

An introduction to the US Corporate Transparency Act (CTA)



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What is the Corporate Transparency Act and what is its purpose?

The Corporate Transparency Act, or CTA, was enacted by the US on January 1, 2021, which will become effective on January 1, 2024.

The CTA represents the most significant reformation of the Bank Secrecy Act and related AML rules since the US Patriot Act requiring disclosure of beneficial ownership information.

The purpose of the CTA is to address the lack of beneficial ownership reporting within the US AML rules. Generally, there are very few requirements to report foreign ownership of a US entity with certain limited exceptions such as IRS form 5472.

In the preamble to the final regulations of the CTA, the Treasury states illicit actors frequently use corporate structures such as shell and front companies to hide their identities and launder their ill-gotten gains through the US financial system. Not only do such acts undermine the US national security, but they also threaten US economic prosperity: shell and front companies can shield beneficial owners' identities and allow criminals to illegally access and transact in the US economy, while creating an uneven playing field for small US businesses engaged in legitimate activity.

They also cite Russia's invasion of Ukraine as an example stating that Russian elites, state-owned enterprises, and organized crime, as well as the Government of the Russia have attempted to use US and non-US shell companies to evade sanctions imposed on Russia.

Too bad the CTA wasn't effective prior to the Ukraine invasion.

Who has to file a report under the CTA?

All “reporting companies” must file certain beneficial ownership information with the US department of treasury's financial crimes and enforcement network commonly known as FinCEN. This would be similar to the FBAR which is a form that US persons file with FinCEN to disclose their foreign bank accounts. If any US persons are listening to this, please remember to file your FBARs.

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There are two types of reporting companies.

- » The first is a domestic reporting company which means a corporation, LLC, or any other similar entity created by filing a document with the secretary of a particular state in the US. This is intended to cover US partnerships as well.
- » The second is a foreign reporting company which means a corporation, LLC, or other similar entity formed under the laws of a foreign country AND must be registered to do business in any State via filing a document with the secretary or any similar office under the laws of a particular state in the US.

There are about 23 exemptions to the definition of a reporting company. I won't get into all the exemptions here, but two relevant exemptions are publicly traded companies and large operating companies. A large operating company is defined as a company employing more than 20 employees in the US, with gross receipts or sales over USD5 mil in their previous US tax return AND has an operating presence at a physical office within the US.

One last note is that all reporting corporations created prior to Jan 1, 2024, will have one year to disclose its beneficial ownership information while all reporting corporations created after Jan 1, 2024 would have to report the information within 30 days of formation.

As a practical note, because of the tight deadline for reporting companies created after Jan 1, 2024, all US entities should try to get their EINs as soon as possible because this is required information on the report.

We see a lot of EIN delays with US entities that are wholly owned by non-US persons because for some reason the IRS requires those specific US entities to fax in their EIN application instead of calling or applying online.

What information must be disclosed?

All beneficial owner and company applicant information must be disclosed.

First, the definition of the beneficial owner is any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise:

1. Exercise substantial control over the reporting company this could include any senior officer or a trustee of a trust.
2. Owns at least 25% of the reporting company OR
3. Controls at least 25% of the ownership interest of the entity

There are a number of exemptions from the definition of beneficial owner which I won't dive into but two relevant exemptions are creditors of the reporting company assuming no equity kicker, or individuals whose only interest in a reporting company is a future interest through the right of inheritance.

Second, a company applicant is the person who files the document that forms the domestic reporting company or the person who files the document to register the foreign reporting company to do business in the US. If there is more than one person responsible for the filing, you would report the person that is "primarily responsible" for directing or controlling such filing. For example, in a law firm, it would be lawyer responsible for the filing even though a paralegal was the one that filed the documents.

For beneficial owners and company applicants, some of the information required by FinCEN would be legal name, birthdate, address, and most importantly a unique identifying number from an acceptable



identification document or FinCEN identifier. For example, a US or foreign passport, ID from a state or local govt, or a state driver's license. You must also upload an image of this document.

Reporting companies created before January 1, 2024, do not have to provide any Company Applicant information.

Is this information available to the public?

This is one of the questions clients always ask and the answer is no, it is not a public registry. However, foreign countries under a treaty with the US can obtain this information if they make a request to FinCEN and it must be part of a criminal or civil investigation.

Practically, we're not sure how broad or narrow the US would define an "investigation".

Disclosure to other departments in the Treasury are subject to minimal restrictions.

What are the penalties for violating the CTA?

The max civil penalty would be USD500 each day that the violation continues and is capped at USD10,000.

For criminal penalty, it could result in imprisonment for up to two years.

The penalty regulation is very broad and is not just limited to the reporting company, the regulation states that it shall be unlawful for

any person to willfully provide false or fraudulent information, or willfully fail to report complete or updated information.

It also specifically states that a person could be any individual, reporting company, or other entity.

I've never seen such a broad penalty provision that could capture so many people and entities if one reporting company fails to file the report.

The main takeaway is that the CTA is not complex relative to FATCA/CRS but there is going to be a lot of work to just determine and gather the required information.

Directors and trustees should ensure that they have a right to access the required information as soon as possible. ■

