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THE CORPORATE TRANSPARENCY ACT: WHAT IT MEANS FOR BUSINESS OWNERS, CONTROL PERSONS, AND REPORTING COMPANIES

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Background

The Corporate Transparency Act (the "Act") imposes a wide-ranging requirement for many business entities to file personal information about their respective owners and control persons with a federal regulatory agency and to keep the information updated over time. Many closely held or small companies, which may otherwise not be regulated or licensed by any federal agency, must also comply with the Act. Indeed, many of the exemptions that would excuse a business entity from making a filing are reserved for bigger and more established businesses that are already heavily regulated.

The Act was enacted in 2021 as part of the Anti-Money Laundering Act of 2020, which is itself part of the National Defense Authorization Act for Fiscal Year 2021. The Act was enacted to fight money laundering, the financing of terrorism, tax fraud, and certain other illicit activities.

The Act becomes effective on January 1, 2024.

Filing Deadlines

With respect to both domestic and foreign "reporting companies" (as defined in the Act) formed before January 1, 2024, those entities will have until January 1, 2025, to make a beneficial ownership information ("BOI") filing with the Financial Crimes Enforcement Network of the Department of the Treasury ("FinCEN").[1]

With regard to any domestic reporting company formed on or after January 1, 2024, such an entity will have until 30 days after the earlier of (i) the date when it receives actual notice that the entity has been formed or (ii) the date that the State or Indian Tribe first provides public notice that the entity has been formed.[2]

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For any foreign entity that is registered as a foreign reporting company on or after January 1, 2024, such an entity will have until 30 days after the earlier of (i) the date when it receives actual notice that it has been approved to conduct business or (ii) the date that the state or Indian Tribe first provides public notice of such fact.[3]

What Entities Have to Submit a BOI Report?

Every "reporting company" needs to submit a Beneficial Ownership Information Report ("BOI") to FinCEN on an annual basis.[4]

What is a Reporting Company?

The Act defines a "reporting company" as a "corporation, limited liability company, or other similar entity" that is

- "created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe" or
- "formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe"[5]

Limited liability partnerships, limited liability limited partnerships, business trusts, and limited partnerships, to the extent that they are created by a filing with a State[6] or Indian Tribe,[7] are all examples of reporting companies.

Sole proprietorships are not reporting companies.

General partnerships, to the extent that they are not created by a filing with a state or Indian Tribe, are not reporting companies. Even if a permissive filing for a general partnership is allowed, such as under California Corporations Code § 16105,[8] California general partnerships that make this permissive filing are nonetheless not reporting companies because California Corporations Code § 16202 makes clear that the formation of a general partnership occurs upon association and not upon the filing with the state.[9] In certain other states, however, it may be the case that general partnerships are created by a filing with the state; in such circumstances, the general partnerships would be considered reporting companies.

Trusts that are not created by a filing with a state or Indian Tribe, which is the case for most personal trusts, are not reporting companies. Certain business

trusts, however, are created by a filing with a state and are therefore reporting companies.

Exemptions to the Definition of Reporting Company

There are 23 types of entities enumerated as being exempt[10] from being a "reporting company." Even if the exempt entity would otherwise be considered a "reporting company" under the core definition provided above, such an entity is specifically carved out from the definition of "reporting company" and therefore does not have reporting obligations under the Act.

A nonexclusive list of exempt entities are as follows:

- Any company that "employs more than 20 employees on a full-time basis in the United States,"[11] that "filed in the previous year Federal income tax returns in the United States demonstrating more than $5,000,000 in gross receipts or sales,"[12] and that "has an operating presence at a physical office within the United States."[13]
- Publicly traded companies.
- Banks, credit unions, brokers, or dealers.
- Investment companies and investment advisers.
- Certain tax-exempt entities, such as 501(c) non-profits.
- Certain pooled investment vehicles.
- Entities whose "ownership interests are owned or controlled, directly or indirectly, by 1 or more" of certain exempt entities.[14]
- Certain entities that have been "in existence for over 1 year," that "[are] not engaged in active business," that "[are] not owned, directly or indirectly, by a foreign person," that "ha[ve] not, in the preceding 12-month period, experienced a change in ownership or received funds in an amount greater than $1,000," and that "do[] not otherwise hold any kind or type of assets, including an ownership interest in any corporation, limited liability company, or similar entity."[15]

The Act also gives the Secretary of Treasury, in conjunction with the Attorney General and the Secretary of Homeland Security and upon the satisfac-

tion of certain conditions, the power to exempt additional entities from the requirements of the Act.[16]

Who is a Beneficial Owner?

The Act defines a "beneficial owner" of an entity as "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise"

- "exercises substantial control over the entity" or
- "owns or controls not less than 25 percent of the ownership interests of the entity"[17]

A "beneficial owner" specifically does not include:

- "a minor child, as defined in the State in which the entity is formed, if the information of the parent or guardian of the minor child is reported in accordance with [the Act]";
- "an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual";
- "an individual acting solely as an employee of a corporation, limited liability company, or other similar entity and whose control over or economic benefits from such entity is derived solely from the employment status of the person";
- "an individual whose only interest in a corporation, limited liability company, or other similar entity is through a right of inheritance"; and
- "a creditor of a corporation, limited liability company, or other similar entity, unless the creditor" falls under the definition of a beneficial owner.[18]

All references to "beneficial owner" or "beneficial owners" in this article shall have the meaning prescribed in the Act.

Who Exercises "Substantial Control" Over an Entity?

