Morgan Stanley

PRIVATE WEALTH MANAGEMENT

ESTATE PLANNING STRATEGIES

Corporate Transparency Act (CTA)

On January 1, 2024, beneficial owner reporting requirements mandated by the Corporate Transparency Act ("CTA") will take effect. The CTA will require entities referred to as "Reporting Companies" – generally smaller, private entities rather than large, highly regulated companies – to report their "Beneficial Owners" and, for new Reporting Companies, "Company Applicants."

Wealth and Estate Planning Strategists
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Why was the CTA enacted?

The CTA was enacted to help fight money laundering and terrorist financing by helping law enforcement identify the individuals behind entities funding terrorist activities, attempting tax evasion schemes, or engaging in other illicit activities. Until now, privately held U.S. companies were not required to identify their beneficial owners or control persons, allowing bad actors to form, for example, a limited liability company ("LLC") to fund terrorist activity, frustrating law enforcement's ability to trace and determine who the actual actors were behind the entity. With the CTA, certain governmental agencies, law enforcement, and financial institutions with customer due diligence requirements will be able to access a database of information regarding the individual owners of such legal entities.

Who reports?

The CTA requires Reporting Companies to disclose information about their Beneficial Owners and Company Applicants (for new Reporting Companies).

- **Reporting Companies**: A Reporting Company is defined as a corporation, LLC, partnership, or similar entity, that is formed by the "filing of a document with a secretary of state or similar office." A Reporting Company may be either a U.S. domestic company or a foreign company registered to do business in the United States.

  Trusts generally do not fall under the definition of a Reporting Company, because they are not usually created by the "filing of a document with a secretary of state." While trusts themselves may avoid direct reporting requirements under the CTA, Reporting Companies owned by trusts will still need to report information related to the trust as a Beneficial Owner.

- **Beneficial Owners**: A Beneficial Owner is an individual who, directly or indirectly, owns or controls a Reporting Company. More specifically, Beneficial Owners include anyone who:

  - directly or indirectly, exercises "substantial control" over a reporting company, or

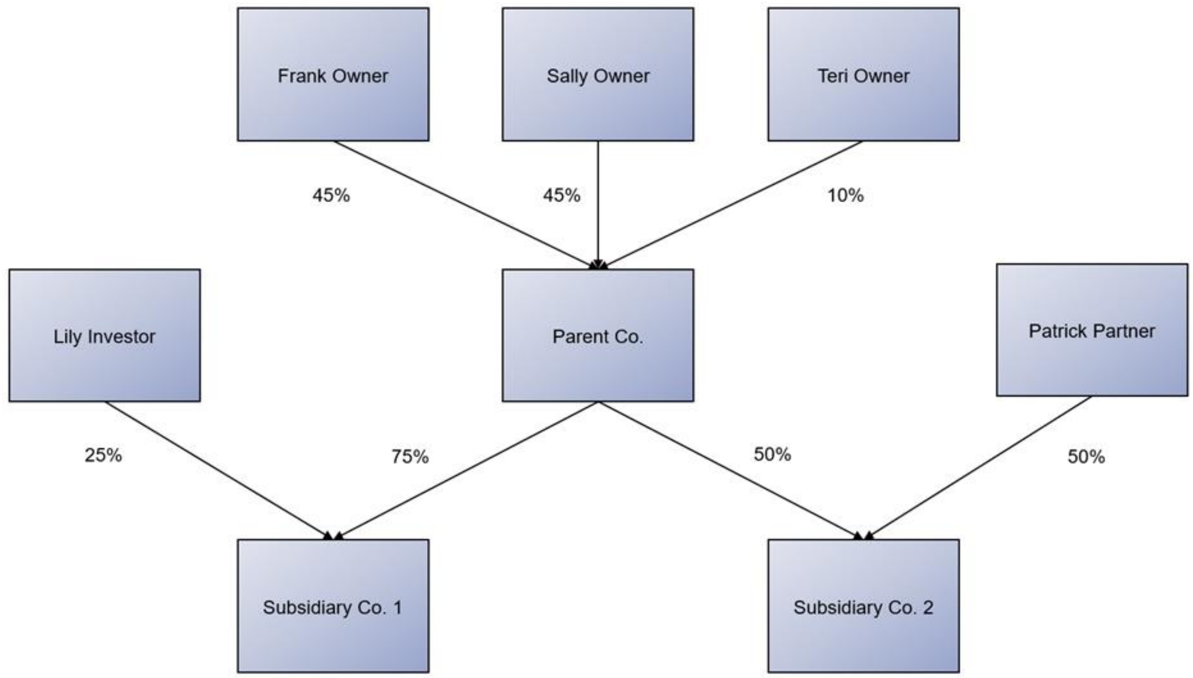
  - directly or indirectly, owns or controls at least 25% of the ownership interests of a reporting company.

