PUBLICATION

To Be or Not to Be… A Reporting Company Under the Corporate Transparency Act

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In just two months the Final Rule implementing Section 6403 of the Corporate Transparency Act will take effect. These regulations will undoubtedly impact millions of businesses, both domestic and foreign. Entities deemed "reporting companies" created on January 1, 2024, or later will have just 30 days to report the required beneficial owner and company applicant information. There is a possibility that this 30-day period could be extended to 90 days, at least for the first year of implementation, but that has not been finalized yet, so companies must presume that the 30-day period will apply until an extension, if any, is issued. Reporting companies formed before January 1, 2024, will have until January 1, 2025, to submit beneficial owner information (BOI), but need not submit company applicant information. In either case, companies must be in preparation mode now and seek to gain a full understanding of the steps that should be taken to comply with the new regulations.

While the first publication in this series of alerts on the Corporate Transparency Act (the CTA) sought to provide an overview of the CTA, this second alert is meant to identify approaches to the analysis one might use in determining whether a particular entity is a "reporting company" under the terms of the CTA. At the beginning of the analysis, it is important to remember that a reporting company may be either domestic or foreign. For a domestic company, it is the filing of a document with a state government that results in the entity's creation that places the entity under the CTA's reporting requirements. For a foreign company, it is the filing of a document with a state government for the purpose of registering to do business in that state, which places the foreign entity under the CTA's reporting requirements. The next step in the analysis is to determine whether that entity (domestic or foreign) is exempt pursuant to a list of 23 exemptions specified in the CTA.

The 23 exemptions underscore that "reporting requirements **generally apply** *[emphasis added]* to smaller more lightly regulated entities that are less likely to be subject to any other BOI reporting requirements." In other words, exempt entities tend to be larger or more heavily regulated entities. The exempt entities currently include the following:

(i) Securities reporting issuer;

(ii) Governmental authority;

(iii) Bank;

(iv) Credit union;

(v) Depository institution holding company;

(vi) Money services business;

(vii) Broker or dealer in securities;

(viii) Securities exchange or clearing agency;

(ix) Other Exchange Act registered entity;

(x) Investment company or investment advisor;

(xi) Venture capital fund adviser;

(xii) Insurance company;

(xiii) State-licensed insurance provider;

(xiv) Commodity Exchange Act registered entity;

(xv) Accounting firm;

(xvi) Public utility;

(xvii) Financial market utility;

(xviii) Pooled investment vehicle;

(xix) Tax-exempt entity;

(xx) Entity assisting a tax-exempt entity;

(xxi) Large operating company;

(xxii) Subsidiary of certain companies; and

(xxiii) Inactive entity.

It is important to note that the above exemptions are described in substantially greater detail in the regulations and, consequently, it is essential that when attempting to determine whether an entity is exempt one must carefully review the complete exemption as issued in the final regulations. For example, the "Large operating company" exemption refers to a company that:

"(A) Employs more than 20 full-time employees in the United States, with 'full-time employee in the United States' having the meaning provided in 26 CFR 54.4980H–1(a) and 54.4980H–3, except that the term 'United States' as used in 26 CFR 54.4980H–1(a) and 54.4980H–3 has the meaning provided in § 1010.100(hhh);

(B) Has an operating presence at a physical office within the United States; and

(C) Filed a Federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross receipts or sales, as reported as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120–S, IRS Form 1065, or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under Federal income tax principles. For an entity that is part of an affiliated group of corporations within the meaning of 26 U.S.C. 1504 that filed a consolidated return, the applicable amount shall be the amount reported on the consolidated return for such group."

