

There's Still Time, But It's of the Essence

Structuring into an Exemption from the New Beneficial Ownership Information Reporting Requirements

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Less than six months remain until the regulations^[1] implementing the beneficial ownership reporting requirements prescribed by the Corporate Transparency Act^[2] (the "CTA") become effective on January 1, 2024.^[3] Any entity formed prior to January 1, 2024 that constitutes a "Domestic Reporting Company" or "Foreign Reporting Company" and that does not qualify for one of twenty-three exemptions on January 1, 2024 must file an initial report with Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Department of the Treasury, no later than January 1, 2025^[4] and then meet continuing reporting obligations. Because January 1, 2024 is the effective date, an entity not currently qualifying for an exemption may still avoid the beneficial ownership information reporting requirements if it is restructured in 2023 to qualify for an exemption on January 1, 2024 and it maintains its qualification thereafter.

No Exemption — Who Must Report and What

Who Must Report. Any "Domestic Reporting Company" or "Foreign Reporting Company" not qualifying for one of twenty-three exemptions constitutes a "Reporting Company" that must report beneficial ownership information to FinCEN.

- A *Domestic Reporting Company* is a corporation, limited liability company, or other entity that is created by the filing of a document with a secretary of state or any other similar office under the law of any U.S. state, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, or any other U.S. commonwealth, territory, or possession (each a "State"), or an Indian tribe. This definition includes various types of partnerships (LPs, LLPs, LLLPs) and business trusts that are formed by virtue of a State or tribal filing.
- A *Foreign Reporting Company* is a corporation, limited liability company, or other entity, formed under the law of a foreign country, and registered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office.

What Must Be Reported. Beneficial ownership information reports will generally require information regarding the Reporting Company itself (e.g., full legal name, DBA names, business address, formation or business registration jurisdiction, IRS or foreign jurisdiction tax identification number) and each "Beneficial Owner" (e.g., full legal name, date of birth, residential street address, unique identifying number such as a passport or driver's license number, and an image of the document containing the identifying number).^[5]

A Beneficial Owner is an individual who directly or indirectly (i) exercises "Substantial Control" over the reporting entity; or (ii) owns or controls at least 25% of the "Ownership Interests" of the Reporting Company. Substantial Control means providing services as a senior officer, having authority over the appointment or removal of any senior officer or a majority of the board of directors or similar body, directing, determining, or having substantial influence over important decisions, or having "any other form of substantial control over the [R]eporting [C]ompany." Ownership Interests include equity or stock, a capital or profit interests, certain convertible interests, or certain puts, calls, straddles, or other options or privileges of buying any of the enumerated interests. While the final regulations for determining beneficial ownership made certain helpful

clarifications as compared to the proposed regulations, they remain detailed and are clearly intended to pick up a great number of individuals involved with the reporting entity—*i.e.*, more than those that one might think of as an owner colloquially. The determination of who is or is not a Beneficial Owner is highly fact specific. Attorneys at Caplin & Drysdale can help you make that determination.

Reporting Violations. Hefty civil and criminal penalties—up to \$500/day while the violation continues and up to \$10,000 and/or up to 2 years imprisonment, respectively, apply to willful failures to report and willful provision of false or fraudulent information. In addition to Reporting Companies, upon which the obligation to report falls, individuals including Beneficial Owners and Company Applicants may be subject to penalty if they provide false or fraudulent information to the Reporting Company or cause its failure to report complete or updated information. A safe harbor exists for voluntary corrections of reports within 90 days of filing.

Exemptions

Twenty-three types of entities, each of which the CTA and final regulations define and describe, that would otherwise constitute Reporting Companies are exempt from reporting. Many of the exempted entities are already subject to substantial federal or state regulation under which beneficial ownership may already be known (*e.g.*, public companies, banks, credit unions, tax-exempt organizations). An exemption available for privately held, unregulated entities is the exemption for “Large Operating Companies,” defined as entities employing more than 20 full-time employees in the United States (including its possessions and territories, the District of Columbia, and tribal lands), having an operating presence at a physical office in the United States (including its possessions and territories, the District of Columbia, and tribal lands), and reporting more than \$5 million in gross receipts or sales from sources within the United States (generally including only the fifty states and the District of Columbia) on its previous year’s federal income tax or information tax return. Employees and offices of subsidiaries are not taken into account for this purpose, but gross receipts reported on an information return from a tax transparent entity or on a consolidated return filed by an affiliated group to which the entity belongs are taken into account.

Subsidiaries that are wholly owned or controlled, directly or indirectly, by one or more of the specified types of exempt entities, such as a Large Operating Company are also exempt. Subsidiaries less than wholly owned or controlled, directly or indirectly, by one or more exempt entity are not exempt, but may report the name of the relevant exempt entity in lieu of detailed information regarding any individual who is considered a Beneficial Owner of the subsidiary Reporting Company solely by virtue of their Ownership Interest in one of the exempt entities. Note that this will not avoid the need to report the names of non-exempt Beneficial Owners.

An entity exempt as of the later of January 1, 2024 or the date upon which it first becomes a Domestic or Foreign Reporting Company need not file an initial beneficial ownership information report or a claim of exemption with FinCEN so long as it remains exempt, whereas a Reporting Company that later becomes an exempt entity, but is not initially so, must file an initial report, updated reports if applicable, and a claim of an exemption when eligible.

Restructuring Opportunities. The CTA and its implementing regulations favor structures in which the parent entity is an operating company with its own offices, employees, and income and that owns all of the equity of its lower tier subsidiaries. If an existing entity is a Reporting Company, but does not qualify for an exemption under its current structure, it should consider whether undertaking a restructuring prior to January 1, 2024 would result in exemption from the above-described beneficial ownership information reporting. For example,

by consolidating operations and ownership, entities might qualify for the Large Operating Company or subsidiary exemption or might be able to limit its reportable information. Attorneys at Caplin & Drysdale can help you evaluate the possible means of restructuring and the tax consequences of the restructuring itself.

If you have questions concerning this Alert or for more information, please contact the Caplin & Drysdale attorneys below.

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[1] 31 C.F.R. 1010.380. *See also*, Financial Crimes Enforcement Network, Beneficial Ownership Information Reporting Requirements, RIN 1506-AB49, 87 Fed. Reg. 59498 (Sept. 30, 2022).

[2] Pub. Law. 116-283, §§ 6401-03 (Jan. 1, 2021), codified as 31 U.S.C. § 5336.

[3] Attorneys at Caplin & Drysdale are closely monitoring recently proposed legislation in the House that could alter the relevant effective date of the final regulations, but whether any such legislation is enacted is entirely speculative at this juncture. Entities should, therefore, evaluate their obligations and potential restructuring opportunities under the final regulation unless and until Congress or FinCEN officially alters the fast-approaching deadline.

[4] For a Domestic Reporting Company created on or after January 1, 2024, the initial report must be filed within 30 days of creation. For an entity that becomes a Foreign Reporting Company on or after January 1, 2024, the initial report must be filed within 30 days of such date.

[5] Domestic Reporting Companies created, and Foreign Reporting Companies registered, on or after January 1, 2024 must also report information regarding each “Company Applicant.” A Company Applicant is any individual who directly files the creation or registration documents for a Domestic or Foreign Reporting Company, respectively, or is primarily responsible for directing or controlling such a filing.

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