WHAT EMERGING GROWTH COMPANIES AND INVESTORS NEED TO KNOW ABOUT THE CORPORATE TRANSPARENCY ACT

Date: 8 August 2022

U.S. Corporate Alert

By: France Beard Johnson, W. H. Snyder, Michael M. Storm, David C. Rybicki

In an effort to combat the use of shell corporations, limited liability companies and similar entities to facilitate money laundering and other illicit activities, Congress enacted the Corporate Transparency Act (CTA) as part of the Anti-Money Laundering Act of 2020.[1] The CTA requires domestic and foreign "reporting companies" to report certain identifying information concerning "beneficial owners", generally an entity's major equity owners, and managers and directors and senior officers to the Financial Crimes Enforcement Network (FinCEN).[2] The CTA's reporting requirements specifically target smaller, less regulated entities (such as early stage emerging growth companies) that may not be subject to any other beneficial owner reporting requirements. For example, Delaware and many other states do not require any beneficial ownership reporting upon formation. Failure to adhere to the reporting requirements of the CTA can result in stiff penalties, including a civil penalty of up to US$500 per day for every day that the reporting company is not in compliance.

On 8 December 2021, FinCEN promulgated proposed regulations implementing the reporting obligations of Section 6403 of the CTA (the Proposed Regulations). The period for public comments on the Proposed Regulations ended on 7 February 2022. While FinCEN has yet to release final regulations or a proposed effective date,[3] pressure is mounting among members of Congress to implement the CTA.[4]

REPORTING REQUIREMENTS UNDER THE PROPOSED REGULATIONS

Reporting companies must report the identifying information of beneficial owners and company applicants to FinCEN.[5] A "reporting company" is a corporation, limited liability company or "other similar entity" that does not fall under one of the 23 broad exceptions discussed below. The Proposed Regulations clarify that "other similar entities" are entities created by the filing of a document with a secretary of state, including limited liability partnerships, limited liability limited partnerships, business trusts (such as statutory trusts or Massachusetts trusts) and most limited partnerships.[6] Entities that are formed in foreign countries that are registered to do business in the United States are also considered reporting companies.[7]

The CTA limits the definition of reporting companies with a list of 23 classes of exempt entities.[8] Among others, principal exempt entities include:

- Certain publicly-traded entities;
- Banks;

©2005-2026 K&L Gates LLP. All Rights Reserved.

- Large operating entities that filed a tax return showing revenue in excess of US$5 million per year, have over 20 full-time employees and have a physical operating presence in the United States;
- Entities in which the ownership interests are owned, or controlled, directly or indirectly, by certain other types of exempt entities;
- Governmental entities;
- Inactive entities that are domestically owned entities over one year old that do not engage in an active business, hold any type of asset and have not changed ownership or sent or received funds over US$1,000 in the preceding 12-month period; and
- Pooled investment vehicles that are operated or advised by certain persons.

FinCEN does not currently propose to exempt additional types of entities beyond those specified by the CTA.

A "beneficial owner" is as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise exercises substantial control over an entity or owns or controls 25% or more of the ownership interests of the entity.[9] Such ownership interests include equity in the reporting company and other types of interests, such as capital or profit interests (including partnership interests) or convertible instruments, warrants or rights or other options or privileges to acquire equity, capital or other interests in a reporting company.[10] The definition excludes minor children (however, parental/guardian information must be reported instead), creditors and employees who only have control or economic benefits solely as the status of an employee.[11]

The Proposed Regulations provide that senior officers, persons with authority of appointment or removal of officers or dominant majority of the board and persons that make decisions or have substantial influence over important decisions are also considered beneficial owners.[12] "Senior officers" include the president, secretary, treasurer, CFO, CEO, COO, general counsel or any other officer (regardless of title) who performs a similar function.[13] The definition of substantial control includes a catchall for "[a]ny other form of substantial control over the reporting company."[14]

A "company applicant"[15] is the individual that files an application to form a domestic reporting company or register a foreign reporting company.[16] The Proposed Regulations also include any individual who directs or controls the filing of such a document by another person (*i.e.,* there can be multiple company applicants).[17] From a practical standpoint, in many instances, the person who directs or controls the filing of such a document will likely also be considered a beneficial owner.

