, LLC, or LP, it is highly advisable that they should follow up with counsel to determine their company and/or individual reporting obligations under the CTA.

Here is a general description of each of these important terms and related timing requirements:

CTA Defined Term	Description
<p>Reporting Company</p>	<p>A “Reporting Company” is a business entity which has been formed by filing documents with any Secretary of State (or equivalent state authority) or an Indian Tribe. This might include, but not be limited to:</p> <ul style="list-style-type: none"> (1) Corporations (2) LLCs (3) LPs (4) Business Trusts <p>Foreign entities which were not formed in the US but are registered to do business here are also included as Reporting Companies.</p>
<p>Exempt Entity</p>	<p>A business entity that falls within any of 23 different enumerated exceptions to the definition of “Reporting Company” may avoid CTA reporting. The list of exceptions might be generally characterized as entities that are already highly regulated by some other government agency, like banks, securities issuers, and tax-exempt entities and trusts.</p>
<p>Large Operating Entity – a Type of Exempt Entity</p>	<p>A Large Operating Entity is 1 of the 23 types of Exempt Entities (and thus not itself a Reporting Company). While a variety of special rules may apply, generally a Large Operating Entity must satisfy each of the following:</p> <ul style="list-style-type: none"> (1) Directly employ at least 20 full-time employees; (2) Report in the prior tax year more than \$5M of gross receipts; and (3) Maintain an operating presence at a physical office within the United States.

<p>Beneficial Owner</p>	<p>The term “Beneficial Owner” potentially includes both those who own, and separately those who control, Reporting Companies.</p> <p>Generally, Beneficial Owners include individuals who, directly or indirectly:</p> <p>(1) Exercise substantial control over a Reporting Company; or (2) Own at least 25% of the ownership interests of a Reporting Company.</p> <p>The CTA requires each Beneficial Owner to report his or her full name, date of birth, residential address, identifying number, and provide an image of an identification document (typically a passport or driver’s license).</p> <p>There is still some mystery on reporting for non-Business Trusts as beneficial owners. It appears that trustees will need to report as Beneficial Owners if the trust’s ownership or control over the Reporting Company meets the definition. Certain trust beneficiaries, settlors, and potentially others (like trust advisors or protectors) may also have sufficient rights under a trust to warrant Beneficial Owner reporting.</p>
<p>Company Applicant</p>	<p>Company Applicants are those involved in the formation of a Reporting Company. Perhaps most often limited to attorneys and paralegals, this could include anyone who engages in the formation of Reporting Companies. Company Applicants are also required to provide information to FinCEN alongside Beneficial Owners.</p>
<p>Reporting Deadline</p>	<p>FinCEN Beneficial Owner Information Reporting is generally due:</p> <p>(1) For Reporting Companies that existed prior to 1/1/24: Reporting deadline is 1/1/25; and (2) For Reporting Companies formed on or after 1/1/24: Within 30 days of formation*.</p> <p>(Note: FinCEN has proposed to extend the 30-day period to 90 days for entities formed in 2024, but this extension has not yet been finalized)</p>
<p>Reporting Mechanics</p>	<p>FinCEN has created an electronic filing system which will be the only way to submit required reports. This system is not yet open and available to the public.</p>
<p>Penalties</p>	<p>The CTA provides for both civil and criminal penalties for those who fail to report or who report inaccurate information. Civil penalties include daily fines of up to \$500. Criminal penalties include up to 2 years imprisonment.</p>

If the foregoing seems like a very comprehensive review of the provisions of the CTA and its regulations – it's not!

This new reporting framework has many twists and turns which will need to be navigated by Reporting Companies with multi-layered entity structures and different kinds of Beneficial Owners. The endnotes of this article will provide reference to some very comprehensive resources on the details of the CTA for anyone interested in learning more.

Next Steps to Consider in Complying with the CTA

Being subject to the CTA is one consideration, but like any legal framework, the well-advised private client might consider a variety of planning opportunities to make life easier. CTA compliance is still in its infancy, so this is bound to be an ever-evolving compliance topic.

1. **Rely on the attorneys:** As of now, it appears that attorneys and law firms will be taking the lead on FinCEN beneficial owner information reporting. Anecdotally, many law firms have started sending out email blasts to potentially affected clients offering CTA compliance engagements.

Many law firms have set the stage for assessing compliance obligations and timely reporting as efficiently as possible by assigning attorneys and paralegals to these tasks. Those clients who will need these services might raise the following with their attorney before launching off into a CTA compliance engagement:

- Has the law firm assigned specific attorney(s) and paralegal(s) to be trained on and carry out CTA compliance work?
- Will the "Reporting Company" pay for CTA compliance or will individual "Beneficial Owners" shoulder the cost?
- Can the work be done on a flat fee or project basis or must it be done hourly?
- What can Reporting Companies and/or Beneficial Owners do to help reduce the law firm's time and cost to carry out necessary CTA reporting?