FinCEN has provided that "[a]n individual exercises substantial control if the individual":

- "[s]erves as a senior officer of the reporting company";

- "[h]as authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body)";
- "[d]irects, determines, or has substantial influence over important decisions made by the reporting company"; or
- "[h]as any other form of substantial control over the reporting company."[19]

FinCEN has made clear that "[b]oard representation," "[o]wnership or control of a majority of the voting power or voting rights of the reporting company," "[r]ights associated with any financing arrangement or interest in a company," "[c]ontrol over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company," "[a]rrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees," or "any other contract, arrangement, understanding, relationship or otherwise" are all ways in which "substantial control" may be exercised.[20]

A nonexclusive list of those who are commonly considered to exercise "substantial control" over a reporting company are as follows:

- Chief executive officer, chief financial officer, general counsel, or other "senior officer" (as defined in 31 C.F.R. § 1010.380)[21]
- Directors of a corporation or managers of a limited liability company
- Equity holders (i.e., shareholders or members) with less than 25 percent ownership who are nevertheless entitled to appoint one or more of the board of directors (or similar body) of their reporting company

When determining who exercises "substantial control," the title of the individual is not determinative. For instance, a "vice president" in one reporting company may exercise substantial control, but an individual who occupies the same title at a different company may not. As well, an individual with a "C-Suite" title may not exercise "substantial control" if his or her position relates only to an incidental aspect of a company's business. Whether or not someone exercises "substantial control" is a fact-based inquiry.

A nonexclusive list of those who do not exercise "substantial control" over a reporting company are as follows:

- The Secretary of a corporation or a limited liability company whose only function is ministerial
- The Treasurer of a corporation or a limited liability company whose only function is ministerial[22]

Who Owns or Controls 25 Percent or More of a Reporting Company?

Ownership interests include (but are not limited to) all equity interests, stock interests, capital interests, profit interests, convertible debt, options, or "any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership."[23]

An individual can own or control an ownership interest through "any contract, arrangement, understanding, relationship, or otherwise" that allows one to "directly or indirectly own or control an ownership interest."[24] A non-exclusive list includes: "joint ownership . . . of an undivided interest," control via "another individual acting as a nominee, intermediary, custodian, or agent," as "a trustee of the trust or other individual . . . with the authority to dispose of trust assets," as "a beneficiary who (i) [i]s the sole permissible recipient of income and principal from the trust" or who "(ii) [h]as the right to demand a distribution of or withdraw substantially all of the assets from the trust," as "a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust," or via "ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the reporting company."[25]

In determining if someone owns or controls 25 percent or more of a reporting company, the interests of such "individual shall be calculated at the present time, and any options or similar interests of the individual shall be treated as exercised."[26]

If the calculation methods outlined in 31 C.F.R. § 1010.380 cannot "be performed with reasonable certainty, any individual who owns or controls 25 percent or more of any class or type of ownership interest of a reporting company shall be deemed to own or control 25 percent or more of the ownership interests of the reporting company."[27]

Only Individuals can be Beneficial Owners

Beneficial owners (as defined in the Act) must be individuals, not entities. Where an entity would otherwise be a "beneficial owner" if it were a natural person, the rule is to look past that entity until one reaches one or more individuals that satisfy the "beneficial owner" definition.[28]

For example, a general partner of a general partnership that fully owns a reporting company would be a beneficial owner because she controls the general partnership, which in turn controls the reporting company. In such cases, the general partnership itself, because it is an entity, is neither a "reporting company" nor a "beneficial owner," despite owning 100 percent of the reporting company.

Another example would be the case of a general partner of a limited partnership that is the sole owner of a reporting company. Here, the general partner would be a "beneficial owner" if she were an individual but would not be a "beneficial owner" if it were itself an entity. If the general partner in this case were an individual, then she would be a beneficial owner because she controls the limited partnership, which in turn controls the reporting company as its sole owner. If, however, the general partner was a corporation, then the beneficial owner would not be the corporation; it would instead be the officers, directors, or shareholders of the corporation who fit the beneficial ownership definition.

It is not clear whether the BOI reporting form will include an area to specify whether an individual is a direct beneficial owner or whether he or she is an indirect beneficial owner.

Analysis of Beneficial Ownership in Tiered Structures Under the Ownership Prong

Hypothetical: James Doe owns 100 percent of Corporation A. General Partnership ABC owns 30 percent of Corporation B, Jenny Doe owns 30 percent of Corporation B, and Limited Partnership HIJ owns 40 percent of Corporation B. Jackie Doe, Jamie Doe, Jake Doe, and Jacob Doe each own 25 percent of General Partnership ABC. Jerry Doe owns 90 percent of Limited Partnership HIJ, and Jimmy Doe owns 10 percent of Limited Partnership HIJ. Corporation A and Corporation B each own 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. John Doe and Jane Doe each own 33 percent of

XYZ LLC. Judging just by percentage ownership, who are the beneficial owners of XYZ LLC?

Jane Doe and John Doe are both beneficial owners because each of them is an individual who owns at least 25 percent of the equity interests of XYZ LLC. 123 LLC is not a beneficial owner because, even though it owns at least 25 percent of XYZ LLC's equity interest, it is not an individual. As mentioned above, only individuals can be beneficial owners.

Accordingly, one must look up the organizational chart to the next tier. Corporation A and Corporation B each own 50 percent of 123 LLC. Again, because they are not individuals, one must look up to the next level of ownership.

James Doe owns 100 percent of Corporation A. Corporation A owns 50 percent of 123 LLC, and 123 LLC owns 34 percent of XYZ LLC. James Doe is therefore the ultimate owner of only 17 percent of XYZ LLC and is, accordingly, not a beneficial owner of XYZ LLC.