SUBSTANCE AND STORAGE OF REPORTED INFORMATION

Under the Proposed Regulations, a reporting company must report basic information about the company itself, including (1) its name, (2) any "doing business as" names, (3) its business address, (4) its jurisdiction of formation or registration and (5) a unique identification number (*e.g.,* Taxpayer Identification Number, Employer Identification Number, Dun & Bradstreet Universal Numbering System number or Legal Entity Identifier).[18] In addition, a reporting company must also report certain identifying information about each beneficial owner and company applicant, including their (1) full legal name, (2) date of birth, (3) current residential or business street

©2005-2026 K&L Gates LLP. All Rights Reserved.

address and (4) a unique identifying number from an acceptable identification document (e.g., an unexpired passport or driver's license) (including an image of the document).[19] In the case of individual beneficial owners, the residential address for tax residency purposes should be reported.[20] For company applicants that provide a business service as a corporate or formation agent (including law firms), the reporting company should report the company applicant's business address, rather than the actual filer's residential address.[21] In lieu of providing the foregoing information, a reporting company may provide a FinCEN identifier for any beneficial owner or company applicant.[22]

Finally, in the case of an exempt pooled investment vehicle that is formed under the laws of a foreign country, the vehicle must file with FinCEN a written certification that provides the above information for an individual that exercises substantial control over the vehicle.[23]

Under the Proposed Regulations, domestic reporting companies created, or foreign reporting companies registered to do business in the United States, before the effective date of the final regulations would have one year to file their initial report with FinCEN. Domestic reporting companies created, or foreign reporting companies registered to do business in the United States for the first time, on or after the effective date of the final regulations would be required to file their initial report with FinCEN within 14 calendar days after the formation filing or registration filing.[24]

In the event any reported information becomes inaccurate, the CTA requires the information to be updated.[25] The Proposed Regulations suggest a 30-day time period for the updated report.[26] Individuals and entities with FinCEN identifiers would need to update any inaccurate information reported to FinCEN to obtain their FinCEN identifier.[27] The Proposed Regulations do not establish a separate time period for updating this information; accordingly, the 30-day time period will likely also apply to FinCEN identifier updates.

Failure to report can lead to civil and criminal penalties, including up to a US$500 fine per day, and up to a US$10,000 fine or imprisonment for up to two years for a criminal violation.[28]

Section 6403 of the CTA requires FinCEN to maintain the information that it collects under the CTA in a confidential, secure and nonpublic database. However, FinCEN may disclose the information to certain government agencies, domestic and foreign, as provided in the CTA, and to financial institutions to assist them in meeting their customer due diligence requirements. FinCEN has not yet clarified how reporting will occur, however reporting companies will not have to submit their own letters to report information to FinCEN. FinCEN is reportedly in the process of creating a new IT system to collect reported information that will be completed before the regulations take effect.[29]

ACCESS TO DATA

While non-compliance with the reporting requirements can result in the civil and criminal penalties outlined above, after disclosure of the beneficial ownership information to FinCEN, such information may be disclosed by FinCEN to certain governmental entities to support law enforcement activities. Using appropriate procedures, federal agencies may request access to the data directly through FinCEN.[30] State and local law enforcement agencies, on the other hand, must have a court order to receive access.[31] For tax administration purposes, the Internal Revenue Service will also have access to the database.[32]

©2005-2026 K&L Gates LLP. All Rights Reserved.

CONCLUSION

The number of legal entities already in existence in the United States that may need to report information on themselves, their beneficial owners and their formation or registration agents pursuant to the CTA is very likely in the tens of millions. Although several types of entities are excluded from the definition of reporting companies, many businesses, including early stage emerging growth companies, may nonetheless be significantly burdened by the reporting costs associated with complying with the CTA.

FinCEN intends to issue regulations (and solicit public comments on) implementing the requirements of the CTA in three stages: (1) Proposed Regulations containing the beneficial ownership information reporting requirements; (2) to implement protocols for access to and disclosure of beneficial ownership information; and (3) to revise the existing customer due diligence rule.

As noted above, FinCEN has not alluded to when the final regulations will be released but is committed to identifying the soonest possible effective date after their publication. Future Proposed Regulations are expected to contain more details on reporting protocols and relevant forms.

Please contact the authors of this client alert or your primary contact at K&L Gates for further insight with respect to the Proposed Regulations.

