

M INTELLIGENCE

THE CORPORATE TRANSPARENCY ACT: THE COUNTDOWN IS ON FOR SMALL BUSINESSES

Small businesses face a new federal reporting requirement aimed at creating transparency that reveals beneficial owners, and could indirectly affect trusts and their trustees.

The Corporate Transparency Act (CTA or Act) was enacted in 2021 as part of the National Defense Authorization Act for Fiscal Year 2021. The CTA requires that small businesses (“reporting companies”) file information on the individuals who own and control the business (“beneficial owners”). The purpose of the CTA is to remove the cloak of anonymity that may shield illegal financial activities such as money laundering, financing of terrorism, tax fraud, corruption, and other illegal activities. Reporting companies in existence before 2024

REPORTING COMPANIES

With important exceptions, the new law targets all businesses (i) with fewer than 20 full-time employees, (ii) less than \$5 million of prior-year gross receipts or sales or (iii) that do not operate out of a physical location in the United States. CTA therefore applies to most small businesses operating in the United States including single-member LLCs (disregarded entities). It is estimated that the CTA will affect over 32 million existing small businesses and, annually, five million new businesses.

must file by January 1, 2025, and reporting companies formed in 2024 must file within 90 days of creation. Although the CTA was recently declared unconstitutional in an Alabama U.S. District Court case, *as a protective measure*, businesses not within one of the 23 exceptions are strongly urged to file. The U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) is responsible for enforcing the Act.

REPORTING COMPANY EXCEPTIONS

The 23 reporting company exceptions to CTA are generally for entities that are already subject to substantial state or federal regulation. Noteworthy exceptions include:

1. State Licensed Insurance Producers

Any entity that (A) is an insurance producer authorized by, and subject to, state supervision and (B) is operating from a physical office in the United States.

2. Investment Advisor

An entity that is an investment advisor as defined in Code Section 202 of the Investment Advisers Act of 1940 and registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.

3. Tax Exempt Entity

An organization described in Code Section 501(c) that is exempt from tax under Section 501(a).

4. Broker or Dealer in Securities

Any broker or dealer as defined in Section 3 and registered under Section 15 of the Securities and Exchange Act of 1934.

5. Large Operating Company

A business with (i) 20 or more full-time employees, (ii) prior-year gross receipts or sales exceeding \$5 million and (iii) operates out of a physical office in the United States. (Note: A business will be a reporting company subject to the Act if it fails to meet any-one of the three requirements.)

6. Inactive Business

An inactive business that (i) has been in existence for over one year, (ii) is not owned by a foreign person, and (iii) does not own an interest in another entity.

REPORTING COMPANY FILING OBLIGATIONS

A reporting company (not the beneficial owners) must report its full legal name, trade names, and “doing business as” (DBA) name, complete U.S. address, and provide a taxpayer identification number (TIN) or employer identification number (EIN). The reporting company (not the beneficial owners) must file each beneficial owner’s full legal name, date of birth, current address and the unique number and image from a valid U.S. passport, state driver’s license, or other state-issued document with a current address. Once filed, any changes to (i) the reporting company’s information (for example, operating under a new DBA or a change of officers) and/or (ii) the beneficial owners’ information (for example a change of address, or a new driver’s license).

BENEFICIAL OWNERS

Beneficial owners include anyone owning 25% or more of an entity. Ownership is defined broadly to include interests such as voting and non-voting equity interests, profit interests, subscriptions, convertible instruments, and various put, call, and other options. Ownership interests may be controlled jointly, through trust arrangements or through other entities.

Beneficial owners also include any person who exercises substantial control over an organization. This includes the manager of an LLC or partnership (irrespective of whether they own an equity, profit, or other interest in the entity) and all officers of the entity such as the CEO, president, chief financial officer, general counsel, and chief operating officer.

TRUSTS

Generally, a trust is not considered a reporting company unless it is formed under a specific state statute that requires a state filing. However, if the trust owns an interest in a reporting company and is considered a beneficial owner (see above) it will be required to file. There are a number of important trust-related considerations:

First, is the trust required to file? That is, does the trust own greater than 25% in a reporting company? Does it make sense for the trust to continue to own those interests? If the trust is a grantor trust, it may be a good time to swap out those interests so the trust falls below the threshold for classification as a beneficial owner.

Second, since the trustee will likely be considered the beneficial owner, is the trustee aware of CTA responsibilities and deadlines? Compliance with the Act may place a significant burden on individual trustees such as family members. It is advisable that the trustee engage professional legal and tax counsel to ensure compliance with the CTA. An independent trustee, such as a CPA or attorney, may be a better choice, while an institutional trustee may be in the best position to meet the filing and other requirements of the CTA. Co-trustees consisting of a family member and an institutional trustee can bring the best of both worlds — a trustee who understands the needs, personalities of beneficiaries, and family goals and values as well as a professional trustee who can interpret the document and ensure compliance with the CTA and state and federal laws.

Third, a person holding a power of appointment over trust assets may be considered a beneficial owner. Review of their power and the authority they hold over trust interests in reporting companies should be reviewed. Finally, it is a good time to review a trust protector’s authority to establish whether they are a beneficial owner and need to file.

FILING DEADLINES

Under current law, the filing deadline for a business created before 2024 is January 1, 2025. Based on FinCEN final regulations, a new business formed in 2024 must file within 90 days of the date of its creation. Any changes to a reporting company's filing must be made within 30 days. Changes due to the death of a beneficial owner must be reported within 30 days after the estate is settled.

Pending passage in the Senate, legislation that passed the House by a vote of 420 to 1 will extend the filing deadline for businesses created before 2024 from January 1, 2025 to January 1, 2026 and the time for filing updates from 30 to 90 days.

STRICT PENALTIES

There are strict penalties for noncompliance (that is, failure to file or filing incomplete or inaccurate information) of \$500 per day up to \$10,000 and imprisonment for up to two years.

IS CTA UNCONSTITUTIONAL?

Although the CTA was declared unconstitutional in a recent Alabama U.S. District Court case, businesses not falling within one of the 23 exceptions are strongly urged to begin the process because the holding in that case may only apply to the plaintiff, and it is likely not the final word. For many ultra-high net worth families, compliance with the CTA will be an extremely invasive, disruptive, time consuming, and expensive process. There will be many unanswered questions that may take years to resolve. Nevertheless, with significant financial penalties and possible imprisonment for noncompliance, the best advice regarding the CTA is for clients to (1) begin the information gathering process and (2) in complex situations, engage qualified legal and tax counsel to ensure compliance.

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