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The Corporate Transparency Act: Practical Implications for Real Estate Investors

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On January 1, 2024, the final rule implementing reporting of beneficial ownership information[1] under the Corporate Transparency Act (the "CTA") will go into effect. "Reporting companies" (i.e., entities that are subject to the reporting requirements that are formed or registered to do business in the US and which do not fall under certain exemptions) will be required to report certain ownership and control information about the company to the Financial Crimes Enforcement Network ("FinCEN"). Failure to comply with the rule may result in civil and/or criminal penalties. For companies who have been conducting businesses in the United Kingdom or the European Union, ownership disclosures are not unusual. However, this is the first time the United States has implemented mandatory disclosure rules on private entities; so, for many, this is their first foray into the often confusing and overwhelming world of regulatory oversight.

The CTA and its rules are stated to target "small businesses" to thwart money laundering and other illegal activity (hence the exemption from the CTA of public companies and other institutions that are already subject to regulatory oversight). What the CTA does not contemplate is the often complex structuring that goes into how real estate companies and investors do deals and operate their businesses. As a result, a typical real estate operating company may be looking at hundreds of filings on both a look-back and look-forward basis (as most real estate ventures often have layers of ownership and operating entities). Not to mention the ongoing requirements of updating filings with FinCEN on changes in ownership and control. It's enough to make any general counsel's head spin!

To help navigate this new world, below is a high level overview of the CTA requirements as well as some practical suggestions on implementation, documentation, and other operational matters to facilitate compliance with the CTA.[2]

This document is being provided to facilitate consideration and implementation of the CTA's reporting requirements and is not intended to, and does not, provide legal, compliance or other advice to any person, and receipt of this document does not constitute the establishment of an attorney-client relationship. Counsel should be consulted as each legal entity and its ownership/control structure are unique and the scope of each filing (or ability to rely on exemptions) will be a case by case and often entity by entity analysis. In addition, while rules and guidance has been issued by FinCEN since the enactment of the CTA, there remain many unanswered questions on the interpretation of the statutory language. We hope that as the first filings are made, additional guidance will be issued and clarity

[1] 31 CFR §1010.380; Final Rule, Beneficial ownership Information Reporting Requirements, 87 Fed. Reg. 59498 (Sept. 30, 2022). https://www.govinfo.gov/content/pkg/FR-2022-09-30/pdf/2022-21020.pdf

[2] FinCEN guidance published to date is available via FinCEN's website: https://www.fincen.gov/boi/small-business-resources.

provided; until then, everyone is left to interpret the CTA and its related rules. The information below should be reviewed in concert with guidance that FinCEN may issue and advice from counsel.

I. Q&A Fundamentals.

Question*: *What is a "reporting company"?

If a company was formed by the filing of a document with a secretary of state or similar office under the laws of any State or Indian tribe,[3] then it could be a reporting company. If a company was formed in a foreign jurisdiction but has filed to register or qualify to do business with a secretary of state or similar office under the laws of any State or Indian tribe, then it could be a reporting company. A company that meets the foregoing criteria but otherwise qualifies for an exemption is not a reporting company.

Question*: *What are the exemptions to being classified as a reporting company?

The CTA created twenty-three categories of entities that are not required to report their beneficial ownership information.[4] Unfortunately, while some categories of exemption are clear (e.g., a public company is exempt), others are more opaque (e.g., it is unclear if a joint venture that has multiple ownership parties but is indirectly controlled by a public company is exempt).

Putting aside banks, credits unions, insurance companies, public utilities, and other categories of exemption that a real estate company likely does not fall under, certain exemptions from the definition of reporting company are particularly relevant for real estate investors. Those include:

- *Securities Reporting Issuers.* Any issuer of securities registered under Section 12 or required to file information under Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act").
- *Broker Dealers*. Any broker or dealer, as defined in the Exchange Act.

[3] States means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, and any other commonwealth, territory, or possession of the United States. Indian tribes means any Indian or Alaska Native tribe, band, nation, pueblo, village or community that the Secretary of the Interior acknowledges to exist as an Indian tribe. (See §102 of the Federally Recognized Indian Tribe List Act of 1994)

[4] 31 C.F.R. § 1010.380(c)(2)(i-xxiii). See also https://www.fincen.gov/boi-faqs#C_2 and related guidance referenced therein.