FOOTNOTES

[1] Corporate Transparency Act, Pub. L. No. 116-283, § 6402, 134 Stat. 4604, 4604¬−05.

[2] *See* 31 U.S.C. § 5336(b)(1)(A).

[3] *See* 86 Fed. Reg. 69920, 69945 (proposed Dec. 8, 2021).

[4] Letter from Elizabeth Warren, United States Senator, et al., to Janet Yellen, Secretary, U.S. Dep't of the Treasury, and Himamauli Das, Acting Director, FinCEN (May 9, 2022) (available at https://www.rubio.senate.gov/public/_cache/files/0a02d1a8-45cd-4fbe-b419-13328da59f25/6B258B6323766FE81305EA6E2256AE37.2022.05.09-letter-to-treasury-and-fincen-on-cta-implementation3.pdf); *cf* Letter from Sheldon Whitehouse, United States Senator, et al., to Chris Van Hollen, Chairman, Committee on Appropriations, Subcommittee on Financial Services, and Cindy Hyde-Smith, Ranking Member, Committee on Appropriations, Subcommittee on Financial Services (May 12, 2022) (available at https://www.whitehouse.senate.gov/imo/media/doc/FY23%20FinCEN%20(FSGG)%20final%20w%20sig.pdf) (requesting additional funding for FinCEN).

[5] 31 U.S.C. § 5336(a)(11)(A)(i).

[6] Proposed 31 C.F.R. § 1010.380(c)(1)(i)(C).

[7] 31 U.S.C. § 5336(a)(11)(A)(ii).

[8] 31 U.S.C. § 5336(a)(11)(B).

[9] 31 U.S.C. § 5336(a)(3)(A).

[10] Proposed 31 C.F.R. § 1010.380(d)(3)(i).

©2005-2026 K&L Gates LLP. All Rights Reserved.

[11] 31 U.S.C. § 5336(a)(3)(B).

[12] Proposed 31 C.F.R. § 1010.380(d)(1).

[13] Proposed 31 C.F.R. § 1010.380(f)(8).

[14] Proposed 31 C.F.R. § 1010.380(d)(1)(iii)(G)(iv).

[15] The CTA uses the term “applicant;” the proposed regulations use the term “company applicant.”

[16] 31 U.S.C. § 5336(a)(2)

[17] Proposed 31 C.F.R. § 1010.380(e)(1).

[18] Proposed 31 C.F.R. § 1010.380(b)(1)(i).

[19] 31 U.S.C. § 5336(b)(2)(A); Proposed 31 C.F.R. § 1010.380(b)(1)(ii).

[20] Proposed 31 C.F.R. § 1010.380(b)(1)(ii)(C)(2).

[21]Proposed 31 C.F.R. § 1010.380(b)(1)(ii)(C)(1).

[22] 31 U.S.C. § 5336(b)(3).

[23] 31 U.S.C. § 5336(b)(2)(C).

[24] Proposed 31 C.F.R. § 1010.380(a)(1)(i).

[25] 31 U.S.C. § 5336(b)(1)(D).

[26] Proposed 31 C.F.R. § 1010.380(a)(2).

[27] 31 U.S.C. § 5336(b)(3)(A)(ii).

[28] 31 U.S.C. § 5336(h)(3).

[29]86 Fed. Reg. 69920, 69945 (proposed Dec. 8, 2021).

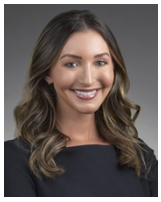
[30] 31 U.S.C. § 5336(c)(2)(B)(i)(I).

[31] U.S.C. § 5336(c)(2)(B)(i)(II).

[32] 31 U.S.C. § 5336(c)(5).

©2005-2026 K&L Gates LLP. All Rights Reserved.

KEY CONTACTS



FRANCE BEARD JOHNSON
ASSOCIATE

CHARLOTTE
+1.704.331.7458
FRANCE.JOHNSON@KLGATES.COM



W. H. SNYDER
PARTNER

PITTSBURGH
+1.412.355.6720
HENRY.SNYDER@KLGATES.COM



MICHAEL M. STORM
ASSOCIATE

PITTSBURGH
+1.412.355.3715
MIKE.STORM@KLGATES.COM



DAVID C. RYBICKI
PARTNER

WASHINGTON, DC
+1.202.778.9370
DAVID.RYBICKI@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.