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## Reveal Yourself: The Corporate Transparency Act

Corporate law across jurisdictions in the United States generally provides small business owners with various forms of confidentiality, including anonymity of ownership and control. While these legal regimes are beneficial for limiting liability, operational flexibility, and asset protection, bad actors have often abused these protections to conceal their identities while perpetrating financial crimes. To counteract this, as part of the Corporate Transparency Act, the U.S. Treasury Department is now requiring all qualifying small businesses – including the legitimate ones – to disclose and report information regarding their (a) “company applicant” and (b) “beneficial ownership.” These reporting obligations go into effect starting January 1, 2024. For even legitimate businesses, any failure to report could result in stiff penalties for the noncompliant businesses themselves, as well as for their owners and controlling officers.

### ***The Corporate Transparency Act***

Congress and the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) have sought to combat financial crimes by targeting shell companies used to launder illicit money through the U.S. financial system. To that end, in 2021, as part of the Anti-Money Laundering Act, Congress passed the Corporate Transparency Act (CTA).<sup>i</sup> The CTA requires FinCEN to create and maintain a national registry of beneficial owners of each qualifying domestic and foreign entity operating in the United States, which it designates as a “reporting company.”<sup>ii</sup>

While intending to help prosecute the beneficiaries of, and people in power behind, these sham companies, the CTA’s broad scope requires strict compliance from legitimate businesses too.

### ***FinCEN’s Final Rule***

In September of 2022, FinCEN issued the final beneficial ownership information reporting rule (BOI Rule).<sup>iii</sup> The BOI Rule applies to nearly every small business operating as a corporation, limited liability company, or similar entity. Indeed, irrespective of the government’s intent to combat financial crime, both illicit and legitimate business entities alike are captured as “reporting companies,” which are now required to disclose specific ownership and control information to FinCEN.<sup>iv</sup>

## ***The Disclosure Requirements***

Per the BOI Rule, effective January 1, 2024, each entity qualifying as a “reporting company” must timely disclose to FinCEN (a) its “company applicant” information, and (b) its “beneficial ownership” information.<sup>v</sup> These terms apply broadly and are determined by set testing criteria:

### ***“Applicant” and “Beneficial Ownership” Tests***

A “company applicant” is either (a) the individual who filed the requisite documents for the formation of the reporting company with the applicable secretary of state (or similar office), or (b) the person who directed or controlled the initial filing.<sup>vi</sup>

A company’s “beneficial owner” is any person that (a) owns or controls at least 25% of the company, or (b) exercises substantial influence or control over it.<sup>vii</sup> More specifically:

- (a) The 25% ownership/control test is determined by any combination of: equity, stock, or voting rights; a capital or profit interest; convertible instruments; options or other non-binding privileges to buy or sell any of the same; and any other instrument, contract, or other mechanism used to establish ownership.<sup>viii</sup>
- (b) An individual satisfies the substantial influence or control test if, regardless of any ownership interests, that individual (1) is a senior officer; (2) has authority to appoint or remove certain officers or a majority of directors of the reporting company; (3) is an important decision-maker; or (4) has any other form of substantial control over the reporting company.<sup>ix</sup>

There are numerous decision steps and specific hypothetical examples provided in the governing guidance regarding these tests, which should help businesses make the proper determinations.<sup>x</sup>

### ***“Reporting Company” Exemptions***

There are 23 different types of entities that are exempt from the BOI Rule’s “reporting company” definition. These include certain nonprofit organizations, publicly traded companies, and companies already required to file reports with the SEC, among others.<sup>xi</sup>

One of the most notable exemptions is the “large operating company” exemption.<sup>xii</sup> This exemption covers any company that employs more than 20 full-time employees, has an operating presence in a physical office in the U.S., and has filed Federal U.S. income tax returns in the previous year showing more than \$5,000,000 in gross receipts or sales.<sup>xiii</sup>

## ***“Beneficial Owner” Exceptions***

In addition to the “reporting company” exemptions, there are five exceptions to the definition of a “beneficial owner,” including minor children, agents of a beneficial owner, employees, future inheritors, and creditors.<sup>xiv</sup> Nonetheless, some of these exceptions require providing modified/substitute information.<sup>xv</sup>

Companies should carefully review and consider if they fall under an exemption or exception before assuming that they do. Legal counsel should be consulted as necessary to ensure the proper determinations are being made.