- *Investment Company or Investment Advisers*. Any investment company registered with the SEC under the Investment Company Act of 1940 (the "Investment Company Act") or the Investment Advisers Act of 1940 (the "Advisers Act").
- *Venture Capital Fund Adviser*. Investment Advisers that are exempt from registration with the SEC under section 203(l) of the Advisers Act because they act as an investment adviser solely to one or more venture capital funds.
- *Pooled Investment Vehicle*. Any pooled investment vehicle[5] that is operated or advised by certain exempt entities, including banks, credit unions, broker dealers, registered investment companies or registered investment advisors, or venture capital fund advisors (note that foreign pooled investment vehicles are subject to limited reporting requirements).
- *Large Operating Company*. Any entity that (i) has more than 20 full-time employees in the United States, (ii) has an operating presence at a physical office within the US, *and* (iii) filed a tax return in the US for the previous year demonstrating more than $5 million in gross receipts or sales. Note that this exemption does not permit consolidation of the employee count across multiple entities.[6]
- *Subsidiaries of Certain Exempt Entities*. Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by, among others: securities reporting issuers, banks, credit unions, broker dealers, investment companies, or investment advisors, venture capital fund advisers, insurance companies, or large operating companies. Note that subsidiaries of pooled investment vehicles are not, by themselves, exempt from reporting and to be exempt would have to otherwise qualify under an exemption.

An analysis would need to be undertaken to determine if an entity falls under any of the exemptions above (or any other exemption). For example, an entity formed, wholly-owned and controlled by a registered investment advisor or public company would be exempt. However, a joint venture controlled by a wholly-owned subsidiary of a registered investment advisor or public company but that has a 30% third party owner (or a third party managing member that controls day-to-day matters and whose consent is required for decisions) would likely not be exempt.

[5] The CTA defines "pooled investment vehicle" as (i) any investment company, as defined in Section 3(a) of the Investment Company Act, or (ii) any company that (A) would be an investment company under that section but for the exclusion provided from that definition by paragraph (1) or (7) of section 3(c) of the Investment Company Act, and (B) is identified by its legal name by the applicable investment adviser in its Form ADV filed with the SEC or will be so identified in the next annual updating amendment to Form ADV required to be filed by the applicable investment adviser pursuant to rule 204-1 under the Advisers Act. (31 C.F.R. § 1010.380(f)(7)(i-ii))

[6] Beneficial Ownership Information Reporting Frequently Asked Questions ("BOI FAQs"), L.4. https://www.fincen.gov/boi-faqs (through November 16, 2023)

Question: Ok, I know for which entities I have to file, when do the filings for a reporting company have to happen?

For reporting companies formed on or after January 1, 2024 and before January 1, 2025, initial beneficial ownership information reports are required to be filed within 90 calendar days of receiving notice that the formation or registration has become effective.[7] For reporting companies formed on or after January 1, 2025, initial beneficial ownership information reports are required to be filed within 30 calendar days of receiving such notice. Reporting companies formed prior to January 1, 2024 will have until January 1, 2025 to file their initial beneficial ownership information reports. So, yes, every entity in your real estate portfolio and operating business may be subject to a beneficial ownership filing requirement with FinCEN unless that entity fits within an exemption.

Question: What information has to be provided for a reporting company?

The beneficial ownership information reports filed by each reporting company are required to include information on any individual who, directly or indirectly, either (x) exercises substantial control over a reporting company, or (y) owns or controls at least 25% of the ownership interests of the reporting company.

For many entities, an analysis of substantial control will include a detailed examination of the major decision rights or rights to appoint members to a board or investment committee, and an analysis of ownership will require consideration of equity or stock rights, profit interests and convertible instruments.

Question: How do you determine is someone exercises substantial control over a reporting company?

Unfortunately, substantial control is an expansive term that in some instances is straight forward (i.e., C-suite executives) and in others is interpretative (i.e., someone who has substantial influence over important decisions). Accordingly, for many companies and organizations, analysis will be needed to determine who qualifies as exercising substantial control of a reporting company (e.g., a family office with a single person who makes all decisions is an easier answer than a multi-layered organization with multiple investment strategies with different chief investment officers or portfolio managers who may be exercising control over their strategies).

[7] 31 CFR §1010.380(a)(1)(i).

The final rule issued under the CTA lists the following as individuals who exercise substantial control[8]:

- Senior officers (defined in the final rule and includes any individual holding the position (or exercising the authority of) a president, chief financial officer, general counsel, chief executive officer, chief operating officer or any other officer, regardless of official title, who performs a similar function (but excluding individuals who serve only as a corporate secretary or treasurer[9]));
- Individuals who have authority over the appointment or removal of any senior officer or a majority of the board of directors or similar body;
- Individuals who direct, determine, or have substantial influence over important decisions made by the reporting company, including those regarding:
    - nature, scope and attributes of the business, including the sale, lease or transfer of its principal assets;
    - reorganization, dissolution, or merger;
    - major expenditures or investments, equity issuances, incurrence of significant debt, or approval of the operating budget;
    - selection or termination of business lines or geographic focus;
    - compensation schemes and incentive programs for senior officers;
    - entry into or termination of significant contracts;
    - amendments of any substantial governance documents (e.g., articles of incorporation, bylaws, and significant policies or procedures).
- Individuals who have any other form of substantial control.

