

Congress Pierces the Veil and Establishes Beneficial Ownership Reporting Requirements for U.S. Companies

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Included as part of the National Defense Authorization Act, the Corporation Transparency Act (CTA), enacted on January 1, 2020, is an effort by the federal government to crack down on what are commonly referred to as “shell companies” and stem the rising level of illicit activity, such as money laundering and fraud, that these shell companies are often used for. The CTA was created to be a tool for the U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) to pierce the veil of companies to identify the individuals who truly own and control these entities and assist the efforts of intelligence and law enforcement agencies in countering these types of illicit activities. However, the CTA is drafted very broadly such that ordinary businesses and companies will also be required to disclose their beneficial ownership information. Therefore, companies should familiarize themselves with the CTA and the impact of these reporting requirements on their business and corporate ownership structure.

What Are the Requirements Under the CTA?

A reporting company formed after^[1] the effectiveness of FinCEN’s regulations is required to disclose to FinCEN each beneficial owner’s:

1. full legal name;
2. date of birth;
3. current residential or business address; and
4. identifying number from a non-expired U.S. passport, a personal identification card issued by a state, tribe, or local government, or a state driver’s license.

The CTA also requires reporting companies to update their beneficial ownership information by submitting a report within one year after the date on which there is a change in the information of a beneficial owner of that company.

What Companies Are Subject to the CTA?

For purposes of the CTA, a reporting company includes any corporation, LLC or similar entity that is formed under U.S. state or tribal law or a foreign entity registered to do business in the United States. Given this broad definition, the CTA provides an extensive list of types of companies that are excluded from the definition of a “reporting company” and thereby exempt from the requirements to submit the beneficial ownership information to FinCEN. Exempt companies include, among others:

1. publicly traded companies;
2. closely regulated entities, such as credit unions, broker-dealers, banks, registered investment companies, certain pooled investment vehicles, public accounting firms or insurance companies;
3. tax-exempt entities such as churches, charities or nonprofit entities;
4. entities that (i) have more than 20 employees on a full-time basis in the United States, (ii) more than \$5 million in gross receipts or sales based on their income tax returns, including gross receipts or sales from other entities owned by that entity and other entities through which that entity operates and (iii) have an operating presence at a physical office in the United States; and
5. entities that (i) have been in existence for over a year, (ii) not engaged in any active business, (iii) are not owned, directly or indirectly, by a foreign person, (iv) have not had a change in ownership or sent or received funds in an amount greater than \$1,000 and (v) do not otherwise hold any assets, including ownership interests of other entities.

Who Is a Beneficial Owner Required to Provide Information?

With respect to who is considered a “beneficial owner” of a company and required to supply the requested beneficial ownership information, the CTA defines a beneficial owner as an individual who directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise (i) exercises substantial control^[2] over the entity or (ii) owns or controls not less than 25% of the ownership interests of that entity. The CTA explicitly exempts the following individuals from the definition of “beneficial owners”:

1. minor children, if the information of the parent or guardian is provided;
2. nominees, intermediaries, custodians or agents on behalf of another individual;
3. an individual acting solely as an employee of the entity whose control over, or economic benefit from, such entity is solely as a result of their employment status;
4. an individual whose only interest in the entity is from a right of inheritance; and
5. a creditor of the entity, unless such creditor meets the requirements of a beneficial owner.

What Are the Penalties?

Subject to certain safe harbors,^[3] the CTA provides that it is unlawful for any person to (i) willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN pursuant to the beneficial ownership information requirements or (ii) willfully fail to report complete or updated beneficial ownership information to FinCEN. A violation of the CTA can result in a civil penalty of up to \$500 for each day that the violation continues or has not been remedied and criminal fines up to \$10,000, imprisonment for up to two years, or both.

When Does the CTA Go into Effect?

The beneficial ownership disclosure requirements go into effect on the effective date of the regulations related to the CTA that will be prepared by the Secretary of the Treasury. Such regulations are to go into effect no later than one year after the date of the enactment of the CTA (i.e., January 1, 2022). After the regulations go into effect, any new reporting company formed after the effective date will need to provide the beneficial ownership information to FinCEN. Companies in existence prior to the effectiveness of the regulations will have two years after the effective date of the regulations to provide the information to FinCEN.

What Is the Impact of the CTA?

The legislative intent of the CTA was to address what Congress identified as a gap in the information requirements collected at the time of forming a company in the United States. Congress found that many states do not require any information about the ownership of a particular entity when it is formed. Congress noted that this information gap provides an opportunity for companies to conceal their ownership so as to facilitate illicit activity, including money laundering, the financing of terrorism, counterfeiting, securities fraud and acts of corruption. Therefore, the CTA was enacted to assist law enforcement agencies in identifying the individuals who are controlling companies that are engaging in illicit activities and prevent these illicit activities from occurring.

It is important to note that companies will not have access to the beneficial ownership data that is provided and that only certain government authorities and financial institutions in certain circumstances would have access to that information to crack down on illicit activity. While most companies do not engage in these types of activities, the CTA applies to a broad range of companies and will likely have the greatest impact on small business that are not otherwise exempt. The result is that clients should be aware of these new requirements and their impact on their business. While the regulations promulgated by FinCEN have yet to be prepared, to the extent one thinks that they may be required to provide the required disclosure under the CTA, they should start thinking about their compliance processes and the steps they need to take so as to ensure they will be able to provide the requested information to FinCEN, when needed.

Endnotes

^[1] The CTA imposes the same disclosure requirements on existing entities two years after the effective date of FinCEN's regulations.

^[2] Interestingly, the CTA does not define "substantial control," so it may very well be a facts and circumstances test determined by the regulations and guidance, if any, from FinCEN.

^[3] The CTA provides a safe harbor from civil or criminal penalty if the person submitting the information has reason to believe that any report submitted by such person in accordance with the

CTA contains inaccurate information and voluntarily and promptly, but no later than 90 days after the date on which the person submitted the initial report, submits an updated report containing the corrected information.

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