Practical Guidance

Disclose or Beware - What the Corporate Transparency Act Means for Investors and Lenders

A Practical Guidance® Article by Terri Adler, Brian Blitz, Beth Turtz, and Max Feder, Duval & Stachenfeld LLP

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The Corporate Transparency Act (the Act) became law on January 1, 2021, as part of the National Defense Authorization Act for Fiscal Year 2021. Under the Act, "reporting companies," which are corporations, limited liability companies, and similar entities (presumably including limited partnerships) formed in the U.S., or non-U.S. entities registered to do business in the U.S., will be required to report certain information about each beneficial owner, including their name, date of birth, current address, and a unique identifying number from an acceptable identification document, such as a driver's license or non-expired passport number. Reporting companies will be required to file the report with the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) upon registration or formation. Entities that already exist as of the effective date of the regulations will have a two-year grace period before reporting is required. The Act requires that the information reported to FinCEN be kept confidential and will not be made public, but can be requested by a financial institution in connection with their customer due diligence requirements (with the consent of the reporting company) and in connection with certain law enforcement activities.

While the United States Department of Treasury has one year to enact enabling regulations, given the Act's applicability to reporting companies that already exist, every participant in the real estate industry should start to consider how to incorporate the Act's requirements into their business. While we do not anticipate that the Act will impact most clients on a day-to-day basis, special attention should be paid to the documentation used for ongoing transactions involving third parties, such as joint ventures and debt transactions.

As a starting point, real estate investors at all levels of the capital stack should consider adding provisions into their equity documents – including joint venture and management agreements – requiring compliance by the partner with the Act or evidence that the partner is exempt. Funds that are not exempt from the reporting requirements (because, for example, their advisor is not a registered investment advisor) should also consider adding similar representations and covenants to their partnership, subscription, and management agreements. As the Act contains ongoing reporting obligations to account for changes in ownership, governance documents should incorporate continued compliance with the Act's requirements in a similar manner as is done for other anti-bribery, anti-corruption, and anti-terrorism reporting regulations.

Lenders, particularly mezzanine lenders who could step into the ownership of a reporting company if they foreclose on their collateral, should consider addressing the Act in their loan documents. For example, representations regarding compliance with the Act or exemption from its requirements should be added, as well as covenants requiring continued compliance and additional reporting requirements relating to any submissions required by the Act

In addition, the Act imposes criminal penalties on persons who willfully provide false or fraudulent beneficial ownership information or fail to report complete or updated beneficial ownership information to FinCEN. While the Act's reporting requirements fall on reporting companies, it is unknown whether regulators would seek to impose civil or criminal sanctions on a reporting company acquired by a mezzanine lender or other entity following the acquisition. To that end, mezzanine lenders and others should treat compliance with the Act in the same manner as compliance with other anti-money laundering and anti-terrorism laws.

Sellers of high-end residential real estate, which frequently attracts investors seeking the anonymity and protections of buying through a single purpose entity such as a limited liability company, may be concerned that the Corporate Transparency Act could dampen the market for their units. On initial review, the Act might appear to require additional disclosures from potential buyers; however, it should be noted that as part of a lender's "know your client" process, financial institutions already generally require disclosure of beneficial ownership information. Moreover, in certain areas of the country, including New York City, title companies are required to collect and report beneficial ownership information to FinCEN for all cash transactions in excess of $300,000.

We encourage companies to stay cognizant of these regulations, which may require adjustments to internal governance procedures.

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