Jenny Doe owns 30 percent of Corporation B, which in turn owns 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. As such, Jenny Doe is the ultimate owner of only 5.1 percent of XYZ LLC. She is therefore not a beneficial owner of 123 LLC.

Jackie Doe, Jamie Doe, Jake Doe, and Jacob Doe each own 25 percent of General Partnership ABC. General Partnership ABC owns 30 percent of Corporation B, which in turn owns 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. As such, Jackie Doe, Jamie Doe, Jake Doe, and Jacob Doe each are the ultimate owners of only 1.275 percent of 123 LLC and are therefore not beneficial owners of 123 LLC.

Jerry Doe owns 90 percent of Limited Partnership HIJ. Limited Partnership HIJ owns 40 percent of Corporation B, which in turn owns 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. Jerry Doe therefore is the ultimate owner of only 6.12 percent of XYZ LLC and is not one of its beneficial owners.

Jimmy Doe owns 10 percent of Limited Partnership HIJ. Limited Partnership HIJ owns 40 percent of Corporation B, which in turn owns 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. Jimmy Doe therefore is the

ultimate owner of only 0.68 percent of XYZ LLC and is not one of its beneficial owners.

While every entity will always have at least one beneficial owner, this is a good example of how it may be possible for there to be no beneficial owners as a result of the "ownership" prong of the beneficial ownership definition.

Analysis of Beneficial Ownership in Tiered Structures Under the Substantial Control Prong

Hypothetical: Benny Kong, Catherine Kong, and Leslie Kong are directors of Corporation A. Catherine Kong serves as Chairperson of Corporation A. Leslie Kong is also the President of Corporation A. Tim Kong is the Secretary of Corporation A and only performs ministerial tasks in that capacity. Tim Kong is also the Treasurer of Corporation A and performs as a CFO would. Sofia Kong is the General Counsel of Corporation A, and Corporation A owns 50 percent of 123 LLC. 123 LLC owns 34 percent of XYZ LLC. Terry Kong is the Manager of XYZ LLC. Evelyn Kong is a mid-level employee of XYZ LLC who reports to Terry Kong. Corporation A operates by majority vote on both the director and shareholder levels. Judging just by whether one has "substantial control" over XYZ LLC, who are the beneficial owners of XYZ LLC?

Terry Kong would certainly be a beneficial owner of XYZ LLC. As its Manager, Terry has a tremendous amount of control over XYZ LLC.

Irrespective of whether Evelyn Kong's control over XYZ LLC fits the definition of "substantial control," the fact that she is an employee (but not a "senior officer") of XYZ LLC means that she is not a beneficial owner of XYZ LLC.[29]

It's not clear if Benny Kong would be a beneficial owner under the substantial control prong. Even though he is a director of Corporation A, one can be a director and not exercise substantial control. The facts here do not establish the percentage vote that Benny has as a director. Even assuming that Benny has a co-equal vote (33.33 percent) with the other directors, it is not clear if 33.33 percent of the vote would constitute "substantial control." On the one hand, "substantial control" probably does not require a majority vote (as one would presume that such a requirement would have been explicitly stated in either the Act or the corresponding regulation). On the other hand, Benny shares power co-equally with the other directors; there would be a much stronger case for arguing that Benny had substantial control if he had, for example, 50 percent of the vote.

Even if one assumes that Benny has "substantial control" over Corporation A, a separate analysis is needed to determine whether Benny has "substantial control" over XYZ LLC. To begin, Corporation A owns 50 percent of XYZ LLC, which is not a majority interest. Nonetheless, Corporation A is the largest equity holder of XYZ LLC by far and has a dominant minority position. As such, it would likely be the case that Benny has "substantial control" over XYZ LLC. Therefore, Benny would likely be considered a beneficial owner of XYZ LLC. By the same logic, Catherine Kong and Leslie Kong would also likely have "substantial control" over XYZ LLC (by virtue of their positions as directors), would likely exercise indirect substantial control over XYZ LLC, and would therefore likely be considered beneficial owners of XYZ LLC.

Another reason that Catherine Kong would likely be considered a beneficial owner of XYZ LLC is by virtue of her position as Chairperson of Corporation A, a position in which she likely would exercise substantial control over Corporation A. As Corporation A has an incredibly strong minority position in XYZ LLC, Catherine would likely have indirect "substantial control" over XYZ LLC and would therefore likely be a beneficial owner thereof.

Likewise, Leslie Kong is the President of Corporation A and has substantial control over Corporation A (and indirectly over XYZ LLC) by virtue of that position alone; as such, she would be considered a beneficial owner of XYZ LLC.

In his capacity as Secretary of Corporation A, Tim Kong does not exercise substantial control over Corporation A because his duties are only ministerial in nature; as such, his position as Secretary of Corporation A does not afford him substantial control over XYZ LLC. However, in his capacity as Treasurer of Corporation A, Tim Kong functions as a CFO. As such, he does exercise substantial control over Corporation A and would indirectly exercise substantial control over XYZ LLC in that capacity. Therefore, Tim would be a beneficial owner of XYZ LLC indirectly through his role as Treasurer of Corporation A but not through his role as Secretary of XYZ LLC.

As the General Counsel of Corporation A, Sofia Kong exercises substantial control over Corporation A. As such, Sofia exercises indirect substantial control over XYZ LLC and is therefore a beneficial owner of XYZ LLC.

Unlike the "ownership" prong, there will always be at least one beneficial owner under the "substantial control" prong of the beneficial ownership

definition. This is because there will always be at least one individual that has substantial control of a reporting company; after all, a company can only act through the individual(s) that it is comprised of.

What Happens if a Parent Company is Exempt but Its Subsidiary is Not?

