taxnotes federal

Volume 174, Number 2 ■ January 10, 2022

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Reprinted from *Tax Notes Federal*, January 10, 2022, p. 191

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In this article, Sykes suggests changes to recently proposed regulations under the Corporate Transparency Act to ease the administrative burden on, and promote compliance by, the 30 million small businesses affected by the act's beneficial ownership information reporting provisions.

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On December 7, 2021, Treasury's Financial Crimes Enforcement Network issued proposed regulations (RIN 1506-AB49)[1] interpreting the Corporate Transparency Act (CTA).[2] The CTA, 31 U.S.C. section 5336, was enacted in January 2021 by the National Defense Authorization Act (NDAA).[3]

A fact sheet accompanying the proposed regulations states that the CTA is designed to help combat corruption, money laundering, terrorist financing, tax fraud, and other illicit activity, and that the ultimate goal of the regulatory proposal is to "combat, to the broadest extent possible, the proliferation of anonymous shell companies that facilitate the flow and sheltering of illicit money in the United States." The CTA accomplishes this by establishing a federal database, operated by FinCEN, that requires tens of millions of corporations, limited liability companies, and similar companies to report the identities of natural persons who qualify as beneficial owners. The database is designed primarily for use by law enforcement, national security, and intelligence agencies, as well as by federal regulators overseeing financial institutions that are subject to the "know your customer" rules of anti-money-laundering statutes.

The CTA provides that the reporting requirements will take effect on the effective date of the final regulations.[4]

This article is not intended to provide an exhaustive discussion of the CTA, which sets out a broad statutory rule for which 23 exceptions are specified. Instead, it focuses on small companies and businesses that will be required to file the new beneficial ownership reports. The number of companies, small and large, that will be subject to the mandated reporting is staggering — perhaps as many as 30 million, according to the preamble to the proposed regulations.[5] The NDAA estimates that more than 2 million corporations and LLCs are formed under state laws each year,[6] while the preamble to the proposed regulations puts the estimate at 3.7 million.[7]

The primary service providers that will interact directly with the affected companies are small accounting and law firms (both of which will face reporting obligations of their own, as discussed later). The CTA instructs Treasury to

[1] 86 F.R. 69920 (Dec. 8, 2021). Final regulations, when issued, will become 31 C.F.R. section 1010.380.

[2] 31 U.S.C. section 5336(b) describes the obligations imposed by the CTA and the penalties for a violation of those obligations.

[3] NDAA section 6403. For the "sense of Congress" in passing the CTA, see NDAA section 6402.

[4] 31 U.S.C. section 5336(b)(5).

[5] 86 F.R. at 69956-69957.

[6] NDAA section 6402.

[7] 86 F.R. at 69958.

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take reasonable steps to provide persons notice of their reporting obligations. Those steps include appropriate forms or other informational materials to be regularly distributed by the IRS and FinCEN.[8] Many small companies presumably will learn about their reporting obligations from privately run websites and blogs.

This article is mainly intended to raise awareness among small law and accounting firms so they can better advise their clients about the reporting obligations imposed by the CTA and its eventual final regulations. Many practitioners are already familiar with FinCEN from their experiences in preparing and filing reports (former Form TDF 90-22.1 and current Form 114) for foreign financial accounts with a value exceeding $10,000 in the aggregate at any time during the year.

Treatment of Reporting Companies

A company or business that is required to file a beneficial ownership report with FinCEN is known as a reporting company.[9] The CTA defines that term broadly to encompass a corporation, LLC, or similar entity that is created by the filing of a document with a secretary of state or a similar office under the law of a state or Native American tribe. The proposed regulations indicate that a partnership (for example, a limited partnership, a limited liability partnership, or a limited liability limited partnership) may be a reporting company if it satisfies the requirement of a filing with the secretary of state.[10] A reporting company also includes that type of entity formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or similar office under the laws of a state or Native American tribe.[11]

The CTA lists 23 exceptions to the definition of a reporting company, and as a 24th exception it allows for the Treasury secretary (with the written concurrence of the U.S. attorney general and the secretary of homeland security) to issue regulations providing for further exceptions if specified standards are met.[12] Section 5336(a)(11)(B)(xxi) of title 31 states that a reporting company does not include any entity that:

> (I) employs more than 20 employees on a full-time basis in the United States;
>
> (II) filed in the previous year Federal income tax returns in the United States demonstrating more than $5,000,000 in gross receipts or sales in the aggregate, including the receipts or sales of —
>
> > (aa) other entities owned by the entity; and
> >
> > (bb) other entities through which the entity operates; and
>
> (III) has an operating presence at a physical office within the United States.