To make the analysis even more nuanced, an individual may directly or indirectly exercise substantial control over a reporting company through (i) board representation, (ii) ownership or control of a majority of the voting power or voting rights of the reporting company, (iii) rights associated with any financing arrangement, (iv) control over one or more intermediary entities that separately or collectively exercise substantial control, (v) arrangement or financial business relationships with other individuals or entities acting as nominees, or (vi) any other contract, arrangement, understanding, relationship or otherwise. For example, if an individual board director's consent is required for certain actions, or an individual director can control certain decisions (through weighted voting, supermajority requirements, special committee

[8] 31 C.F.R. § 1010.380(d)(1).
[9] 31 CFR 1010.380(f)(8); 87 Fed. Reg. at 59526

memberships, etc.), or an individual director has to consent to appointment or removal of senior officers, that individual could (or would) be deemed to exercise substantial control.

So, determining whether an individual has substantial control will be an entity by entity analysis and may be a director by director/officer by officer analysis. This will also require looking through entities that exercise substantial control up to the applicable individual(s) that is/are indirectly exercising substantial control.

Question: Great, substantial control is about the officers/directors and owners only. I don't need to worry about my outside manager, right?

As with everything else, this becomes a case-by-case review. An unaffiliated company that provides a service to the reporting company by managing its day-to-day operations, but does not make decisions on important matters, is not considered to be a beneficial owner of the reporting company as the beneficial owner must be an individual. However, according to the guidance provided by FinCEN, individuals that exercise substantial control over the reporting company through the unaffiliated company must be reported as beneficial owners of the reporting company.[10]

Question: Well, at least 25% or more ownership should be easy to figure out, right?

Determining an individual's 25% direct or indirect ownership interest is a similarly broad exercise that may require an in-depth understanding of "up-the-chain" entity ownership. In addition to ordinary equity, the CTA specifically includes[11] convertible instruments (regardless of whether characterized as debt), warrants, puts, calls, straddles or other options, or any other instrument used to establish ownership. Ownership interests are calculated as of the present time, and options or similar interests are treated as exercised. Capital or profits interests are also included in this calculation.

It is worth noting that FinCEN exempts the following individuals from the definition of "beneficial owner": (i) a minor child, (ii) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual (the actual beneficial owner must still be reported), (iii) an individual acting solely as an employee of a reporting company

[10] See https://www.fincen.gov/boi-faqs#D_8
[11] 31 C.F.R. § 1010.380(d)(2).

(*excluding* senior officers), (iv) an individual whose only interest in a reporting company is a future interest through a right of inheritance, and (v) creditors of a reporting company.

Question: So, under the CTA and its rules, I have to disclose information for every individual that directly or indirectly substantially controls or owns more than 25% of each reporting company. Does that mean I have to obtain all of this information from every partner in the deal that meets those qualifications? Or can I just report the entity and then my partner is responsible for its own filing?

For each reporting company, if an entity substantially controls or owns 25% or more of a reporting company, then the beneficial ownership information that has to be provided to FinCEN is the individual(s) that hold(s) the indirect ownership or control (unless the entity itself is exempt and then that exemption information is to be provided). So, in many instances, you cannot merely report on the member/partner entity itself and instead must trace to the ultimate individual(s) that hold the beneficial ownership/control interest.

However, the final rule issued by FinCEN permits reporting companies to submit another entity's FinCEN identifier and full legal name in lieu of providing an individual's beneficial ownership interest information, if the following conditions are met: (a) the other entity has a FinCEN identifier and has provided it to the reporting company, (b) an individual is or may be a beneficial owner of the reporting company through an interest in the reporting company held through an *ownership interest* in the other entity, and (c) the beneficial owners of the other entity and the reporting company are the same. So, there is a way to streamline reporting if this limited set of facts is applicable by providing a FinCEN number of the applicable entity. In this instance, if there is a change in the beneficial owners of the reporting company or the other entity whose FinCEN identifier was used, the reporting company will have to file an update with FinCEN and can no longer use the other entity's FinCEN identifier.

Question: I'm the person who signs the documents submitted to the secretary of state to form an entity. What disclosure is required to be made about me?

Reporting companies formed on or after January 1, 2024 will need to include information about the "Company Applicant" – meaning the individuals involved in forming or registering the entity.[12] This individual is defined as the person who directly files or is primarily responsible for the filing of the document that creates or registers the company. So, there could be two Company

[12] 31 C.F.R. § 1010.380(b)(1)(ii), and (b)(2)(iv).

Applicants – the party who directs the filing and the party who actually makes the filing. In the example provided in the FAQs by FinCEN, the attorney who directs the filing of a certificate of formation and the paralegal who makes the filing are both deemed Company Applicants.