The first step in the analysis is to determine whether Exemption 22 applies. Exemption 22 provides that "any corporation, limited liability company, or other similar entity of which the ownership interests are owned or controlled, directly or indirectly, by 1 or more entities described in clause (i), (ii), (iii), (iv), (v), (vii), (viii), (ix), (x), (xi), (xii), (xiii), (xiv), (xv), (xvi), (xvii), (xix) or (xxi)," i.e., Exemptions 1, 2, 3, 4, 5, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 19, and 21, is exempt.[30] The aforementioned clauses refer to 18 of the 23 enumerated exemptions. The ones not listed (other than Exemption 22 itself) are Exemptions 6, 18, 20, and 23:

> Exemption 6: "a money transmitting business registered with the Secretary of the Treasury under section 5330"[31]
>
> Exemption 18: "any pooled investment vehicles operated or advised by" certain banks, certain credit unions, certain brokers or dealers, certain investment companies, or certain investment advisers[32]
>
> Exemption 20: "any corporation, limited liability, or other similar entity that . . . operates exclusively to provide financial assistance to, or hold governance rights over," 501(c) non-profits, certain political organizations, and certain trusts and that (a) "is a United States person," (b) "is beneficially owned or controlled exclusively by 1 or more United States persons that are United States citizens or lawfully admitted for permanent residence," and (c) "derives at least a majority of its funding or revenue from 1 or more United States persons that are United States citizens or lawfully admitted for permanent residence."[33]
>
> Exemption 23: "any corporation, limited liability company, or other similar entity" that is (a) "in existence for over 1 year," that (b) "is not engaged in active business," that is (c) "not owned, directly or indirectly, by a foreign person," that (d) "has not, in the preceding 12-month period, experienced a change in ownership or sent or received funds in an amount greater than $1,000. . .," and that (e) "does not otherwise hold any kind or type of assets, including an ownership interest in any corporation, limited liability company, or other similar entity."[34]

In other words, if an ultimate parent company is exempt by virtue of either Exemption 6, Exemption 18, Exemption 20, or Exemption 23, then none of its direct or indirect subsidiaries can rely on Exemption 22 and be exempt by virtue thereof.

On the other hand, if the parent is exempt under one of the other 18 exemptions, then all of them can rely on the parent's status under Exemption 22.

Hypothetical: Red LLC is exempt by virtue of Exemption 6. Red LLC is the ultimate parent company and is the immediate parent company of Blue LLC. Blue LLC, in turn, is the parent company of Green LLC. Unless Exemption 22 applies, both Blue LLC and Green LLC would be reporting companies. Does Exemption 22 apply? If so, how?

Exemption 22 does not apply because Red LLC, the ultimate parent company, is exempt by virtue of Exemption 6. Exemption 22 specifically does not apply to subsidiaries of any ultimate parent company that is itself exempt by virtue of Exemption 18. Blue LLC is therefore a reporting company. Green LLC is also a reporting company.

Both Blue LLC and Green LLC, therefore, would have to disclose information of its beneficial owners, which would be the beneficial owners (and which must be individuals) of Red LLC. This is despite the fact that Red LLC is itself exempt because of Exemption 6.

Hypothetical: Yellow LLC is exempt by virtue of Exemption 7. Yellow LLC is the ultimate parent company and is the immediate parent company of Red LLC. Red LLC is exempt by virtue of Exemption 6 and is the immediate parent company of Blue LLC. Blue LLC is the parent company of Green LLC. Unless Exemption 22 applies, both Blue LLC and Green LLC would be reporting companies. Does Exemption 22 apply? If so, how?

Here, Exemption 22 does apply because Yellow LLC is exempt by virtue of Exemption 7. Exemption 22 applies to subsidiaries of any ultimate parent company that is itself exempt by virtue of Exemption 7. Therefore, since Blue LLC and Green LLC are each an indirect subsidiary of Yellow LLC, both Blue LLC and Green LLC can take advantage of Exemption 22 and be exempt themselves. This is despite the fact that they are both either a direct or an indirect subsidiary of Red LLC, which is exempt due to Exemption 6.

Whether an entity can take advantage of Exemption 22, therefore, depends on whether its ultimate parent company is exempt under one of the 18 non-excluded exemptions prescribed under Exemption 22. The specific exemption (or lack thereof) by which any of the intermediate parent companies of the entity (even with respect to its direct parent company) are irrelevant. The only

time that the specific exemption (or lack thereof) of an entity's direct parent company is relevant is if that direct parent company is also the ultimate parent company.

Hypothetical: Mango LLC, Guava LLC, and Lychee LLC are each a direct parent company of Kiwi LLC. Banana LLC is the direct parent company and the ultimate parent company of Mango LLC. Banana LLC is one of the ultimate parent company of Kiwi LLC. Coconut LLC is the parent company of Guava LLC. Strawberry LLC is the direct and ultimate parent company of Coconut LLC, the ultimate parent company of Guava LLC, and one of the parent companies of Kiwi LLC. Raspberry LLC is the direct and ultimate parent company of Lychee LLC and one of the ultimate parent companies of Kiwi LLC.

Banana LLC is exempt by virtue of Exemption 1. Strawberry LLC is exempt by virtue of Exemption 18. Raspberry LLC is not exempt at all. If Exemption 22 does not apply, Coconut LLC, Mango LLC, Guava LLC, Lychee LLC, and Kiwi LLC would all be reporting companies. Does Exemption 22 apply? If so, how?

Exemption 22 does apply to Mango LLC. This is because Banana LLC, the ultimate parent company of Mango LLC, is exempt by virtue of Exemption 1, which is one of the exemptions enumerated in Exemption 22. Accordingly, Mango LLC is exempt.

