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Dear Clients and Friends:

The Corporate Transparency Act (signed into law on January 1, 2021) expanded anti-money laundering laws and created new reporting requirements for certain companies doing business in the US. The purpose of the Corporate Transparency Act (referred to in this newsletter as the “CTA”) is create a national database [administered by the Financial Crimes Enforcement Network (known as “FinCEN”)] for use by national security and law enforcement agencies to prevent the use of shell companies for criminal activity. Implementation of the CTA was delayed pending the development of regulations and the reporting system, but the CTA went into effect in 2024. As a result, many small companies are now required to report information to FinCEN about their beneficial owners and other persons with substantial control over the company.

You may have heard or seen news reports that the CTA has been ruled unconstitutional in one federal case. However, the application of this ruling has been limited to the actual litigants in the case, and the CTA (and its reporting requirements) is still in effect with respect to all other businesses. In addition, there have been numerous requests submitted to FinCEN by lawmakers, industry groups and legal and accounting professional organizations, asking that FinCEN delay the implementation of the CTA until 2025 (or later). These requests have not been granted. Accordingly, the CTA is now in full force and effect and applies to all businesses (excluding the successful litigants in one federal case).

Entities created in 2024 should have received notification from the State SOS when the company was registered on how to comply with their reporting obligations. Entities which were formed before 2024 must now turn to the task of making sure that they comply with their reporting obligations by December 31, 2024.

Who Must File. Both domestic and foreign “reporting companies” are required to file reports with FinCEN. A legal entity (referred to in this newsletter as a “company”) is considered a “reporting company” if a document must be filed with a State’s Secretary of State (SOS) or similar office to create or register the entity. Please note:

- Corporations (including S corporations), limited liability companies (“LLCs”), and limited partnerships are required to file a formal document or registration with the SOS in most states (including California), and are therefore subject to the reporting requirements.

Internal Revenue Service Treasury Regulations require that I inform you that, to the extent that this communication or its attachments concern federal tax issues, any advice contained in this communication or any attachment thereto is not intended or written to be used, and cannot be used, to avoid penalties under the Internal Revenue Code.

- However, sole proprietorships, trusts, and general partnerships are usually not required to file a formal document or registration with the SOS in most states (including California) as part of their formation. Accordingly, most sole proprietorships, trusts, and general partnerships should not be considered a reporting company and should not have to file reports with FinCEN. However, if your sole proprietorship, trust, or general partnership was formed outside of California, you should double-check the laws of the state of formation to verify that no formal document was required to be filed with the SOS of that state as part of the formation process.
- Foreign companies are required to file reports with FinCEN if they are registered with the SOS (or similar office) under the laws of any state in which the foreign companies do business.
- Please note that the definition of “reporting company” does not depend on whether the company is engaged in an active trade or business or is merely a passive holding company for assets (e.g., an LLC formed to hold a family vacation home). All reporting companies, regardless of purpose or operating status, are subject to the CTA’s reporting obligations (unless an exemption expressly applies – see below).
- In addition, please note that LLCs which are owned by an individual or married couple and which are treated as “disregarded entities” for tax purposes are still “reporting companies” subject to the CTA’s reporting obligations.

Because the CTA is focused on tracking shell entities used for money laundering or other unlawful activities, the Act contains 23 exemptions for companies which are already required to report certain ownership and/or financial information to a governmental authority. For example, exemptions are available for (i) publicly-traded companies, (ii) banks, federal or state credit unions, (iii) registered broker/dealers, (iv) insurance companies, (v) registered investment companies and advisers, (vi) public accounting firms registered under the Sarbanes-Oxley Act, (vii) Section 501(c)(3) charities (but only after the charity’s exemption application has been approved by the IRS), (viii) registered money transmitter businesses, and (ix) certain qualifying large operating companies. These are just some of the more commonly-available exemptions.

The exemption for a large operating company may be of particular usefulness to many companies. A large operating company is any entity with (i) more than 20 full-time US employees, (ii) an operating presence at a physical office within the US, and (iii) more than \$5,000,000 of US-sourced gross receipts reported on its prior year federal income tax return. If a company meet these qualifications, the company is exempt from the new reporting requirements.

Determining whether an exemption is available for a company can be a complex process, and a close review of the qualifications for a company’s exemption (and appropriate documentation of that exemption) is strongly recommended.

Important Filing Dates For Initial BOI Report. As noted above, reporting companies must file a report (referred to as a “BOI Report”) with FinCEN (see below on how to file a BOI Report). For existing reporting companies created or registered before 2024, the initial BOI

Report is due by January 1, 2025. For reporting companies created or registered in 2024, the initial BOI Report is due 90 days after the entity's creation or registration. For reporting companies created or registered after 2024, the initial BOI Report is due 30 days after the entity's creation or registration.