Question: Once I make my filing do I need to provide any updates?

Unfortunately, if there is any change in the reporting company or its beneficial owners, an updated beneficial ownership interest report is required to be filed *within thirty (30) days* after a change occurs. This includes changes in name, changes to senior officers, changes in beneficial ownership, or any change to a beneficial owners name, address or identifying number (e.g., a new passport is obtained by an individual and the identifying number has changed).

In addition, if a reporting company becomes exempt, a new beneficial ownership interest should be filed checking the applicable box of the newly exempt status.

II. Preparation for Compliance

The above Q&A section only scratches the surface of the various subtleties and nuances of compliance with the CTA and FinCEN rules. Since the passage of the CTA in 2020, there has been a significant amount of ink spilled on how to interpret and prepare for the CTA. Our advice can be distilled into some commonsense procedures that companies should implement.

- To the extent this does not exist in your organization, create a database of all entities in your corporate structure. If possible, include in this database links to structure charts (which makes this process easier).

- Analyze each entity and determine whether an exemption applies.

- To the extent any entity in the corporate structure is not wholly owned, identify third parties who may meet the beneficial ownership interest tests under the CTA and FinCEN rules.

- Update your entity database to include, for each entity, whether it is exempt (and the category under which it is exempt) or is a reporting company, and the relevant data required to be reported to FinCEN if it is a reporting company. For each new entity formed, update your entity database to include all necessary information.

- On a go-forward basis, your joint venture documents should contemplate and require compliance with the CTA including:

    - a requirement for each applicable member/partner/owner/manager to either provide a basis for exemption or all necessary information on all individuals holding direct or indirect substantial control and/or 25% or greater ownership interests in their entity;
    - a requirement for each applicable member/partner/owner/manager to provide updates on any changes to the information provided (noting that filing of an amendment under the CTA must occur within 30 days of any change so notice of any changes by a partner must be received in a timely manner to permit compliance with the 30-day notice requirement);
    - representations by each applicable member/partner/owner/manager as to the accuracy of the information provided for compliance with the CTA and its rules;
    - penalties if a member/partner/owner/manager fails to provide the necessary information (or provides incorrect information) including indemnities and offset rights for breaches of these obligations[13]; and
    - the authorization to file and disclose the information provided in order to comply with the CTA and related rules (and any future state or local disclosures comparable to the CTA).

- To facilitate the gathering of necessary information on beneficial ownership interests from the applicable entities and individuals, prepare and obtain a subscription like information form from each applicable entity and individual that is not within your organization. For individuals, the information provided must include full legal name, date of birth, and current residential street address, together with an image of, and identifying number and issuing jurisdiction, from an unexpired passport, driver's license or state/local government/tribe identification (or if an individual has none of the foregoing, a foreign passport). For entities, this would include a full structure chart, disclosure of ownership and control constructs, list of officers/directors, as well as full entity name, business address, taxpayer identification number, and other requisite information.

[13] While the entity is ultimately responsible for filing the beneficial ownership information report and providing updates as needed, the willful failure to report complete or updated ownership information to FinCEN may result in civil or criminal penalties, including civil penalties of up to $500 for each day that the violation continues, or criminal penalties including imprisonment for up to two years and/or a fine of up to $10,000. Senior officers of an entity that fails to file a required beneficial ownership information report may be held accountable for that failure. Additionally, a person may be subject to civil and/or criminal penalties for willfully causing a company not to file a required beneficial ownership information report or to report incomplete or false beneficial ownership information to FinCEN. This includes beneficial owners.

- Consolidate and streamline entity formation practices so that the same individuals can be listed as Company Applicants on each beneficial ownership report.

- For entities already in existence, review your operative agreements to confirm if there are any obstacles to obtaining the necessary information to comply with the CTA (e.g., strict confidentiality provisions that do not have an exception for compliance with law; a potentially non-cooperative partner who has no obligation to disclose the necessary information).

- For both existing entities and new entities, extra attention should be paid to provisions in connection with shifting percentages of distributions, promotes, buy-sells, ROFOs, ROFRs, tag-alongs, drag-alongs, and partner loans, as these provisions may implicate substantial control or ownership of an entity and can trigger a reporting requirement for beneficial owners that may not be readily apparent or that can be triggered during the course of a transaction, requiring updated filings with FinCEN.

III. Conclusion

Compliance with the beneficial ownership information reporting rules is a complex and detail-oriented process. As FinCEN continues to issue guidance, companies should continue to monitor the requirements and guidance issued in determining whether they are required to report. In addition, operating agreements of new entities should contain provisions addressing compliance with the CTA as well as the risks of non-compliance.

If you have any questions regarding the Corporate Transparency Act, please contact:

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