The new Corporate Transparency Act and its potential impact on North Carolina commercial real estate attorneys

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The Corporate Transparency Act of 2019 (“CTA”)[1] was enacted January 1, 2021, as part of the Anti-Money Laundering Act of 2020 (“AMLA”), which is part of the National Defense Authorization Act for Fiscal Year 2021 (“NDAA”).[2] This article contains highlights[3] of the CTA, an outlook of regulations to come, and an alert to North Carolina attorneys of the potential impact with respect to a commercial real estate practice.

A. Purpose.

The purpose of the CTA is to “(A) set a clear, Federal standard for incorporation practices; (B) protect vital United States national security interests; (C) protect interstate and foreign commerce; (D) better enable critical national security, intelligence, and law enforcement efforts to counter money laundering, the financing of terrorism, and other illicit activity; and (E) bring the United States into compliance with international anti-money laundering and countering the financing of terrorism standards.”[4]

Because of the role commercial real estate attorneys typically serve in the formation of, and amendments to, business entities as part of a closing or other commercial real estate transactions, the CTA may trigger reporting obligations if the role of the attorney fits within the definition of an “Applicant” (defined below).

B. Definitions.

To understand the CTA, you must first understand the statutory definitions:

Applicant:

Applicant is an individual who either files an application to form a Reporting Company under the laws of North Carolina or Indian Tribe; or who registers or files an application for a foreign Reporting Company to do business in the U.S.[5]

Beneficial Owner:

Includes:
(1) those individuals exercising substantial control over the entity; or
(2) those individuals owning or controlling not less than 25% of the ownership interest of an entity.[6]

Beneficial Owner Registry or
Database:

A private database to be maintained by FinCEN (following implementation of regulations). The database of Beneficial Owners will not be public; access will be limited to authorized users upon receipt of an approved request for disclosure.[7]

Business Entity:

See "Reporting Company" below.

FinCEN:

Financial Crimes Enforcement Network of the US Department of the Treasury

Reporting Company:

Corporations, limited liability companies, or other similar entities created by the filing of creation documents with the NC Secretary of State or an out of state entity registered to do business with the NC Secretary of State. There are certain exemptions described below.[8]

C. Requirements.

Under the CTA, each Applicant to form a Business Entity will be required to file a report with FinCEN disclosing the Beneficial Owner(s). The CTA also requires an annual filing of the current Beneficial Owners, disclosing any changes during the previous year.

D. Timeline.

The CTA is an evolving area of law. Although enacted January 1, 2021, there is substantial legislative history and prior legislation that began the process of requiring transparency of the Beneficial Owners of Business Entities. The promulgation of additional regulations is needed to resolve many open issues. Highlights of the timeline follows:

October 26, 1970

Enactment of the Bank Secrecy Act[9]

July 2006

The international Financial Action Task Force on Money Laundering ("FATF") issued a report that criticized the U.S. "for failing to comply with a FATF standard on the need to collect beneficial ownership information."[10]

January 13, 2016

First Geographical Targeting Orders (GTOs) by FinCEN directed to title insurance companies to collect and report certain ownership information on residential properties purchased without loans in certain designated markets.[11]

January 1, 2021

Enactment of the CTA[12]

May 5, 2021

Deadline for comments were due to the Treasury[13]

January 1, 2022

Deadline for the Secretary of the Treasury to promulgate regulations implementing the CTA (with designated effective dates for those regulations to be determined).[14]

2023

CTA anticipated to be fully implemented

E. Deadlines:

Reporting requirements for entities
formed prior to the regulations:

2-years after regulations take effect[15]

Reporting requirements for entities
formed on/after the regulations:

At the time of formation[16]

Reporting requirements for
filing an amendment:

Depending on whether the changes impact beneficial ownership or control, as will be clarified via pending regulations, Reporting Companies should be prepared to provide updated reports at the time the change is made. The CTA's language calls for updated reporting in a "timely manner;" however, that specific period of time has yet to be definitively identified. [17]

Safe Harbor reporting requirements for corrections following discovery of a mistake:

90-Days.[18]

F. Exemptions.[19]

1. Reporting Companies[20]

Large Employment/Sales— company employs more than 20 employees on a full-time basis in the U.S.; filed a tax return in the previous year demonstrating more than $5,000,000 in gross sales or receipts; and has a physical operating presence in the U.S.

Insurance—entities defined as insurance companies under Section 2 of the Investment Company Act of 1940; or an insurance producer that is authorized by a State and subject to the supervision of the Insurance Commissioner or similar official/agency of the State and has a physical office within the U.S.

Tax-Exempt Entities— Section 501(c) corporations, certain political organizations, and charitable/split-interest trusts.