Exemption 22 does not apply to Coconut LLC and Guava LLC, because Strawberry LLC is exempt via Exemption 1, which is not one of the enumerated exemptions listed in Exemption 22. As such, Coconut LLC and Guava LLC are all not exempt because they are either the direct or indirect subsidiaries of Strawberry LLC (the ultimate parent company).

Exemption 22 does not apply to Lychee LLC because its ultimate parent company, Raspberry LLC, is not exempt at all. Accordingly, Raspberry LLC is obviously not exempt via one of the exemptions enumerated in Exemption 22.

Exemption 22 applies to Kiwi LLC because Kiwi LLC has a minority of its equity held by Banana LLC, an ultimate parent company that is exempt by virtue of one of the exemptions enumerated in Exemption 22. This is despite the fact that Kiwi LLC also has Banana LLC as one of its ultimate parent companies. As mentioned above, Banana LLC is exempt via one of the exemp-

tions not enumerated in Exemption 22. As such, only one of a subsidiary's ultimate parent companies need to be exempt via one of the enumerated exemptions listed in Exemption 22 in order for that company to take advantage of Exemption 22. The fact that such a company may have a different ultimate parent company (Strawberry LLC) that is not exempt via one of exemptions enumerated in Exemption 22 does not bar that company from utilizing Exemption 22. Indeed, the fact that Kiwi LLC has an ultimate parent company (Raspberry LLC) that is not exempt at all also does not bar Kiwi LLC from using Exemption 22.

What Happens if a Minority Equity Holder is Exempt but the Company that It is Invested in is Not?

This is an area where FinCEN or the courts should provide additional guidance.

Assuming that the minority equity holder is exempt by virtue of one of the exemptions outlined in Exemption 22, the plain language of Exemption 22 would seem to allow any of the companies in which it holds a direct or indirect investment stake to take advantage of Exemption 22 in order to be exempt themselves.[35] This is because Exemption 22 does not require any specific investment threshold; Exemption 22 simply states that the entity seeking the exemption simply must be "owned or controlled, directly or indirectly, by 1 or more" companies that are exempt by virtue of one of the 18 enumerated exemptions described in Exemption 22.[36]

The phrase "owned or controlled" bears discussion. Certainly, if the provision had used "owned *and* controlled" instead, Exemption 22 would most likely not apply to direct or indirect companies that are held by minority equity holders. The usage of "or" instead of "and" would seem to imply that "owned" and "controlled" are verbs to be considered separately and that a company can be either (1) "owned" and not "controlled" or (2) "controlled" and not "owned."

Alternatively, one might argue that "or" is meant to be inclusive and includes the notion of "and." This interpretation, although less persuasive from a textual standpoint, would certainly seem to fall more in line with the statutory scheme of casting a wide net.

If there is indeed no investment threshold and if the ownership provision can operate independently from the control provision, then it is conceivable that an

entity would be able to take advantage of Exemption 22 if one of its minority equity holders is exempt via one of the enumerated exemptions forth in Exemption 22, even if the minority equity holder only owns a miniscule percentage. This result seems to expand Exemption 22 more than what might have been initially intended because it seems to allow certain entities to not disclose BOI information about itself simply by selling a tiny piece to one of the entities described in Exemption 22. Granted, many of these entities are of the sort that may have to disclose BOI-like information about any of the companies it owns to federal regulatory agencies anyway, and some of the entities, such as the one described in Exemption 21, seem to be the sort that are able to own pieces of companies without necessarily disclosing BOI-like information about those companies to federal regulatory agencies. The more opportunities there are for the entities described in Exemption 22 to own pieces of companies without disclosing BOI-like information about those companies to federal regulatory agencies, the more likely it is that FinCEN would oppose an interpretation of the statute that would allow this result.

Can Exemption 22 Apply if there is No Ownership Relationship?

It is not clear how Exemption 22 would come into play in the case of a company who "controls" but does not "own" the entity that is seeking exemption through Exemption 22. This is presumably possible based on the aforementioned textual analysis. What level of control is needed? What does "control" even necessarily mean? While these are open questions, FinCEN would probably adopt a narrow definition of "control" so as to limit the number of entities that would otherwise be able to take advantage of Exemption 22.

Who is a Company Applicant?

A company applicant is any person who files an application to form a "reporting company" with a state or Indian Tribe or any person who files an application for a foreign "reporting company" to do business in the U.S.[37]

Anyone who files the formation or incorporation document and anyone who directs the filing of such a formation or incorporation document is a company applicant.[38]

The company applicant reporting is applicable only to company applicants who form or register an entity on or after January 1, 2024.[39]

What Needs to be Disclosed in a BOI Report?

Both information (1) concerning the reporting company itself and (2) concerning each beneficial owner and applicant need to be disclosed.

With respect to the information concerning the reporting company itself, this includes:

- Its full legal name;
- Any alternative names, including (but not limited to) any trade names or DBAs;
- (a) current address of principal place of business for a reporting company with a principal place of business in the U.S. or (b) current address of primary location where the reporting company conducts business if it does not have a principal place of business in the U.S.;
- (a) Jurisdiction of formation for a domestic reporting company or (b) in the case of a foreign reporting company, the state or Tribal jurisdiction where the reporting company first registers to do in the case of a foreign reporting company;
- (a) Tax Identification Number, such as an Employer Identification Number (EIN), a Social Security Number (SSN), or a Taxpayer Identification Number (TIN) or (b) in the scenario where a foreign reporting company has not been issued a TIN, a foreign tax identification number and the jurisdiction such number was issued.[40]

As such, a single-member limited liability company subject to the BOI reporting requirement that does not acquire its own EIN would have to provide the SSN, TIN, or foreign tax identification number of its sole member.