## ***What Information Must be Disclosed?***

Supposing that (a) an entity qualifies as a “reporting company,” and (b) a certain individual is determined to be that company’s “applicant” and/or “beneficial owner,” then the company generally must disclose such individual’s name, date of birth, address, and passport or driver’s license number, along with a photocopy.<sup>xvi</sup> Also, the company must report its own name (including any trade names), address, jurisdiction of formation, and taxpayer identification number.<sup>xvii</sup> There is an ongoing requirement to keep all the foregoing information current, and to timely file updated reports to reflect any changes.

While ostensibly simple, these disclosures should significantly increase transparency across all businesses operating in the United States.

## ***Filing Timelines and Deadlines***

All qualifying reporting companies that were created or registered to do business *before* January 1, 2024 have until January 1, 2025 to file their BOI initial reports with FinCEN.<sup>xix</sup> Any qualifying reporting company created or registered *on or after* January 1, 2024, must file their initial reports within 30 days after receiving notice of their company’s effective registration.<sup>xx</sup>

An exempt company is still required to file an initial report declaring their exemption.<sup>xxi</sup> If, after the filing of its initial report, the company loses the basis for its exemption, then it has 30 days from the date it stopped qualifying for the exemption to file an updated BOI report.<sup>xxii</sup>

Furthermore, if a reporting company undergoes any change in beneficial ownership, then it has 30 days from the date of the change to file its updated BOI report with FinCEN.<sup>xxiii</sup> If there is a mistake or omission on the original filing, the reporting company has 90 days from the deadline

of the original BOI report to correct the mistake or omission.<sup>xxiv</sup> This window effectively functions as a safe harbor to avoid penalties for disclosing incorrect information.

### ***What are the Penalties for Noncompliance?***

Penalties for noncompliance vary from civil to criminal penalties. Specifically, any willful failure to report, or any willful provision (or attempt to provide), false information can trigger civil penalties of up to \$500 for each day that the violation continues.<sup>xxv</sup> Criminal penalties include imprisonment for up to two years and/or a fine of up to \$10,000.<sup>xxvi</sup> The senior officer(s) of any entity that fails to file a required BOI report may be held accountable for the company's failure. Note that these penalties are for willful conduct; there does not appear to be any explicit penalties for negligent noncompliance.

### ***What Should Small Businesses Do to Prepare?***

FinCEN is planning to launch its system on January 1, 2024. While companies cannot "pre-register," each should prepare by reviewing the published guidance to determine (a) whether it qualifies for an exemption or exception, and (b) as applicable, which legal persons satisfy the BOI Rule's definitions for "company applicant" and "beneficial owner." Companies and individuals should also evaluate whether it would be more efficient to obtain a FinCEN Identifier in cases of overlapping or duplicative beneficial ownership.<sup>xxix</sup>

After making these threshold determinations, companies should gather the requisite information and materials needed to submit their initial report. To be sure, individuals starting their businesses after January 1, 2024 would be wise to make these determinations *before* forming their entity given the 30-day disclosure deadline.<sup>xxx</sup>

### ***Takeaway***

While the CTA and BOI Rule are targeting sham companies and money launderers, everyday business owners and officers will need to fully and timely comply with these requirements. The effect of these laws will significantly increase business transparency by requiring business owners and officers to disclose more information about the ownership, management, and entity structure of their operations. Legal counsel should be consulted as needed to ensure compliant and sensible disclosures are being made to FinCEN.

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## The Firm

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## Endnotes

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<sup>i</sup> 31 U.S.C. § 5336.

<sup>ii</sup> 31 U.S.C. § 5336(a)(11), (b)(1).

<sup>iii</sup> 87 Fed. Reg. 59498 – 59596 (Sept. 30, 2022); 31 CFR Part 1010.

<sup>iv</sup> 31 CFR § 1010.380(c). *See also* BOI Small Entity Compliance Guide, Section 1.1, [https://www.fincen.gov/sites/default/files/shared/BOI\\_Small\\_Compliance\\_Guide.v1.1-FINAL.pdf](https://www.fincen.gov/sites/default/files/shared/BOI_Small_Compliance_Guide.v1.1-FINAL.pdf) (last visited December 26, 2023).