There is no filing obligation if a reporting company legally dissolved prior to January 1, 2024. However, if the reporting company's dissolution was still pending as of January 1, 2024, the reporting company must file its report (called a BOI Report) even if the reporting company is no longer engaged in any business and in the winding-up process. As a general rule, corporations, LLCs and limited partnerships must file a final dissolution document with the SOS in the state of organization in order for the dissolution to be legally effective. Accordingly, if a company was in the process of dissolving at the end of 2023, careful attention must be paid to the status of the documents filed with the SOS to verify whether the dissolution was legally completed before January 1, 2024.

What Information Must be Provided To FinCEN In The BOI Report; FinCEN Identifiers.

The reporting company must report to FinCEN the following information: (i) the company's legal name, (ii) state of formation, (iii) address, and (iv) federal employer identification number ("EIN"). Some LLCs which are owned by an individual or married couple and which are treated as "disregarded entities" for tax purposes have historically used the social security number of the individual owner. These "disregarded entity" LLCs must now obtain their own EIN for use in filing the BOI Report.

In addition, the reporting company must report to FinCEN all of the beneficial ownership information (BOI) for each of (i) the reporting company's "beneficial owners", and (ii) if the company is formed or registered with a State's SOS after 2023, the company's "company applicant". BOI includes an individual's full legal name, date of birth, street address and a unique ID number. The unique ID number can be from a non-expired US passport, state driver's license, or other government-issued ID card. If the individual does not have any of those documents, then a non-expired foreign passport can be used. An image of the document showing the unique ID number must also be included with the BOI Report.

Individuals and reporting companies can request a FinCEN Identifier (FinCEN ID) to use in place of supplying detailed information on the BOI Report. A FinCEN ID is a unique number assigned by FinCEN which is obtained by submitting the same information as is required of a beneficial owner or reporting company. A FinCEN ID may be useful to individuals that prefer to send their personal information directly to FinCEN rather through a reporting company, or to individuals that may be required to supply information as a beneficial owner or company applicant of several reporting companies.

"Beneficial Owners" and "Company Applicants" Who Must Be Reported By The Reporting Company. Two groups of individuals are considered "beneficial owners" of a reporting company who must be reported on the company's BOI Report: (1) any individual who directly or indirectly owns or controls at least 25% of the ownership interests of the reporting company; or (2) any individual who exercises substantial control over the reporting company (even if the individual does not have an ownership interest). In addition, for companies formed after 2023, the "company applicant" must also be reported on the BOI Report.

- **Individuals Who Own Or Control At Least 25% Of The Reporting Company.** An individual will be considered a “beneficial owner” if that individual directly or indirectly owns or controls at least 25% of the ownership interests of the reporting company. “Directly or indirectly” is very broad language, as the individual may have an indirect ownership interest through any trust, contract, arrangement, understanding, or relationship. Ownership interests are aggregated to determine if an individual owns at least 25% of the ownership interests. For example, if an individual owns 15% of the company directly and is deemed to indirectly own another 10% as the trustee, grantor or sole beneficiary of a trust (see below), the interests are aggregated to reach a total 25% ownership interest.

Moreover, “ownership interests” is defined very broadly in FinCEN’s final rules and includes (without limitation) any and all types of equity, common or preferred stock, pre-formation subscriptions, interests in a joint venture, capital or profits interests, instruments convertible into equity interests (such as convertible debt), any rights to purchase, sell, or subscribe to shares or equity interests, and any put, call, or other purchase option (except to the extent the option is held by a third-party unknown to the reporting company). Debt instruments which do not include a right to convert the debt into equity are not included for purposes of calculating ownership. For purposes of calculating ownership, all puts, calls, options or other rights to acquire equity interests are deemed exercised as of the date of calculating ownership.

For many small companies without a complex capital structure or outstanding options, calculating “ownership interests” may be relatively straightforward. However, for companies with more complex capital structures or outstanding options, the calculation of “ownership interests” may require a very detailed and careful analysis. Please note that the FinCEN rules provide that if the “ownership interests” calculations cannot be made with reasonable certainty for companies with more than one class or type of ownership interest, an individual owning or controlling 25% or more of any single class or type of ownership interest will be deemed to have exceeded the 25% ownership interest threshold.

Special rules apply for ownership interests held in a trust. In this case, all of the following individuals are deemed to hold the ownership interest: (i) the trustee, if the trustee has the authority to dispose of the ownership interest, (ii) a beneficiary who has the sole right to receive income or principal of the trust, (iii) a beneficiary who has a right to demand a withdrawal or distribution of substantially all of the trust assets, and (iv) the settlor(s) of the trust who hold a power to revoke the trust or withdraw assets from the trust.

