

# Business Lawyers, the Corporate Transparency Act and New York State's Response

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**M**illions of privately held businesses will soon be required to report the identities of those individuals who own and control them to the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN). This new beneficial ownership information (BOI) reporting obligation will begin Jan. 1, 2024. It results from the enactment of the Corporate Transparency Act (the CTA) and FinCEN's issuance of the final regulations on how the reporting will work.

These BOI reports will feed data into a new, centralized, BOI registry, which FinCEN will maintain. This registry will be confidential to the public but will be accessible to federal, state, local and foreign law enforcement agencies.

Rarely if ever have most of us had to think about laws that combat money laundering, terrorism financing, human and drug trafficking, sanctions evasion and other financial crimes. That is about to change for lawyers representing businesses in the U.S. or their owners, because the purpose of the CTA is to help law enforcement agencies identify potential criminals.

In a related development, the New York State Assembly and Senate both passed legislation in June of this year that would create state reporting requirements similar to those in the CTA. (See Senate Bill S00995B and Assembly Bill A3484A.)

While the reporting obligations of the New York legislation, called the LLC Transparency Act, require reports of essentially the same

information as the CTA requires, the LLC Transparency Act differs from the CTA in significant ways. Notably, the LLC Transparency Act will create a database of personal information that is available to the public. In contrast,

all of the information that is public under the LLC Transparency Act will be strictly confidential information under the CTA. This and other differences may have unfortunate consequences for business in New York.

Gov. Kathy Hochul has not yet signed this legislation into law. If she does, the LLC Transparency Act will go into effect one year later. As this article goes to press, we do not yet know whether the governor will sign this legislation into law.

Regardless of what happens with the LLC Transparency Act, all New York lawyers whose work involves business clients formed or qualified to do business anywhere in the U.S. will need to advise those clients on the new CTA reporting obligations which will go into effect Jan. 1, 2024. For companies that are formed in New York or qualified in New York, they will also need to advise those clients on the additional requirements of the LLC Transparency Act if Hochul does sign this into law. There are good



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reasons that the LLC Transparency Act should not become law, which are explained below. But first, it is worthwhile to have a basic understanding of the CTA and how it will affect our business law practices.

### **The CTA**

The CTA's beneficial ownership disclosure requirements bring the U.S. approach closer to those of more than 30 countries, including European countries. The CTA will be administered by FinCEN as part of FinCEN's role of coordinating the efforts of law enforcement agencies that investigate money laundering cases.

The final rule on the CTA's beneficial ownership reporting requirements was issued Sept. 30, 2022. This was the first of three sets of FinCEN rulemakings. The second set of FinCEN rules will cover who has access to the reported beneficial ownership information (BOI). The proposed second set of FinCEN rules was published Dec. 16, 2022. The final rule on access to BOI under the CTA has not yet been issued. The third set of rules will revise the existing customer due diligence (CDD) rule for financial institutions to make those requirements consistent with the CTA.

### **What Are the Deadlines for Reporting Under the CTA?**

The reporting requirements under the CTA go live Jan. 1, 2024. Any covered reporting company formed or registered before that date will have the entire calendar year of 2024 to comply with the new requirements. Any company formed or qualified to do business anywhere in the U.S. on or after Jan. 1, 2024, will be required to file an initial report within 14 days of its formation or qualification date.

All reporting companies will be required to file (i) an updated report within 30 days following a change in any information the reporting company previously submitted to FinCEN and (ii) a corrected report within 14 days after the date on which the reporting company becomes aware or has reason to know that any required information previously submitted was inaccurate when filed and remains inaccurate.

### **Who Must Report Under the CTA?**

FinCEN has estimated that during the 2024 calendar year, more than 32 million companies will file initial reports, with approximately 5 million additional companies filing reports each year thereafter. (Fed Reg Vol 87, No. 189, September 30, 2022, page 59589, text at footnotes 417 and 418.)

A "reporting company" under the CTA is a corporation, limited liability company or other business entity that is created either (i) by the filing of a document with a secretary of state or similar office under the laws of a U.S. state or Native American tribe or (ii) under the laws of a foreign country and qualified to do business in the United States by the filing of the qualification document with such office in the U.S.

The CTA requires all companies to file reports disclosing beneficial ownership information unless they fall within one of the CTA's 23 exemptions. Exempt entities include certain securities issuers, banks, investment companies, insurance companies, accounting firms, public utilities, tax exempt entities, subsidiaries of certain exempt entities, large operating companies, inactive entities, and more.

The "large operating company" exemption applies to an entity that (i) employs more than 20 full time employees in the U.S., (ii) has an operating presence at a physical office within the U.S., and (iii) has filed a federal income tax return or information return in the U.S. for the previous year demonstrating more than \$5 million in gross receipts or sales excluding gross receipts or sales from sources outside the United States.

The "inactive entity" exemption applies to a company that: (i) was in existence on or before Jan. 1, 2020; (ii) is not engaged in active business; (iii) is not wholly or partially owned by a foreign person, directly or indirectly; (iv) has not experienced any change in ownership in the preceding twelve month period; (v) has not sent or received any funds in an amount greater than \$1,000 in the preceding twelve month period; and (vi) does not otherwise hold any type of assets, whether in the United States or abroad, including any ownership interest in another entity.