<sup>v</sup> 31 CFR § 1010.380(b)(1)(ii).

<sup>vi</sup> 31 CFR § 1010.380(e). *See also* BOI Small Entity Compliance Guide, Sections 3.1-3.2. Note that otherwise qualifying companies formed prior to January 1, 2024, will not have to report their company applicants. *Id.*

<sup>vii</sup> 31 CFR § 1010.380(d). *See also* BOI Small Entity Compliance Guide, Sections 2.1-2.3.

<sup>viii</sup> 31 CFR § 1010.380(d)(2). *See also* BOI Small Entity Compliance Guide, Section 2.2.

<sup>ix</sup> 31 CFR § 1010.380(d)(1). *See also* BOI Small Entity Compliance Guide, Section 2.1.

<sup>x</sup> *See* BOI Small Entity Compliance Guide, Section 2.3.

As a hypothetical based on the guidance: A reporting company is an LLC with two managers, Individuals A and C.

1. Individual A owns 50 percent of the “membership units” in the LLC.
2. Individual C owns zero percent.
3. Individual B owns 45 percent of the remaining membership units in the LLC, and is not a manager.
4. Individual D owns 5 percent of the remaining membership units, and is not a manager.

Under the BOI Rule, Individual A exercises substantial control because he owns over 25 percent of the membership interests of the company and is a manager. Individual B also has substantial control as he holds over 25 percent of the remaining membership interests as well. Finally, while Individual C does not own any of the LLC’s membership interests, she is still a beneficial owner because she exercises substantial control as a manager. Individual D does not have substantial control because she owns less than 25% and has no position of power in the LLC. Therefore, A, B, and C would all have to report their respective information to FinCEN as the beneficial owners of the LLC, but D would not.

<sup>xi</sup> 31 CFR § 1010.380(c)(2), (g). *See also* BOI Small Entity Compliance Guide, Section 1.2.

<sup>xii</sup> 31 C.F.R. § 1010.380(c)(2)(xxi).

<sup>xiii</sup> *Id.*

<sup>xiv</sup> 31 CFR § 1010.380(d)(3). *See also* BOI Small Entity Compliance Guide, Section 2.4.

<sup>xv</sup> 31 CFR § 1010.380(b)(2); BOI Small Entity Compliance Guide, Section 4.2.

<sup>xvi</sup> 31 CFR § 1010.380(b)(1)(ii).

<sup>xvii</sup> 31 CFR § 1010.380(b)(1)(i).

<sup>xviii</sup> 31 CFR § 1010.380(b)(3). *See also* BOI Small Entity Compliance Guide, Section 6.

<sup>xix</sup> 31 CFR § 1010.380(a)(1)(iii).

<sup>xx</sup> 31 CFR § 1010.380(a)(1)(i)-(ii).

<sup>xxi</sup> 31 CFR § 1010.380(c)(2).

<sup>xxii</sup> 31 CFR § 1010.380(a)(1)(iv).

<sup>xxiii</sup> 31 CFR § 1010.380(a)(2)(i).

<sup>xxiv</sup> 31 CFR § 1010.380(a)(3).

<sup>xxv</sup> BOI Small Entity Compliance Guide, Section 1.3.

<sup>xxvi</sup> *Id.*

<sup>xxvii</sup> *Id.*

<sup>xxviii</sup> 31 CFR § 1010.380(g).

<sup>xxix</sup> FinCEN acknowledges that multiple companies might have the same beneficial ownership and beneficial owners might participate in several companies. To reduce the reporting burden, FinCEN offers a unique identifying number (the “FinCEN Identifier”), which reporting companies may include in place of their BOI. To obtain a FinCEN Identifier, an individual should electronically apply to FinCEN, while a company may check a box requesting one on their initial report. The FinCEN Identifier allows a beneficial owner or company applicant to update their BOI directly with FinCEN without each reporting company also having to file updates. *See* 31 CFR § 1010.380(b)(4); BOI Small Entity Compliance Guide, Section 4.3.

<sup>xxx</sup> *Supra*, note xx.