Banks, Bank Holding Companies, and Credit Unions—certain financial institutions as described in relevant provisions of the Federal Deposit Insurance Act, Investment Company Act of 1940, Investment Advisors Act of 1940, Federal Credit Union Act, and Home Owners' Loan Act.

Companies Reporting to the S.E.C.—issuers of a class of securities registered under Section 12 of the Securities Exchange Act of 1934; or entity that is required to file supplementary and periodic information under section 15(d) of the Act.

Public Utilities—a provider of telecommunications service, electrical power, natural gas, or water and sewer services within the U.S.

2. Beneficial Owners[21]

Solely Creditor—while creditors of Reporting Companies are typically not considered beneficial owners of those entities unless they otherwise qualify (substantial control or 25% ownership/control), covenants dictating control contained in credit agreements, if far-reaching, might be sufficient to trigger substantial control. That substantial control would move a creditor outside of this exception and into reporting as a beneficial owner.

> Minor Child—a child under the age of majority in the state where the entity is formed will not be included as a beneficial owner, so long as the parent or guardian of the child is reported.
>
> Heir Apparent—an individual whose interest in a corporation, limited liability company, or similar entity is through right of inheritance.

G. Penalties.

The CTA imposes substantial penalties for reporting violations, which include criminal and civil penalties.[22] For example, a willful violation of a reporting requirement subjects a person to a civil penalty of not more than $500 per day that the violation continues, a criminal fine of not more than $10,000, and/or imprisonment.

H. Ethics:

The CTA merges legal services and ethics. Compliance with the CTA necessarily involves revealing client information, which may be deemed by the client to be confidential. The CTA will trump a client's desire for confidentiality.

The North Carolina ethics rules already provide an exemption for disclosures required by law. See Rule 1.6 Confidentiality of Information ("A lawyer may reveal information protected from disclosure by paragraph (a) to the extent the lawyer reasonably believes necessary: (1) to comply with the Rules of Professional Conduct, ***the law*** or court order…." (emphasis added). RPC 23, in the context of disclosures required by the IRS on form 1099, provided:

> Whenever Lawyer L is required by tax law provisions to provide certain information to the Internal Revenue Service, he may ethically do so. Since it is a legal requirement, the consent of the client is not required… Therefore, Lawyer L and other attorneys similarly situated should inform their clients, and other affected persons as reasonable and appropriate, when the lawyer must provide information to the Internal Revenue Service.

It would seem that the reporting obligations under the CTA would fall under Rule 1.6 and RPC 23. Note that RPC 23 suggests that the attorney has an obligation to inform the client that the attorney will be making the required disclosure.

I. Representation Agreements and the CTA:

Attorneys should consider the impact of the CTA when drafting representation agreements with clients.

1. Limited Scope of Representation

> Until further guidance is provided by FinCEN via regulation, a recommended practice is to reduce instances of filing formation documents on behalf of new corporations, limited liability companies, and similar entities to avoid the attorney triggering reporting requirements as an "Applicant" under the CTA.

2. Waivers for reliance on information and indemnity

> Because of the potential civil and criminal penalties for willful reporting violations and unauthorized disclosure and use, attorneys should consider incorporating provisions into representation agreements

allowing for reliance on representations made by clients when the scope of representation implicates FinCEN reporting or use of the Beneficial Owner Registry. Furthermore, attorneys may choose to incorporate indemnity provisions for intentional misrepresentations made by clients; however, attorneys should be certain they are obtaining information from an authorized and informed agent of the Reporting Company client. In instances of complex, layered holding companies, the proper information source(s) may not be immediately clear. Proper identification is a crucial step and implicates a lawyer's ethical duties of diligence and communication.

3. Limiting Attorney's Role in Ongoing Reporting Requirements

Clearly communicating to the client that the attorney will be not responsible for tracking changes in beneficial ownership and will not be the party responsible for ongoing reporting requirements to FinCEN.

4. If Acting as an Applicant/Filing Formation Documents, Prepare FinCEN Report

should attorneys choose to file formation documents on behalf of newly formed reporting companies, attorneys should be prepared to comply with any requirements to report the attorney's information to FinCEN within one year of regulation promulgation.

J. Unanswered questions:

Because this is an evolving area of the law, there are many unanswered questions. For example:

(1) in ascertaining reporting information, what source on information can an attorney reasonably rely upon?

(2) when a Business Entity has multiple layers of ownership, how many layers need to be researched?

(3) is an attorney liable for incorrect information if an attorney used commercially reasonable inquiries to report the information?

(4) does an attorney have a duty to update information?

(5) what is an attorney's duty once the attorney no longer represents the Business Entity?

(6) when an attorney's role is simply to qualify an out-of-state entity to do business in North Carolina, does that trigger any reporting responsibility (since the CTA only refers to an application "to form" a Business Entity)?