Examples of individuals with substantial control include senior officers of a Reporting Company, those who have authority over appointment or removal of a senior officer, or individuals who assert direction or substantial influence over important decisions of the Reporting Company, such as the ability to borrow or enter into contracts on behalf of the Reporting Company.

Accordingly, for Reporting Companies owned partially or wholly by one or more parent companies, Beneficial Owners include the individuals who own or control the parent companies.

For example, in the structure below, the Beneficial Owners of Subsidiary Co. 1 would include Lily Investor, due to her 25% ownership interest, and Frank Owner and Sally Owner, who indirectly own at least 25% of Subsidiary Co. 1 due to their ownership of Parent Co. (which holds the remaining 75% ownership interest in Subsidiary Co. 1). Teri Owner indirectly owns less than 25% and would not be considered a Beneficial Owner of Subsidiary Co. 1 unless she exercises substantial control.

The Beneficial Owners of Subsidiary Co. 2 would include Patrick Partner, due to his 50% ownership. However, unless they exercise substantial control, Frank Owner, Sally Owner, and Teri Owner would not be Beneficial Owners. The Parent Co., only holds 50% ownership interest of Subsidiary Co. 2, and, as a result, they each indirectly own less than 25% of Subsidiary Co. 2.



For Reporting Company interests owned by a trust, the Beneficial Owner includes:

- the trustee if the trustee has the authority to dispose of trust assets;
- a beneficiary, if the beneficiary is the sole beneficiary or has a right to demand "substantially all of the assets from the trust"; and
- the grantor, if the grantor has the right to revoke the trust or withdraw the assets of the trust.

Beneficial Owners do not include:

- minor children, though the information of a parent or legal guardian must be reported in lieu of the minor's information;
- employees that are not senior officers of the company;
- creditors; and
- individuals who have a future interest or a right to inherit an interest.

- **Company Applicants**: Reporting Companies formed on or after January 1, 2024, also will have to report the information for up to two Company Applicants. Company Applicants include:
  - the person who files the entity documents with the secretary of state to create the domestic company (or first registers a foreign company to do business in the United States); and
  - the person who is primarily responsible for directing or controlling the filing of the relevant document by another.
  - As such, lawyers, paralegals, or other professionals who assist with entity formation are likely to be treated as Company Applicants, requiring disclosure of their information.

Which entities are exempt from the CTA reporting requirements?

Some entities that may otherwise fall under the definition of a Reporting Company are exempt from the reporting requirements. The CTA provides for 23 exceptions, and notable exemptions include:

- Publicly traded companies (U.S. Securities and Exchange Commission registered issuers);
- Banks and other regulated financial institutions;
- Large Operating Companies;
- Tax-exempt entities, such as charities; and
- Subsidiaries of exempt entities (with limited exceptions).

A Large Operating Company is defined as a company that has:

- more than 20 full-time U.S. employees,
- an operating presence at a physical office within the United States, and
- filed a Federal income tax or information return in the United States for the previous year showing greater than $5 million in gross receipts or sales revenue.

Full-time employees are defined as employees working on average 30 hours a week or at least 130 hours a month. Each entity is evaluated separately. Employees of subsidiaries or affiliates are not aggregated for this determination.

Additionally, a Large Operating Company is considered to be operating in the U.S. if it regularly conducts its business at a physical location in the United States. For example, a Large Operating company might have a principal office in the United States. On the other hand, a company merely leasing or owning a property in the U.S. is not considered a Large Operating Company if the property is not occupied by the company's business.

A Large Operating Company must also have at least $5 million of gross revenue, as reported on the entity's previous year Federal income tax or information return. This may include gross receipts or aggregate sales from subsidiaries or affiliate entities.

What and to whom do you report?

Under the CTA, information must be reported to the U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") for each Reporting Company and their, Beneficial Owners and Company Applicants (if applicable). From a practical standpoint, the Reporting Company is responsible for filing the required information with FinCEN. Reporting Companies will likely be tasked with obtaining the required information from Beneficial Owners, and, in turn, providing the information to FinCEN on a beneficial ownership report, through an online platform called the "BOSS" (Beneficial Ownership Secure System).

