BRADFORD
TAX INSTITUTE

June 2022

Alert: A Massive New FinCEN Filing Requirement Is Coming

In a previous article we told you about the Corporate Transparency Act (CTA), a new law passed in 2021 that requires corporations, LLCs, and other business entities to provide information about their owners to the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN).[1]

The CTA did not take effect immediately. Rather, Congress gave the FinCEN time to write regulations and also gave businesses a heads-up about the new law.

FinCEN has now issued proposed regulations on how it intends to implement the CTA.[2] The new proposed regulations hold several unpleasant surprises for businesses and the lawyers and accounting firms that advise them.

What the CTA Is About

The CTA is part of a major government effort to crack down on corruption, money laundering, terrorist financing, tax fraud, and other illicit activity. The CTA targets the use of anonymous shell companies that facilitate the flow and sheltering of illicit money in the United States.

Currently, few states require corporations, LLCs, or other entities to disclose information about their beneficial owners—that is, the human beings who actually own or control them—or the people who form them. And there has never been a federal requirement to do so. As a result, anonymous shell companies abound, and it can be impossible for law enforcement to discover who really owns them.

This will soon change. The CTA empowers FinCEN to establish a massive database containing beneficial owner information for most types of smaller business entities. These include U.S.-based businesses and foreign entities that register to do business in the U.S. The database will not be publicly accessible; it is solely for the use of law enforcement, national security and intelligence agencies, and federal regulators enforcing anti-money-laundering laws.

The CTA focuses on smaller business entities, since they are most likely to be shell companies. The law contains 23 exemptions for most types of larger businesses. These include publicly traded corporations and other businesses that are heavily regulated by the federal government.[3] Also exempt is any business that[4]

- has more than 20 full-time employees (employees who work 30 hours per week or 130 hours per month),
- has a physical presence at a business office in the United States, and
- has filed a federal tax or information return the prior year showing more than $5 million in gross receipts or sales (net of returns and allowances, and not counting foreign sales).

Violations of the CTA can result in a $500-a-day penalty (up to $10,000) and up to two years' imprisonment.[5]

Surprise #1: The CTA Is Not Just for Corporations and LLCs

The CTA mandatory reporting requirements apply to corporations and limited liability companies. This includes the almost 2.5 million LLCs that have only one member and are taxed as Schedule C sole proprietorships ("disregarded entities").

But the CTA doesn't end there. It also applies to any other non-exempt entity that is created by filing a document with a state secretary of state or similar state agency.[6] FinCEN says that this includes limited liability partnerships, limited liability limited partnerships, business trusts, and most limited partnerships because such entities are normally created by a filing with a secretary of state.[7]

In short, almost every small business that is not a sole proprietorship or general partnership will have to comply with the CTA.

How many businesses are we talking about? FinCEN estimates as many as 30 million!

Surprise #2: The CTA May Take Effect Sooner than Anticipated

It's likely that the regulations will become final sometime in the second half of 2022. The final date will trigger the deadline for complying with the CTA's reporting requirements.

The CTA applies to both newly formed entities and existing companies. The deadline for compliance differs for each.

Key point. The deadlines do not coincide with the deadlines for filing tax returns.

New companies. Once the proposed regulations become final, new companies have to file their beneficial owner reports within 14 calendar days after being formed.[8] Thus, if you're forming a new corporation, LLC, limited partnership, or other entity during the second half of 2022 that requires a filing with your secretary of state, you'll likely have to file a report with FinCEN.

Existing companies. The proposed regulations require existing companies to file a report no later than one year after the effective date of the final regulations.[9] This is so even though the CTA itself provides that existing companies have two years to comply after the regulations become final.[10] So existing companies will have to file their initial reports by mid- to late 2023.

Of course, it's possible that FinCEN will delay the final date of the regulations to 2023 or even later if it becomes clear no one is ready for them to go into effect during 2022.