(7) when the CTA references an "individual," is the CTA referring also to a company that is engaged to form a Business Entity?

Forthcoming regulations should help answer these and other questions.

K. Conclusion:

The reporting requirements, while not yet complete, are here to stay and need to become part of the routine for NC commercial real estate attorneys. A CTA Checklist to incorporate into your practice is attached as Exhibit A. The most important take-away is to determine if you are the responsible party for reporting the Beneficial Owners of a Reporting

Company for a closing that involves formation (or amendment) of an entity that falls within the definition of a Reporting Company. Stay informed of the regulations as they are promulgated.

EXHIBIT A
CTA Checklist for Commercial Real Estate Attorneys

(a) Attorney's Representation Agreement

Did representation agreement address the CTA and any required disclosures?

Did the representation agreement provide an obligation for client to cooperate with any disclosure requirements?

Did representation agreement include an indemnity to the attorney for any inaccurate information provided by the client?

(b) Role of Closing Attorney

Did attorney form a North Carolina Business Entity?

Did attorney qualify a foreign (international) Business Entity to do business in the U.S.?

Did attorney amend the beneficial ownership of a pre-existing Business Entity?

Does attorney otherwise fit within the definition of an Applicant?

(c) Compliance requirement: Reporting Companies

Identify Beneficial Owner(s): ______________________________

Identify Applicant(s): ______________________________

(d) Compliance requirement: Information for <u>each</u> Beneficial Owner(s) and/or Applicant(s) to Report to FinCEN

Full Legal Name: ______________________________

Date of Birth: ______________________________

Current Residential or Business Address:______________________________

____

Unique Identifying Number from an Acceptable Identification Document:______________

Acceptable identification document[23] means:

(i) a nonexpired passport issued by the U.S.

(ii) a nonexpired identification document issued by a State, local government or Indian Tribe

(iii) a nonexpired driver's license

(iv) if an individual does not have any of the above-listed items, a non-expired passport issued by a foreign government

(e) Compliance requirement: Correcting inadvertent reporting errors

Identify Incorrectly Reported Information and Safe Harbor Applicability

Issue a Revised Report to FinCEN within 90 Days

EXHIBIT B
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[1] The CTA is not limited to “corporations” despite the name of the Act. The CTA expressly includes limited liability companies and “other similar entities.”
[2] William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, https://www.congress.gov/116/bills/hr6395/BILLS-116hr6395enr.pdf. Because the CTA has not yet been codified into the United States Code, citations to the Act will be to the sections of the CTA within the Public L. No. 116-283 as they will be codified (hereinafter “CTA § [future U.S.C. section no.]”).
[3] For a more detailed study of the CTA, the legislative history, and related Acts, see the Bibliography attached hereto as Exhibit B.
[4] CTA § 6402(5)(A) to (E). [5] CTA § 5336(a)(2). [6] CTA § 5336(a)(3). [7] CTA § 6402(7)(A). [8] CTA § 5336(a)(11). [9] Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114-2 (codified as amended in scattered sections of 12 U.S.C. and 15 U.S.C.)
[10] CTA, Section 2, Findings, #6. [11] The original GTOs for reporting by title insurance companies included (1) all boroughs of New York City; (2) Miami-Dade County and the two counties immediately north (Broward County and Palm Beach County); (3) Los Angeles County, California; (4) three counties comprising part of the San Francisco area (San Francisco County, San Mateo County, and Santa Clara County); (5) San Diego County, California; and (6) the county that includes San Antonio, Texas (Bexar County). See FinCEN Expands Reach of Real Estate “Geographic Targeting Orders” Beyond Manhattan and Miami, Financial Crimes Enforcement Network, United States Dept. of the Treasury (July 27, 2016) https://www.fincen.gov/news/news-releases/fincen-expands-reach-real-estate-geographic-targeting-orders-beyond-manhattan. North Carolina did not make the initial list in the original two GTOs, and has still avoided inclusion in a GTO.
[12] See CTA § 6401 et seq. [13] Beneficial Ownership Information Reporting Requirements Advance Notice of Proposed Rulemaking, 86 Fed. Reg. 17557 (Apr. 5, 2021) (to be codified at 31 C.F.R. pt. 1010).
[14] CTA § 5336(b)(5). [15] CTA § 5336(b)(1)(B). [16] CTA § 5336(b)(1)(C). [17] CTA § 5336(b)(1)(D). [18] CTA § 5336(h)(3)(C). [19] CTA § 5336(a)(11)(B). [20] This list is not exhaustive. [21] This list is not exhaustive. [22] CTA § 5336(h). [23] CTA § 5336(a)(1)