- **Reporting Companies generally will need to provide the following information:**
  - Company name
  - Business address
  - Jurisdiction of formation
  - Unique identification number(s) of the Reporting Company
  - Beneficial Ownership Information (sometimes referred to as "BOI") for each Beneficial Owner and, if necessary, Company Applicant, which includes:
    - Legal name
    - Date of birth
    - Residential address (or business address for professional Company Applicants)
    - Unique identifying number from an acceptable identification document and an image of the actual document (such as a passport or driver's license)

In some situations, a Reporting Company may report a FinCEN Identifier in lieu of providing the BOI. A FinCEN Identifier is a unique identifying number issued by FinCEN, upon request, to individuals or entities. The FinCEN Identifier, once issued, shifts the burden of updating reported information (addresses, passport numbers, etc.) from the Reporting Company to the individual or entity that was issued the Identifier. The Reporting Company would no longer need to report changes to that individual's information at the company level.

Notably, no financial information must be reported. Additionally, the information reported to FinCEN will not be publicly available and is required to be held at "the highest security level" (the same treatment as tax returns submitted to the IRS). However, individual states may pass legislature similar to the CTA that may make this information public. For example, in New York the proposed LLC Transparency Act, would make this information public for LLCs required to report in New York.

What's the cost of reporting (or not reporting)?

There is currently no proposed fee to file. However, there are costly penalties for failure to comply with the CTA. The penalties for a willful failure to file, or willfully *causing* the failure to file, include:

- Civil penalties of $500 per day, for each day a violation is outstanding, up to a maximum of $10,000 per violation, and
- Criminal penalties of up to two years imprisonment.

When does reporting need to be completed?

Currently, the deadline to comply with the CTA's requirements is:

- January 1, 2025, for entities created or registered to do business in the United States BEFORE January 1, 2024; and
- 30 days from creation or registration to do business for entities created or first registered to do business in the United States ON OR AFTER January 1, 2024.

After the initial CTA filing, an update must be filed within 30 days of a change in information previously submitted to FinCEN regarding the Reporting Company or Beneficial Owners. These changes might include a Beneficial Owner's name change or a change in the Reporting Company's Board of Directors.

On September 28, 2023, FinCEN released a proposal to amend the reporting deadlines for entities created or first registered to do business in the United States between January 1, 2024, and December 31, 2024. The proposal seeks to extend the window to file initial reports from 30 days to 90 days. As of publication, the proposed amendment has not been made final.

Where are we with the implementation of the CTA?

Under the CTA, the plan was to release three sets of regulations to govern the reporting requirements: 1) Reporting Regulations, 2) Access Regulations, and 3) Customer Due Diligence Regulations. Reporting Regulations were released at the end of 2022, and the proposed Access Regulations were released in 2023. Customer Due Diligence Regulations are expected to be issued no later than January 1, 2025.
Additionally, drafts of the Beneficial Owner Identification (BOI) reports and FinCEN Identifier Applications were released in early 2023.

There have also been rumors that the implementation of the CTA may be delayed, but postponement is not guaranteed, and Reporting Companies should be prepared for the effective date to remain January 1, 2024.

What are the next steps and planning strategies for Reporting Companies?

One of the goals of the CTA is to a create a central registry of reporting companies, owners, and affiliates, that can be used for fighting terrorism, money laundering, and tax evasion. However, clients in certain situations may still want to protect their privacy and/or avoid the burden of reporting.

Existing Reporting Companies may want to be proactive about gathering the information needed to comply with the CTA requirements far in advance of the January 1, 2025, deadline.

New Reporting Companies formed on or after January 1, 2024, may want to ensure the required information is obtained during the formation process in order to meet the CTA initial filing deadline.

Additionally, business owners, entrepreneurs, and the professionals who work with Reporting Companies may want to consider the following:

- Developing and implementing procedures for identifying and obtaining the documents and information required under the CTA, in order to show a good-faith effort to comply and avoid the willful failure to file penalties.

- Obtaining and using FinCEN Identifiers to reduce the reporting burden on Reporting Companies and reduce the number of times a Beneficial Owner or Company Applicant needs to provide potentially sensitive information to the Reporting Company.
- Being strategic with entity creation and mindful of the potential reporting requirements by, for example, creating a company as a subsidiary controlled or wholly owned, directly or indirectly, by an exempt parent company so that it too can be exempt.
- Appointing a specific individual within the Reporting Company to be responsible for CTA reporting. This may help limit access to sensitive Beneficial Owner information (within the Reporting Company) and provide oversight for CTA reporting and monitoring of CTA deadlines.
- Considering strategies to qualify for an exemption. For example, considering how to qualify for the Large Operating Company exemption.
- Reviewing entity structures and simplifying CTA reporting by restructuring, including by dissolving unnecessary or inactive entities.