There are five pieces of information required in the BOI for each beneficial owner and company applicant:[41]

1) full legal name;
2) date of birth;
3) current residential address ("[i]n the case of a company applicant who forms or register an entity in the course of such company applicant's business, the street address of such business"[42]);

4) unique identifying number and issuing jurisdiction from a) an unexpired U.S. passport number, b) an unexpired identification document from a state, Indian Tribe, or local government that was issued for the purpose of identification, c) an unexpired state driver's license number, or d) an unexpired foreign passport number;[43]

5) the official document from which the unique identifying number originates.[44]

A foreign passport number can only be used if the beneficial owner or company applicant does not have an unexpired U.S. passport number, an unexpired state driver's license number, or an unexpired identification document at the state or Tribal level.[45]

A social security number is not required to be reported.

An individual or a reporting company can apply for a FinCEN ID by providing the same information to FinCEN that it would otherwise have to provide on a BOI Report.[46] Once the FinCEN ID is acquired, an individual or reporting company may opt to provide the FinCEN ID instead of the information used to obtain it on any BOI Reports.[47] One downside of using the FinCEN ID is that there is a corresponding and ongoing updating requirement.[48] Therefore, for example, an individual would have to update FinCEN with her current residential address if she were to move after obtaining the FinCEN ID. Another example that would require updating is if a reporting company adds or changes a DBA. FinCEN IDs can be useful for individuals that do not want to have their identifying documents and other personal information (mentioned above) in the possession of each entity in which she is a beneficial owner or a company applicant. It is important to note that while the Treasury department takes some security measures to protect the information received from BOI reports from inadvertent disclosure,[49] the same or higher level of protection may not be available when that same information is in the hands of the reporting companies.

Updating BOI Information

Within 30 days after the date on which any information disclosed on the BOI report changes, the company must update FinCEN with the new information.[50] Common examples are changes to who the beneficial owners (as defined in the Act) are or changes to information about such beneficial owners

(such as a change in address). When any information previously filed is subsequently discovered by the reporting company to be incorrect, such reporting company must file an updated report with the correct information within 30 days.[51] Company applicant information does not need to be updated.[52] If a reporting company later meets the definition of an exemption under the Act, the reporting company is required to notify FinCEN of this change in a new BOI report.[53]

Who Will Have Access to the Information Provided on a BOI Report?

The information submitted on a BOI report is not publicly available and will be held on FinCEN's "Beneficial Ownership Secure Systems" (BOSS) database.[54] The Act provides for criminal and civil penalties for any officer or employee (i) of the U.S., (ii) of any state agency, tribal agency, or local agency, and (iii) of any financial institution or regulatory agency that discloses BOI information in a way that is not authorized under the Act or under protocols promulgated thereunder.[55]

The Act authorizes FinCEN to provide the information (i) to certain federal law enforcement, intelligence, or national security agencies, (ii) to certain state, tribal, or local law enforcement agencies upon the authorization of a court, (iii) upon the request of a federal agency, to foreign law enforcement, foreign prosecutors, or foreign judges, (iv) if the reporting company so agrees, to certain financial institutions (such as banks), and (v) to the regulators of the aforementioned financial institutions.[56]

What Constitutes a Reporting Violation Under the Act?

According to FinCEN, it is illegal for any person (reporting company or individual) to

> "willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document" or
>
> "willfully fail to report complete or updated beneficial ownership information to FinCEN."[57]

If an individual causes a reporting company to fail to fulfill its reporting obligations or is a "senior officer" of the reporting company when the violation happens, such individual is subject to liability under the Act.[58]

The use of the term "willfully" would seem to indicate that negligence (or even gross negligence) would not be sufficient to trigger liability under the Act. However, it should be noted that whether a defendant was willful or negligent in her misconduct is a factual question. As there are certainly circumstances where a set of facts can lend itself both to a finding of willful misconduct or of negligent misconduct, reporting companies and individuals should conduct the proper due diligence to ensure that the information being submitted is accurate. That way, if the information ends up being inaccurate, they will have mitigated the possibility of an inference that their misconduct was willful.

An example follows: A shareholder intentionally provides incorrect information about her current residential address to the chief compliance officer of the reporting company for BOI reporting purposes. The chief compliance officer, acting on behalf of the reporting company and taking the shareholder's statement at face value, submits the BOI report with the incorrect information. The chief compliance officer did not do an independent investigation of whether the address provided is indeed the current residential address of the shareholder. In the reporting company's files is an email from a week ago where the shareholder provided her current residential address to a mid-level accountant within the reporting company for the purposes of receiving a check. Did the shareholder willfully violate the act? What about the reporting company or the chief compliance officer?

The shareholder is likely to be found to have willfully violated the Act because she intentionally provided false information for BOI reporting purposes.

The reporting company may be found to have willfully violated the Act. On the one hand, the chief compliance officer, acting on behalf of the reporting company, took the shareholder's statement at face value, did not necessarily have any reason to believe that the shareholder was lying, and did not necessarily have knowledge about the email sent a week ago. As well, even if the chief compliance officer knew about the discrepancy, she may have honestly believed that the shareholder had moved her residence. Under these circumstances, a fact finder may find that the reporting company did not willfully violate the Act.

On the other hand, both the chief compliance officer and the mid-level accountant are agents of the reporting company. If the mid-level accountant's knowledge of the different residential address previously provided is imputed to the reporting company, then a fact finder may very well find that the reporting

company "knew" of the discrepancy. If the reporting company is found to have "known" about the discrepancy and nevertheless made the filing (through the actions of its chief compliance officer), the reporting company may be found to have "willfully" violated the Act.