2. **FinCEN Identifier:** Perhaps the most significant action that an individual can take to preserve privacy through the Beneficial Owner information reporting process is to obtain a FinCEN identifier. A FinCEN identifier is an identifying number issued directly to a Beneficial Owner by FinCEN. The Beneficial Owner must separately register with FinCEN and provide the required personal information to obtain a FinCEN identifier.

When a Reporting Company provides information on its Beneficial Owners, it would use the FinCEN identifier rather than separately provide each Beneficial Owner's personal information and identifying documents. This allows individuals to avoid disclosing personal information to the Reporting Company and Reporting Company's attorney.

3. **Secure file sharing and storage:** Without a FinCEN identifier (or in order to obtain one) individuals may need to send sensitive personal information and copies of government-issued identification electronically to Reporting Company staff and/or attorneys. To help protect their personal data, individuals who must provide this information might inquire into the recipient's electronic storage and email security protocols.

For those individuals who know they will be subject to CTA reporting, it might also make sense to go ahead and collect (and perhaps send to relevant counsel) necessary Beneficial Owner information and identifying documents ahead of time. This information could be retained by a Beneficial Owner's law firm to be used for immediate CTA compliance upon the formation of new entities. Doing so may avoid disclosure tasks that may be logistically difficult or burdensome in the future.

4. Simplify the company structure: One way to efficiently comply with Corporate Transparency Act reporting regime may be to LEGALLY avoid it in the first place!

Entity owners might consider exploring with their legal and tax advisors opportunities to simplify their company ownership and planning structures. For example, real estate investors and entrepreneurs often maintain a bevy of active, so-called "shelf" entities for future use. Perhaps this new CTA reporting regime will give reason to reduce the number of such entities maintained.

Although still in its infancy, beneficial owner planning to avoid the Corporate Transparency Act reporting regime may also become ripe for advice. For instance, a passive investor in an entity may choose to maintain 24% ownership (or any ownership figure less than 25%) rather than the 25% level that would render the investor a beneficial owner who must be included in the report to FinCEN. Of course, care must be taken not to unintentionally trip over indirect ownership or control rules that could still render an individual as a Beneficial Owner.

5. Amend or update company documents: It may also become both timely and necessary to address company records and documentation. Reporting Companies might consider engaging with their attorneys to review and, if necessary, update existing company documentation to ensure the company records clearly evidence who is (and who is not) a Beneficial Owner.

Company documentation may also be necessarily kept and maintained specifically to support a conclusion that a company is not a Reporting Company under the CTA.

For example, LLCs are often organized by non-lawyers as "member-managed" instead of "manager-managed" companies. Member-management might give each LLC member the legal right to exercise "substantial control" over the LLC even if that is not the intention. This is the kind of legal issue that could cause an unwitting individual to qualify as a Beneficial Owner (and as a result, be subject to the CTA's reporting requirements).

It may be that an individual who is not officially included in the company's records has historically exerted sufficient control to be deemed a Beneficial Owner. This type of situation should be addressed within the company records appropriately.

6. It can get REALLY complicated: As the complexity of a given ownership structure increases, so will beneficial owner identification and consequent FinCEN reporting. Although many will view compliance costs as non-value added to the business of the entity, it will be necessary to engage with competent legal counsel to ensure proper FinCEN reporting is done.

Choreo advisors routinely assist clients who own complicated investments and sophisticated entity planning structures. While Choreo does not advise clients on CTA compliance, Choreo advisors can and often do help clients locate the right professional counsel.

End Notes

This article is based on the following resources:

1. <https://www.govinfo.gov/content/pkg/USCODE-2021-title31/pdf/USCODE-2021-title31-subtitleIV-chap53-subchapII-sec5336.pdf>
2. https://www.fincen.gov/sites/default/files/shared/31_CFR_1010_380_excerpt_from_Final_Rule.pdf
3. https://www.americanbar.org/groups/business_law/resources/business-law-today/2021-may/the-corporate-transparency-act/
4. <https://www.wealthmanagement.com/estate-planning/what-clients-need-know-about-corporate-transparency-act-rules>
5. <https://tax.thomsonreuters.com/blog/are-you-ready-the-corporate-transparency-act-becomes-effective-jan-1-2024/#who-does-the-corporate-transparency-act-affect?>

Choreo, LLC is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Registration as an investment adviser does not imply a certain level of skill or training of the adviser or its representatives. This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, insurance, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. Information has been obtained from a variety of sources believed to be reliable though not independently verified. Choreo, LLC its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person. This communication is being sent to individuals who have subscribed to receive it or who we believe would have an interest in the topics discussed. The sole purpose of this document is to inform, and it is not intended to be an offer or solicitation to purchase or sell any security, or investment or service. Investments mentioned in this document may not be suitable for investors. Before making any investment, each investor should carefully consider the risks associated with the investment and make a determination based on the investor's own particular circumstances, that the investment is consistent with the investor's investment objectives.