As is readily apparent the actual definition of a "Large operating company" requires meaningful analysis before determining whether a given entity falls under this exemption. In response to certain comments questioning the method used for determining the number of employees for a "large operating company," FinCEN states, in part, that "FinCEN declines to permit companies to consolidate employee headcount across affiliated entities. Although the CTA specifies that gross receipts or sales are to be consolidated, the CTA contains no similar specification for employee headcount." Prior to this statement, FinCEN stated more generally that "the 'full-time employee' factor expresses well-known and well-established general business tax principles and should not require further elaboration." The point here is that the determination as to whether a particular exemption applies, especially at this early stage of the CTA's implementation, needs to be approached carefully to avoid certain interpretations that, perhaps even if intuitive, are inconsistent with the language of the regulation, especially considering FinCEN's own commentary. Here, simply because gross receipts may be based on a consolidated filing does not necessarily reflect how the number of employees may be calculated, which is based upon a definition included in another regulation.

In another example, the exemption for "Insurance company" reads: "Any insurance company as defined in Section 2 of the Investment Company Act of 1940 (15 U.S.C. 80a-2)." Now while one would be wise to review Section 2 of the Investment Company Act of 1940 in general when considering the applicability for this exemption, consider the following commentary discussed by FinCEN in connection with its Final Rule in connection with this exemption. It noted that it received a comment claiming that the definition of "Insurance company" was too broad and could conceivably include captive insurance companies. Captive insurance companies are often used by businesses to self-insure by creating a wholly owned subsidiary of the insured entity which acts as the insurer thereby allowing the insured to underwrite its own insurance (along with other benefits). This commenter expressed concern that captive insurance companies were "high-risk" and that the broad language could enable these entities to avoid scrutiny under the CTA. Without addressing why the possibly "high-risk" aspect of a captive is relevant to the CTA's purpose, FinCEN rejected the idea of modifying the final rule. It did observe, however, that "FinCEN does not opine here on whether or to what extent certain captive insurance companies, which can vary significantly in structure and size, might be able to properly claim this exemption. FinCEN may further consider captive insurance companies in connection with the study of exempt entities required under CTA section 6502(c)," which requires the comptroller general to conduct a study of the CTA and the effectiveness of the CTA's entity coverage. The point here is that what might start out as an apparently simple, straightforward inquiry, namely whether the CTA exempts captive insurance companies, will nevertheless require careful review of the CTA's language and FinCEN's related commentary.

The above represents just two relatively simple examples of how the language contained in the CTA's exemptions should initially be parsed. It is essential to review the language of the exemptions in full, along with FinCEN commentary, before forming any conclusion that could inadvertently lead one to improperly believe that a given entity is exempt under the CTA.

Finally, even before directing one's attention to the exemptions, one might consider whether a given entity is a reporting company based on the initial "created by a filing" threshold. "In general, FinCEN believes that sole proprietorships, certain types of trusts, and general partnerships in many, if not most, circumstances are not created through the filing of a document with a secretary of state or similar office. In such cases, the sole proprietorship, trust, or general partnership would not be a reporting company under the final rule." This is clear as long as one is able to properly identify the circumstances that fall outside the "many, if not most" limitation. Suppose a corporation formed as a Florida limited liability company in 2023 elects to convert to a Delaware corporation as of January 1, 2024. Based on the current exemptions, if the limited liability company satisfied the "large operating company" exemption in 2023, would the new corporation in 2024 be able to use that as a basis for claiming the same exemption in 2024? After all, the "corporation" was born, via statutory conversion, in 2024. In the Final Rule, FinCEN states: "In such cases, the touchstone is whether the successor entity is created by the filing of a document with a secretary of state or similar office." In this case, the successor or at least converted "corporation" has been formed via a state filing, namely the statutory conversion. Solely for purposes of the CTA, we might ask whether the converted "corporation" is a new entity, subject to all the compliance requirements that would naturally flow from such status. In the Final Rule, FinCEN comments: "It is similarly difficult to craft a generally applicable rule for conversions or reorganizations of entities, given the range of possible scenarios for conversions or reorganizations under state law and the variety of outcomes in terms of an entity retaining certain attributes of its predecessor entity…Given the potential range of relevant facts, FinCEN will consider issuing guidance as necessary to resolve questions on whether entities of particular types in particular circumstances are created by the filing of a document with the relevant authority."

Should you have any questions about the Corporate Transparency Act and how it could affect your business, reach out to Perry F. Sofferman or any member of Baker Donelson's Corporate Group.