Finally, certain individuals are excluded from the “ownership interests” test:

- Minors (instead, information is reported for the minor’s parents or guardians).
- Heirs or other individuals with potential inheritance rights.

- Nominees, intermediaries, custodians, and agents acting on behalf of another individual.
- Employees of the company who (i) exercise substantial control over, or receive economic benefits from, the company solely from their employment status, and (ii) are not senior officers with substantial control (as discussed below).
- **Individuals With Substantial Control.** Individuals with substantial control are those individuals with substantial influence over important decisions about a reporting company's business, finances, and structure. Board members and senior officers (president, CFO, general counsel, CEO, COO, and any other officer who performs a similar function) are automatically deemed to have substantial control, as are individuals with the authority to appoint or remove senior officers and board members. There is no requirement that these individuals have actual ownership in the company to be considered a “beneficial owner” for reporting purposes.
- **Company Applicants Who Must Be Reported By The Reporting Company.** The company applicant is the person who actually files the document that creates or registers the reporting company with the State’s SOS (e.g., an attorney who acts as the original incorporator of a shell entity). Company applicants must provide the same information that is required of beneficial owners, but only if the reporting company is formed or registered after 2023. Because of the difficulty in tracking down information about company applicants for reporting companies that have been in existence for a number of years, reporting companies formed or registered with the State’s SOS before 2024 do not have to supply BOI for their company applicants.

Updates to Previously-Filed BOI Report. After the initial filing of the BOI Report, no further filings are required unless (i) there is a change to previously-reported information about the reporting company or its beneficial owners or individuals with substantial control, or (ii) to correct any incorrect information on the initial BOI Report.

If there is a change to previously-reported information about the reporting company or its beneficial owners or individuals with substantial control, an updated report must be filed within 30 days of the change. A FinCEN representative recently stated that this 30 day window to update the BOI Report beginning when a company applicant knows or would have good reason to know of any reportable discrepancies from what is already on file.

If a reporting company needs to correct any incorrect information on the initial BOI Report, the reporting company has 14 days from the date that it becomes aware or has reason to know that any required information contained in the BOI Report was inaccurate when filed and remains inaccurate.

It is imperative that your company implement a system to identify reportable changes and file an updated BOI Report with FinCEN in a timely manner. You may also want to amend shareholder agreements, limited partnership agreements, limited liability agreements, etc., to impose an

obligation on each shareholder, partner, member or other beneficial owner to immediately notify the entity of any change to their reportable information (or to update the information on file under their FinCEN identifier) so that the entity can update its BOI Report.

No Additional BOI Report Required Upon Company's Dissolution. At present, if a reporting company files an initial beneficial ownership information report and then legally dissolves, there is no requirement for the reporting company to file an additional BOI Report with FinCEN notifying it of the company's dissolution.

Privacy. Given the extreme sensitivity of the information included in the BOI Report, the FinCEN registry will not be public. FinCEN is authorized to disclose the beneficial ownership information it collects for only two purposes: (i) to facilitate important national security, intelligence, and law enforcement activities, and (ii) to confirm beneficial ownership information provided to financial institutions to facilitate their compliance with applicable anti-money laundering and customer due diligence requirements. FinCEN cannot independently disclose information on a BOI Report to financial institutions without the reporting company's consent.

Penalties. The penalties for willfully failing to file the initial BOI Report or updated BOI Report are steep – civil and/or criminal penalties of \$500 per day (up to \$10,000) for each day until the BOI Report (or updated BOI Report) is filed, and possible criminal prosecution and imprisonment for up to two years. These penalties can be assessed on the reporting company or on any individual with substantial control over the company who was involved in the willful violation of the filing obligations. A FinCEN representative recently affirmed that unknowing or good faith mistakes in complying with the filing obligations should not be subject to enforcement actions.

Similar penalties are applicable to any individual who willfully misuses or discloses information contained in a BOI Report.

How to File. BOI Reports must be filed electronically. FinCEN's e-filing portal, available at <https://boiefiling.fincen.gov/>, provides two methods to submit a report: (1) by filling out a web-based version of the form and submitting it online, or (2) by uploading a completed PDF version of the BOI Report. Some third-party service providers may also offer the ability to file the BOI Report through their software. The person who submits the BOI Report will need to provide their name and email address to FinCEN. There is no fee for filing the BOI Report.

FinCEN also has a Small Entity Compliance Guide and frequently asked questions to help guide businesses through the reporting requirements. These are available at <https://www.fincen.gov/boi/small-business-resources>.

If you have any questions about these new reporting rules and how they affect your company, I would be happy to discuss them with you and provide you with recommendations.

Very truly yours,


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