Surprise #3: Beneficial Owners Are Broadly Defined

The CTA requires affected business entities to file a "beneficial owner information" report including each beneficial owner's full legal name, date of birth, and residential street address, as well as a unique identifying number from an acceptable legal document such as a driver's license or passport.[11] The proposed regulations make it clear that a company can have multiple beneficial owners, and it may not always be easy to identify them all.

There are two broad categories of beneficial owners:[12]

1. Any individual who owns 25 percent or more of the company.

2. Any individual who, directly or indirectly, exercises substantial control over the company.

The CTA didn't define "substantial control." The proposed regulations define it quite broadly, to include[13]

- senior officers of the company;

- individuals who have authority over appointment or removal of any senior officer, or of a majority of the company's board of directors; and

- individuals who have substantial influence over important matters affecting the reporting company, including major expenditures, investments, or borrowing; sale or other transfer of assets; selling, dissolving, or reorganizing the company; selecting or terminating business lines or ventures; entering into or terminating significant contracts; compensation for senior officers; or amending the company's governing documents.

Moreover, a person's substantial control need not be exercised directly. It can be indirectly exercised through a variety of means.

Surprise #4: Tight Deadline for Updated Beneficial Owner Reports

If changes occur in the information included in a beneficial owner information report, the proposed regulations require that an updated report be filed with FinCEN within 30 calendar days after the change.[14]

For example, if a beneficial owner moves, an updated report will have to be filed within 30 days. FinCEN estimates that about 9 percent of all beneficial owners will have a change of address each year requiring an updated report. Updated reports also will have to be filed when a beneficial owner dies.

FinCEN estimates that over 11.4 million updated reports will have to be filed each year.

Surprise #5: The Report Must Identify Those Who Help Form Corporations and LLCs

In addition to the company's beneficial owners, the "company applicant" will have to be identified in the beneficial owner information report. This is "any individual who files the document that creates the domestic reporting company" or directs or controls others to do so.[15] This would appear to include an attorney who files articles of incorporation to create a corporation or articles of formation to establish an LLC.

Neither the CTA nor proposed regulations contain any exemption for legal or accounting firms, except for public accounting firms registered under Section 102 of the Sarbanes-Oxley Act of 2002.[16] According to FinCEN, only 851 accounting firms are so registered.

Get Ready—It's Coming

Whether it starts in late 2022 or 2023, a massive new filing requirement is coming for small businesses.

The FinCEN estimates that during the first year the CTA is in effect, over 25.8 million reports will have to be filed at a cost of $1.264 billion. In subsequent years, over 3.2 million initial reports and 11.4 million updated reports will have to be filed, at a total annual cost of over $364 million.

If you're a beneficial owner of a company subject to the CTA (in other words, a reporting company), you should provide your identifying information to the company so it can file the beneficial owner report.

Instead of providing your information directly to the company, you'll have the option of applying to FinCEN for a FinCEN identifier and using that instead. You'll have to provide FinCEN with all the required information, and it will assign you a unique number to give to the reporting company. You'll need to keep this information up-to-date with FinCEN.

Reporting companies should identify every individual who meets the definition of "beneficial owner" and inform them of the need to provide the required information or obtain a FinCEN identifier.

Takeaways

Here are five things to know from this article:

1. FinCEN has issued proposed regulations showing how it intends to implement the CTA—a law enacted in 2021 requiring smaller businesses to disclose the names, addresses, and other identifying information of their beneficial owners for inclusion in a FinCEN database that will be accessible only to law enforcement.

2. The CTA will take effect when the proposed regulations become final, which may be as early as mid-2022.

3. After the CTA takes effect, all new smaller businesses will have to file a beneficial owner report with FinCEN within 14 days of formation. All existing smaller businesses will have to file a report within one year.

4. Beneficial owners will include individuals who own 25 percent of a business entity, and all those who exercise substantial control over it.

5. Beneficial owner reports will have to be updated within 30 days if there is a change in the reported information, including a change in an owner's address.