This exception, which is addressed by prop. reg. section 1010.380(c)(2)(xxi) under title 31, is known as the large operating company exception.[13]

The broad sweep of the definition of reporting company, coupled with the carefully limited exceptions — especially the limitation found in subparagraph (B)(xxi) — would encompass most corporations, LLCs, and similar entities operating in the United States that have 20 or fewer full-time employees.

An exception for inactive entities meeting specified conditions is found in 31 U.S.C. section 5336(a)(11)(B)(xxiii).

Reportable Beneficial Ownership

The CTA defines a beneficial owner (whose identity must be reported to FinCEN) in terms of the exercise of control, and ownership or control of a 25 percent ownership interest:

> (3) Beneficial owner — The term "beneficial owner" —
>
> > (B) does not include —
> >
> > > (i) a minor child, as defined in the State in which the entity is formed, if

[8] 31 U.S.C. section 5336(e).

[9] 31 U.S.C. section 5336(a)(11).

[10] Prop. reg. section 1010.380(d)(3)(i)(B).

[11] 31 U.S.C. section 5336(a)(11)(A).

[12] 31 U.S.C. section 5336(a)(11)(B).

[13] 86 F.R. at 69972.

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> the information of the parent or guardian of the minor child is reported in accordance with this section;
>
> (ii) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
>
> (iii) an individual acting solely as an employee of a corporation, limited liability company, or other similar entity and whose control over or economic benefits from such entity is derived solely from the employment status of the person;
>
> (iv) an individual whose only interest in a corporation, limited liability company, or other similar entity is through a right of inheritance; or
>
> (v) a creditor of a corporation, limited liability company, or other similar entity, unless the creditor meets the requirements of subparagraph (A).[14]

The proposed regulations elaborate on this.[15] The elaborations are especially notable for their comprehensiveness. Among other things, service as a senior officer of the reporting company constitutes substantial control, as does substantial influence over important matters affecting the reporting company. But ownership interest does not include an employee of a reporting company acting solely as an employee, nor does it include a senior officer whose substantial control over or economic benefits from the entity are derived solely from the employment status of the employee.[16]

Required Identifying Information

Broadly, the information that a reporting company must provide consists of information identifying the company itself and its beneficial owners. For a beneficial owner, the required identifying information includes full legal name, date of birth, residential or business street address, and a unique identifying number from an acceptable legal document such as a driver's license or passport.[17] As interpreted by the proposed regulations, a report or updated report must include a beneficial owner's complete residential street address used for tax residency purposes — a potentially problematic requirement, as discussed later.[18]

Foreshortened Deadlines

After final regulations are issued, there will be four situations in which a reporting company must file a report.

First, the proposed regulations seem to provide (the language is garbled) that existing reporting companies will be required to file a report no later than one year after the effective date of the final regulations.[19] The CTA, however, specifies that reporting must be done "in a timely manner, and not later than two years after the effective date" of the final regulations.[20]

Second, the proposed regulations provide that newly formed reporting companies, whether domestic or foreign, must file a report within 14 calendar days of formation.[21] The CTA specifies that the report shall be filed "at the time of formation or registration."[22]

Third, the proposed regulations provide that a reporting company must file a corrected report within 14 calendar days after the date on which it becomes aware or has reason to know that any of the required information in any report was inaccurate when filed and remains inaccurate.[23] The CTA does not address this error-correction issue.

Fourth, the proposed regulations provide that a reporting company must file an updated report setting out changes to the information previously reported. This must be done within 30 calendar days after the change.[24] The CTA, however,

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[14] 31 U.S.C. section 5336(a)(3).