One disturbing aspect of the CTA is the fact that law firms are not exempt from the CTA's reporting requirements simply by virtue of the fact that they are law firms. Accounting firms, on the other hand, are indeed exempt. The reason for this difference is not at all clear. It means that law firms that do not fall within one of the listed exemptions, meaning virtually all solo and small law firms formed as entities in the U.S. will be required to comply with the CTA reporting requirements. Those firms that qualify as "large operating companies" will be exempt. Of course, lawyers and paralegals even at large law firms may be considered "applicants" for their clients regardless of whether their law firms are reporting companies.

### **What Information Must Be Reported Under the CTA?**

Each reporting company that is not exempt must provide to FinCEN an ultimate beneficial ownership (UBO) report identifying each beneficial owner and each applicant of the reporting company.

The regulations define a "beneficial owner" of a reporting company as "any individual who, directly or indirectly, either exercises substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such reporting company."

The regulations say that a person who exercises substantial control includes any individual who (i) serves as a senior officer of the company, (ii) has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body), (iii) directs, determines or has substantial influence over, important decisions made by the reporting company, or (iv) has any other form of substantial control over the reporting company.

The reporting company must also report information about every "company applicant." A company applicant is the individual who files the document (i) that creates a domestic reporting company or (ii) that first registers a foreign reporting company in the U.S. In both cases, if more than one person is involved in the filing, the

"applicant" is the person primarily responsible for directing or controlling the filing. The rule does not require reporting companies existing or registered Jan. 1, 2024, to identify and report on their company applicants. Reporting companies formed after the effective date of the rule, on the other hand, must report their applicants, but they do not need to update company applicant information.

### **New York's LLC Transparency Act**

The New York LLC Transparency Act would require limited liability companies formed in or qualified to do business in New York state to disclose their beneficial ownership information to the New York secretary of state. Some of this information would become part of a public database. While the information to be submitted to the secretary of state is essentially the same as that required by the CTA, the names of the beneficial owners and their business addresses would be accessible to the public. Access to the entire FinCEN database, in contrast, will be limited to certain government agencies for law enforcement purposes, financial institutions to facilitate compliance with customer due diligence requirements, and the U.S. Treasury Department. The reasons for making the database public at all under the LLC Transparency Act are not evident from the supporting sponsor's memorandum.

From a law enforcement point of view, the New York database would be duplicative of the CTA database and so appears unnecessary. State law enforcement agencies will have access to the FinCEN data base regardless of whether the LLC Transparency Act becomes law.

An obvious difference between the New York legislation and the CTA is that the LLC Transparency Act would apply only to limited liability companies. The CTA applies also to corporations, limited partnerships and other types of entities. The reason for this specific focus on limited liability companies is not stated in the law or its supporting memorandum. It may be that the sponsors sought to expose anonymous owners of real estate, which are commonly limited

liability companies. Another reason may be that LLCs donate large sums to candidates for state office and the drafters of the legislation wanted to make these names public.

Another difference between the two approaches is that the criminal penalties for failure to comply with the LLC Transparency Act are far less severe than those for failure to comply with the CTA.

The CTA imposes civil and criminal penalties for the failure to file the required reports or to willfully file a report that contains false or fraudulent beneficial ownership information. The civil penalty is up to \$500 for each day that the violation continues. On the criminal side, anyone who willfully violates this law may be fined up to \$10,000 and imprisoned for not more than two years, or both. The CTA also imposes civil and criminal penalties for the unauthorized disclosure or use of beneficial ownership information. (See 31 U.S.C. § 5336(h).) The civil penalty is up to \$500 for each day that the violation continues. But a person who willfully discloses confidential reported information can be fined up to \$250,000 and imprisoned for up to five years.

By contrast, under the LLC Transparency Act, the failure to file the required disclosure for a period of more than 30 days means only that the entry will be shown as past due. If the failure to file lasts more than two years, it will be shown to be delinquent after a notice of delinquency has been mailed to the last known business address of the reporting company, and the company has failed to file the required information within 60 days. The delinquency will be removed from the records upon the filing of an up-to-date beneficial ownership disclosure, and the payment of a civil penalty of \$250.

The LLC Transparency Act adopts the 23 exemptions available under the CTA. But the LLC Transparency Act would require such entities to file a statement signed by a member or manager indicating the provision of the CTA that excludes such entity from the definition of a reporting company. The CTA has no such requirement.

The LLC Transparency Act would allow non-exempt beneficial owners who have significant privacy interests to seek waivers allowing their names and business addresses to remain confidential. But the standard for such waivers is undefined, so there is no assurance that these owners would be able to persuade the state that they have a significant privacy interest.

The LLC Transparency Act imposes a filing burden on companies formed in New York or qualifying to do business in New York that no other state requires. This public filing obligation is entirely duplicative of the separate but confidential filing obligation under the CTA. But the CTA data is already available to law enforcement personnel in New York and all other states.

As the New York State Bar Association's Business Law Section pointed out in a memorandum submitted to the governor's office July 13, 2023, New York's LLC Transparency Act completely ignores the security and confidentiality aspects of the database that FinCEN has recognized as a critical priority. As a result, beneficial owners "could become targets of various crimes, including identity theft, as well as physical and property-related crimes, such as robberies. Beneficial owners may be subject to protests from fringe groups and targeted by unwanted and harassing sales and other solicitations." (See <https://nysba.org/committees/business-law-section/>.)

Finally, the additional reporting requirements of the LLC Transparency Act are likely to discourage at least some companies from establishing their businesses in New York state. Business lawyers may have to discourage some of their clients from setting up their businesses in New York to avoid the burdens imposed by the act. This cannot be good for the New York state economy or for jobs in the state.

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