Frankfurt Kurnit Klein + Selz PC

Corporate Alert

New Laws Will Require Certain Companies to Disclose Formerly Anonymous "Beneficial Owners"

A federal law taking effect on January 1st 2024, and a New York law awaiting Governor Hochul's signature, will require certain companies to disclose their beneficial owners to regulators. These are big changes for owners that had previously preferred to remain anonymous. Whom do the laws cover? And what information will need to be disclosed? Here's what you need to know:

The Corporate Transparency Act

The Corporate Transparency Act (the "CTA") is a federal law passed by Congress in 2021 as part of the National Defense Authorization Act and the Anti-Money Laundering Act. The CTA was enacted with the goal of preventing bad actors from using U.S. business entities as anonymous shell companies to conceal illicit activities such as money laundering, terrorism financing, and tax fraud. Beginning on January 1, 2024 for newly formed entities (and January 1, 2025 for entities in existence prior to January 1, 2024), the CTA will, subject to certain exceptions, require all corporations, limited liability companies, limited partnerships, statutory trusts and any other entities created in or registered to do business in the United States (each, a "Reporting Company") to disclose information regarding certain of their beneficial owners (and those who form or register such entities[1]) to the Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN"). As part of the CTA, FinCEN will launch an information collection and management system, accessible to law enforcement and financial institutions, to track beneficial ownership information for each Reporting Company. Willful failures to comply with the CTA may result in penalties of up to ten thousand dollars ($10,000) and imprisonment for not more than two (2) years.

Each Reporting Company will be required to submit a disclosure report to FinCEN (due within thirty (30)[2] days after formation/registration), containing the following information:

1. Entity name, including any alternative trade or d/b/a names;
2. Complete and current street address in the United States;
3. State, tribal or foreign jurisdiction of formation;
4. Taxpayer identification number (TIN) and Employer Identification Number (EIN); and
5. Information regarding the Reporting Company's Beneficial Owners (as defined below)

The CTA defines a "Beneficial Owner" as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, (1) exercises "substantial control" (as defined below) over a Reporting Company, or (2) owns or controls twenty five percent (25%) or more of the ownership interests of a Reporting Company. Under the CTA, an individual exercises "substantial control" over a Reporting Company if the individual (A) serves as a senior officer of the company, (B) has authority to appoint or remove any senior officer or a majority of the company's board of directors, or (C) directs, determines, or has substantial influence on decisions made by the company. Individuals can exercise substantial control directly or indirectly through board representation, ownership, rights associated with financing arrangements, or control over intermediary entities that separately or collectively exercise substantial control. Some examples of indirect ownership or control include: (i) joint ownership with one or more persons, (ii) ownership through another individual acting as a nominee, intermediary, custodian or agent, and (iii) ownership through ownership or control of one or more intermediary entities that separately or collectively own or control ownership interests of the Reporting Company. There is no maximum number of Beneficial Owners who must be reported; FinCEN expects that every Reporting Company will be substantially controlled by one or more individuals, and as such, every Reporting Company is expected to identify and report at least one Beneficial Owner to FinCEN. More information regarding the precise applicability of these provisions to private equity funds or other investment vehicles will become available upon the CTA becoming effective and enforced.

Reporting Companies must provide the following information with respect to each Beneficial Owner [3]: (i) full legal name, (ii) date of birth, (iii) complete and current residential or business street address, and (iv) unique identification number (e.g., non-expired state ID, driver's license or passport number), along with an image of the same document.

The CTA provides exceptions for certain entity types that are not required to comply with the reporting obligations. Companies that are publicly traded, heavily regulated, or otherwise already reporting information to a governmental agency, as well as charities and nonprofits, are exempt. Significantly, there is also an exception from required reporting for entities that (1) employ more than twenty (20) employees, (2) filed in the previous year a tax return demonstrating more than five million dollars ($5,000,000) in gross receipts or sales, and (3) have an operating presence at a physical office within the United States.

New York State's LLC Transparency Act

In June 2023, the New York State legislature passed the LLC Transparency Act (the "Transparency Act"), which would require all limited liability companies ("LLCs") formed or qualified to transact business in New York to disclose, upon their formation, registration, or changes in beneficial ownership, certain identifying information concerning their Beneficial Owners. The Transparency Act's stated aim is to "end the practice of anonymous ownership of LLCs in New York." It is unclear whether Gov. Kathy Hochul supports the bill, which would become effective 365 days after being signed into law. After passage by the legislature, the Governor's spokesman, Justin Henry, said only that Gov. Hochul would "review the legislation."

Reporting Requirements

The reporting requirements of the Transparency Act are similar to those under the CTA, and certain key defined terms in the Transparency Act, such as "Beneficial Owner," incorporate the definitions of the CTA. Under the Transparency Act, all LLCs registered or operating in New York must file with the New York State Department of State (the "NYS DOS") a disclosure identifying each Beneficial Owner by: (i) full legal name, (ii) date of birth, (iii) current business street address and (iv) a unique identification number. Such LLCs can also satisfy New York's requirements by submitting a copy of the report filed with FinCEN pursuant to the CTA.

All LLCs subject to the Transparency Act must file the required Beneficial Owner information with the NYS DOS:

- By January 1, 2025, if formed or qualified to do business in New York on or before the Transparency Act's effective date.
- With the articles of organization, if a domestic LLC formed after the Transparency Act's effective date.
- With the application for authority to do business in New York, if a foreign LLC qualified in New York after the Transparency Act's effective date.
- Differences Between the CTA and the Transparency Act.

There are certain key differences between the Transparency Act and the CTA. First, the Transparency Act would require New York's Secretary of State to maintain a *publicly available* and searchable online database that includes the Beneficial Owner identifying information for all LLCs registered or transacting business in New York, whereas the information collected by FinCEN pursuant to the CTA will be kept confidential, except in limited circumstances where disclosure may be made to certain government authorities and financial institutions. Under the Transparency Act, Beneficial Owners that can cite significant privacy interests (*e.g.*, whistleblowers) may apply for a waiver permitting them to withhold their identifying information from the database under procedures to be established by the New York Secretary of State.

Second, the CTA applies to a broader range of business entities, including corporations, LLC's, limited partnerships, limited liability partnerships, business trusts and statutory trusts. Only New York LLCs and foreign LLCs authorized to do business in New York must report information under the Transparency Act, unless they meet an exemption under the CTA.

Finally, the penalties for noncompliance with the Transparency Act are more moderate than those imposed by the CTA. As mentioned above, the penalties for violating the CTA may result in a $10,000 fine and up to two years of imprisonment. Under the Transparency Act, a failure to file a required beneficial ownership disclosure for a period exceeding two years would result in a "delinquency" notice issued by the NYS DOS. In order to remove the delinquency designation from the NYS DOS records, companies would have to file a current beneficial ownership disclosure and pay a $250 fine. It is unclear what consequences would result from a delinquency notice, including whether a "delinquent" business entity would be dissolved or lack authority to conduct business in New York.

All businesses should prepare for the implementation of the CTA and Transparency Act by, for example, analyzing which, if any, of their owners meet the requirements for reporting and then gathering the relevant information.

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[1] Entities created prior to January 1, 2024 are not required to report company applicants.
[2] FINCEN is currently soliciting comments on a proposal to extend this deadline to ninety (90) days to ease compliance burdens.
[3] A Reporting Company must file an updated report to FinCEN within thirty (30) calendar days after the date on which a change occurs (or the Reporting Company becomes aware of or has reason to know of an inaccuracy) in the information previously reported to FinCEN.