The chief compliance officer may also be found to have willfully violated the Act. To begin, one may wonder about whether or not she knew or had reason to know about the discrepancy. As the chief compliance officer, she presumably has a duty to institute proper protocols for ensuring compliance with applicable laws, such as the Act. Compliance with many different types of laws would likely require keeping track of the residential addresses of the reporting company's shareholders. Even if she did not know about the discrepancy, one could perhaps argue that she was willfully blind as to the difference with respect to the addresses; there are many precedents for when willful blindness has been found to satisfy the mens rea requirement of "willfulness" in statutes.

Now consider how the conclusions may change if the mid-level accountant was a direct subordinate of the chief compliance officer, if the chief compliance officer knew that the shareholder had a history of being dishonest, or if the chief compliance officer had done a diligent search of the company's files but did not find the aforementioned email.

The purpose of these examples is not to provide a definitive answer as to how particularly cases may be adjudicated. Rather, the point of the examples are precisely to highlight the ambiguities and uncertainties as to how FinCEN or the courts may view enforcement cases in the future.

Penalties for Not Complying

Entities who willfully fail to comply with the Act can be subject to civil penalties of up to $500 a day and criminal penalties of up to $10,000.[59] Individuals who willfully fail to comply with the Act can be subject to the aforementioned consequences and may also be imprisoned for up to two years.[60]

Safe Harbor

The safe harbor in the Act operates to protect a reporting company or an individual who would otherwise be subject to liability under the Act. This stands in contrast to an exemption, by which an entity is not considered a "reporting company" at all and is therefore not subject to the Act's reporting obligations. The safe harbor is as follows: If a person becomes aware of any inaccuracies in

information submitted on the BOI report and voluntarily and promptly submits an updated report with the correct information no later than 90 days after the filing of the initial report, then that person is not liable for civil and criminal penalties under the Act.[61] FinCEN has made clear that the safe harbor does not apply to an individual who makes the corrected filing in good faith after the 90-day deadline even if that person did not find out that the information was incorrect until after the 90-day deadline.[62]

What if a Beneficial Owner or a Company Applicant Refuses to Comply?

The requirement that reporting companies provide information about its beneficial owners and its company applicants can put a reporting company in a difficult position if any such individual refuses to cooperate. As mentioned above, a reporting company needs to either (i) provide the full legal name, date of birth, current residential address, unique identifying number, and a copy of an official documents from which the unique identifying number originates or (ii) a FinCEN identification number for each of its beneficial owners.

Here, it is important to note that a reporting company is subject to liability under the Act only if it "willfully" violates the Act. As such, if a reporting company diligently requests and pursues the required information from its beneficial owners or company applicants but is nevertheless thwarted, it is unlikely that the reporting company will be found to have "willfully" violated the Act. The required level of diligence is unclear at this point and will likely be elucidated as time goes on.

As well, if the reporting company is itself being lied to by its beneficial owners or company applicants that causes such reporting company to draw inaccurate conclusions as to which individuals need to provide the required information, such reporting company is unlikely to be found to have "willfully" violated the Act.

A similar analysis as the ones above could be applied to the individuals working on behalf of the reporting companies to collect such information.

Moving forward, before allowing any individual to become a company applicant of a yet-to-be formed company or to become a beneficial owner of any formed company, reporting companies should collect all the pieces of information that it will need to provide on each of these individuals. This way, the

reporting company will likely have the most up-to-date information that it needs to provide by the first reporting deadline. While the reporting company should solicit updated information from its beneficial owners each time that the company needs to provide a new report, most pieces of information are unlikely to change. Indeed, the reported date of birth would never change unless the original date was reported erroneously. The piece of information most likely to change is the current address, which should be confirmed on a regular basis.

Reporting companies should also consider entering into contractual arrangements with would-be "company applicants" and "beneficial owners" that require them to provide the required information in the first instance and to continually update the information as needed.

Special Considerations for Lawyers and Accountants

Lawyers and accountants should be mindful of any of their respective professional responsibilities that may require them to act in certain ways in order to ensure that their clients are complying with the Act with respect to both the initial filing and the ongoing reporting obligations. That said, the Act does not specifically create any heightened duties for lawyers and accounts in this regard.[63] It is not clear whether information reported under the Act may be discoverable in litigation.

Conclusion

In summary, compliance with the Act can be complex. Unless an entity falls squarely within one of the exemptions, such entity should assume that it is a reporting company. This is especially true given the broad definition of reporting company and the narrowness of the exemptions. Likewise, one should be conservative in evaluating whether one is a beneficial owner, especially given the inclusive nature of the statutory and regulatory language. Reporting companies should carefully review their management and organizational relationships in order to properly determine the individuals who are "beneficial owners" and to fulfill their reporting obligations accordingly. Along those lines, a reporting company should keep in mind how changes in its management and organizational structure may impact its reporting obligations.

ENDNOTES:

[1]See 31 C.F.R. § 1010.380(a)(1)(iii).

[2]See *Id.* § 1010.380(a)(1)(i).

[3]See *Id.* § 1010.380(a)(1)(ii).

[4]See *Id.* § 1010.380(a)(1).

[5]Corporate Transparency Act, 31 U.S.C.A. § 5336(a)(11).

[6]The Act defines "State" as "any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, and any other commonwealth, territory, or possession of the United States." § 5336(a)(12).

[7]The Act defines "Indian Tribe" as having "the meaning given the term 'Indian Tribe' in section 102 of the Federally Recognized Indian Tribe List Act of 1994 (25 U.S.C. § 5130)." § 5336(a)(8).

[8]Corp. Code, § 16105(a).