[15] Prop. reg. section 1010.380(d)(1), (2), (3), and (4).

[16] Prop. reg. section 1010.380(d)(4).

[17] 31 U.S.C. section 5336(b)(2)(A).

[18] Prop. reg. section 1010.380(b)(1)(ii)(C)(2).

[19] Prop. reg. section 1010.380(a)(1)(iii).

[20] 31 U.S.C. section 5336(b)(1)(B).

[21] Prop. reg. section 1010.380(a)(1)(i).

[22] 31 U.S.C. section 5336(b)(1)(C).

[23] Prop. reg. section 1010.380(a)(3).

[24] Prop. reg. section 1010.380(a)(2).

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specifies more generously that updating shall be done "in a timely manner, and not later than 1 year after the date on which there is a change."[25]

One may wonder whether it is lawful under the *Chevron*[26] standard for regulations addressing a compliance obligation to alter, to the detriment of those affected by the compliance requirement, precise deadlines found in the very statute that the regulations purport to interpret.

Several million small businesses are formed each year, often by founders without sufficient capital to secure professional legal advice. Presumably, many will use websites to form their entities. And many founders are immigrants, sometimes offering blue-collar services, who may be unfamiliar with the United States' hyper-legalistic environment. The reporting requirements of the CTA apply to a U.S. person as defined in section 7701(a)(30).[27] Subparagraph (A) of that provision states that a citizen or resident of the United States is a U.S. person. As interpreted by long-standing rules centering on a person's substantial presence, subparagraph (A) encompasses most immigrants who have founded a business in the United States.

Obviously, a reporting company's owners would have to be attentive to the CTA to update FinCEN within 30 days of the date on which (1) any beneficial owner had a change in residential address or (2) a new beneficial owner, perhaps a new senior officer with substantial influence over the entity's important affairs, joined the roster.[28]

Willfully failing to report complete or updated beneficial ownership information to FinCEN in accordance with the regulations is a reporting violation.[29] A civil penalty of $500 per day may be imposed for as long as the willful failure continues without being remedied.[30] Further, the CTA provides for a fine of up to $10,000 and imprisonment for up to two years for a willful failure.[31] Willfulness here means a voluntary, intentional violation of a known legal duty.[32]

Even without a penalty, fine, or imprisonment, a violation of the CTA's foreshortened reporting deadlines can be detrimental to a small company. Simply having to respond to a FinCEN investigation could be disturbing, distracting, and costly.

In instructing FinCEN to publicize its requirements, the CTA recognizes the compliance challenges faced by undercapitalized small businesses.[33] Specifically, it recognizes that the requirement to update information about a change of beneficial ownership is a sensitive issue: Section 5336(b)(1)(E) of title 31 instructs the Treasury secretary to review and evaluate the necessity of a requirement that companies update reporting related to changes in beneficial ownership, and the secretary must review and evaluate the benefit to law enforcement and national security officials that might be derived from shortening the period for updating a change in the list of beneficial owners. The secretary's findings and determinations are then to be incorporated into the regulations within two years of the date of the CTA's enactment.

These statutory instructions do not seem to directly address the compliance problems likely involved in requiring updating about an existing beneficial owner's change of address. This lack of a special instruction concerning existing owners may be relevant to the scope of any judicial review under *Chevron* of the validity of the regulations' foreshortened deadlines regarding existing owners' changes in address.

No Exemption for Small Firms

No doubt many lawyers and accountants reading this article are wondering whether small law firms and small accounting firms are considered reporting companies.

For accounting firms, an exception from the reporting requirements is found in 31 U.S.C.

[25] 31 U.S.C. section 5336(b)(1)(D).

[26] *Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984).

[27] 31 U.S.C. section 5336(a)(14).

[28] *See* prop. reg. section 1010.380(f)(8).

[29] Prop. reg. section 1010.380(g)(1).

[30] 31 U.S.C. section 5336(h)(1) and (3).

[31] *Id.*

[32] 31 U.S.C. section 5336(h)(6).

[33] 31 U.S.C. section 5336(e).