[9]*Id.* § 16202(a).

[10]31 U.S.C.A. § 5336(a)(11)(B)(i)-(xxiii).

[11]*Id.* § 5336(a)(11)(B)(xxi)(I).

[12]*Id.* § 5336(a)(11)(B)(xxi)(II).

[13]*Id.* § 5336(a)(11)(B)(xxi)(III).

[14]*Id.* § 5336(a)(11)(B)(xxii).

[15]*Id.* § 5336(a)(11)(B)(xxiii).

[16]*Id.* § 5336(a)(11)(B)(xxiv).

[17]*Id.* § 5336(a)(3).

[18]*Id.* § 5336(a)(3)(B).

[19]31 C.F.R. § 1010.380(d)(1)(i)(A-D).

[20]31 U.S.C.A. § 5336(d)(1)(ii)(A-F).

[21]31 C.F.R. § 1010.380(f)(8).

[22]See Federal Register/Vol. 87, No. 189/September 30, 2022/Rules and Regulations/III. Discussion of Final Rule, iii. Information To Be Reported Regarding Beneficial Owners and Company Applicants, C. Beneficial Owners, i. Substantial Control, Final Rule, Pg. 59526; see also § 1010.380(f)(8) (excluding secretary and treasurer from definition of "senior officer").

[23]31 C.F.R. § 1010.380(d)(2)(i)(A-E).

[24]*Id.* § 1010.380(d)(2)(ii).

[25]*Id.* § 1010.380(d)(2)(ii)(A-D).

[26]*Id.* § 1010.380(d)(2)(iii).

[27]*Id.* § 1010.380(d)(2)(iii)(D).

[28]See 31 U.S.C.A. § 5336(a)(3)(A) (specifically denoting that a beneficial

owner is an "individual," as opposed to a person (which many be interpreted to include both natural persons (i.e., individuals) and juridical persons (e.g., LLCs, corporations, etc.))).

[29]31 C.F.R. § 1010.380(d)(3)(iii).

[30]31 U.S.C.A. § 5336(a)(11)(B)(xxii).

[31]*Id.* § 5336(a)(11)(B)(vi).

[32]*Id.* § 5336(a)(11)(B)(xviii).

[33]*Id.* § 5336(a)(11)(B)(xx).

[34]*Id.* § 5336(a)(11)(B)(xxiii).

[35]See *Id.* § 5336(a)(11)(B)(xxii).

[36]*Id.*

[37]*Id.* § 5336(a)(2).

[38]31 C.F.R. § 1010.380(e)(1-3).

[39]*Id.* § 1010.380(a)(2)(iv); see also Federal Register/Vol. 87, No. 189/ September 30, 2022/Rules and Regulations, III. Discussion of Final Rule, Pg. 59509.

[40]31 C.F.R. § 1010.380(b)(1)(i)(A-F).

[41]*Id.* § 1010.380(b)(1)(ii)(A-E).

[42]*Id.* § 1010.380(b)(1)(ii)(C)(1).

[43]*Id.* § 1010.380(b)(1)(ii)(D)(1-4).

[44]*Id.* § 1010.380(b)(1)(ii)(E); see also Federal Register/Vol. 87, No. 189/ September 30, 2022/Rules and Regulations/III. Discussion of Final Rule, B. Content, Form, and Manner of Reports, iii. Information To Be Reported Regarding Beneficial Owners and Company Applicants, b. Unique Identifying Number and Image from Identification Document, Pg. 59519.

[45]31 C.F.R. § 1010.380(b)(1)(ii)(D)(4); see also Federal Register/Vol. 87, No. 189/September 30, 2022/Rules and Regulations/III. Discussion of Final Rule, B. Content, Form, and Manner of Reports, iii. Information To Be Reported Regarding Beneficial Owners and Company Applicants, b. Unique Identifying Number and Image from Identification Document, Pg. 59519.

[46]31 C.F.R. § 1010.380(b)(4)(i)(A-B).

[47]*Id.* § 1010.380(b)(4)(ii).

[48]*Id.* § 1010.380(b)(4)(iii)(A-B).

[49]31 U.S.C.A. § 5336(c)(3)(C).

[50]See 31 C.F.R. § 1010.380(a)(2)(i).

[51]See *Id.* § 1010.380(a)(iii).

[52]Federal Register/Vol. 87, No. 189/September 30, 2022/III. Discussion of Final, September 30, 2022/Rules and Regulations/Final Rule, Pg. 59509.

[53]31 C.F.R. § 1010.380(a)(2)(iii).

[54]Federal Register/Vol. 87, No. 189, II. Background, D. The Beneficial Ownership Secure System (BOSS), Pg. 59508; see also § 5336(c)(3)(C).

[55]31 U.S.C.A. § 5336(c)(4); § 5336(c)(2)(A).

[56]*Id.* § 5336(c)(2)(B).

[57]31 C.F.R. § 1010.380(g).

[58]*Id.* § 1010.380(g)(4)(iii).

[59]See § 5336(h)(3)(A)(i-ii).

[60]See *Id.*

[61]*Id.* § 5336(h)(3)(C)(i)(l)(aa).

[62]See Federal Register/Vol. 87, No. 189/September 30, 2022/III. Discussion of Final Rule, ii. Timing of Updated and Corrected Filings, Pg. 59513; See 31 C.F.R. § 1010.380(a)(iii).

[63]See Federal Register/Vol. 87, No. 189/September 30, 2022/Rules and Regulations/III. Discussion of Final Rule, ii. Timing of Updated and Corrected Filings, B. Content, Form, and Manner of Reports, i. Certification, Final Rule, Pgs. 59514-59515.