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section 5336(a)(11)(B)(xv), which states that a reporting company does not include "a public accounting firm registered in accordance with section 102 of the Sarbanes-Oxley Act of 2002."[34] However, few accounting firms are so registered. The narrowness of that exception reinforces the idea that accounting firms that have no more than 20 employees and an entity structure predicated on a document filed with a secretary of state are reporting companies subject to the filing requirements.

Likewise, there is no exception for law firms that have 20 employees or fewer and have an entity structure predicated on a document filed with a secretary of state. One may wonder why. Information about the identities of the beneficial owners of law firms — which can be owned only by lawyers — is already widely available through filings that lawyers are required to make with state bar authorities. Also, lawyers had to pass character and fitness reviews before being admitted to the state bar.

One may question how often small law firms operate as shell companies for money-laundering purposes.

The preamble to the proposed regulations does not suggest that FinCEN considered whether to exempt small law firms from the reporting obligation.[35] However, it does say that FinCEN will continue to consider whether additional exemptions should be available.[36] The preamble notes that key considerations under the CTA are (1) whether collecting identifying information "would not serve the public interest" and (2) whether the information would not be "highly useful" in national security, intelligence, and law enforcement in efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes.[37]

Next Steps

With the comment period open until February 7, it is likely that final regulations triggering the CTA's compliance requirements will arrive no earlier than mid-2022. In the meantime, small law and accounting firms should use the upcoming deadlines for the filing of forms 941, 1040, 1120, and 1065 as an opportunity to raise awareness of the CTA's requirements among the small companies they advise. Small law and accounting firms should also consider the shape of the internal controls to be installed, both for their own use and for the use of their clients.

Small law and accounting firms, and relevant trade groups, also should consider commenting on the proposed regulations. The preamble invites comment on a host of issues, including the burdens of compliance.[38]

One subject that seems to cry out for comment is the very short deadlines proposed for filing updated reports regarding beneficial owners' change in address. The foreshortened, 30-day deadline seems unrealistic for small companies and firms, setting the stage for widespread noncompliance.

The 14-day reporting deadline for newly formed companies may also be unrealistic, given that many founders of small businesses take a do-it-yourself approach to formation.

Commentators should suggest that the longer and flexible reporting deadlines authorized by the CTA are a basis for Treasury to harmonize due dates across the beneficial ownership reports and forms 1040, 1120, and 1065. Small businesses that are in contact with their tax return preparers will be in a position to receive instructions about the beneficial ownership filings that are due.

Readers will recall a similar situation with foreign bank account reports, which are also filed with FinCEN. Originally, FBARs were due on June 30. In recent years, that due date was changed to April 15, with an automatic extension granted to October 15. This change allowed FBAR filings to be made in conjunction with filings of federal tax returns. A similar change for beneficial ownership reports should be considered.

Changing the due dates for the CTA's filings so they coincide with the filing dates for federal tax returns (whether based on a calendar year or a fiscal year) would substantially reduce

[34] *See also* prop. reg. section 1010.380(c)(2)(xv).

[35] 86 F.R. at 69940-69941.

[36] *Id.* at 69941.

[37] *Id.*

[38] *Id.* at 69968-69969.

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compliance burdens and noncompliance. As noted earlier, Congress expressed concern about balancing the burdens imposed on reporting companies against the benefits to law enforcement and financial institutions.[39]

Conclusion

It is unlikely that most small companies and firms, including most small law and accounting firms, yet appreciate the full significance of the CTA's imminent reporting requirements. FinCEN's proposed regulations, if adopted without change, would impose foreshortened deadlines for reporting the formation of a new reporting company and for reporting changes in the address of beneficial owners. FinCEN's proposed deadlines would almost never coincide with the due dates applicable to federal tax returns. That disconnect would reduce opportunities for small companies to become aware of, and comply with, the new reporting obligations. It would also increase the burdens of compliance. Trade groups for small companies, and their service providers, should make timely comments to FinCEN about foreshortened deadlines. Small law firms should suggest that they be exempt. Small companies, including small law and accounting firms, should also consider the shape of the internal controls that should be adopted to secure routine compliance. ■

[39] 31 U.S.C. section 5336(b)(1)(E) and (F).

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