



CORPORATE TRANSPARENCY ACT 101: TIPS FOR BUSINESS AND RESTRUCTURING FIDUCIARIES

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On January 1, 2024, the Corporate Transparency Act (the “CTA”) went into effect. The CTA will likely result in the filing of millions of reports disclosing beneficial ownership information with the United States Department of Treasury’s Financial Crimes Enforcement Network (FinCEN).

Congress enacted the CTA as part of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021. The stated goals of the CTA are to investigate and otherwise deter illicit activity, including money laundering, terrorist financing, fraud, corruption and tax fraud schemes, of which in the past, individual owners’ identities have been obfuscated by complex corporate structures. The CTA will allow the federal government to gain a greater understanding about the individuals that own, operate, and otherwise control certain entities operating or qualified to do business in the United States.

The CTA impacts professionals in the business community generally, and more specifically the bankruptcy and restructuring community. This article provides bankruptcy and restructuring professionals with certain “need to know” information, as well as practical tips for navigating CTA filings.

Before proceeding to file a CTA report with FinCEN, company management (and potentially bankruptcy trustees, receivers and recently retained chief restructuring officers (CRO)) should be able to answer the following questions about the relevant entity:

- Which entities are required to file beneficial ownership reports?
- When must the initial report be filed with FinCEN?
- Who are the Beneficial Owners (as is hereinafter defined)?
- What information is required to be reported by a Reporting Company (as is hereinafter defined) on behalf of each Beneficial Owner?
- Who is considered a Company Applicant (as is hereinafter defined) and is it required that their information be disclosed in every filing?

- What are the consequences if reports are not timely filed or not filed at all?

Answering these questions will require a level of familiarity with the organization and potentially additional due diligence to understand who owns or controls the company that is required to report. In a restructuring or bankruptcy context, these answers may be especially difficult to obtain due to internal barriers, resistance, or a failure to maintain accurate or complete books and records. Note that the analysis under the CTA requires peeling back the corporate onion layers to reveal the individuals (humans) that own or control the organization; if there are multiple entities or trusts layered within a certain organization, the report filed with FinCEN should identify only those individuals that qualify as beneficial owners.

Reporting Companies and Filing Exemptions

To begin, a “Reporting Company” is defined as (a) any domestic entity that was created by the filing of a document or instrument with a Secretary of State or similar office, or (b) a foreign entity if a similar document or instrument was filed with a Secretary of State or other similar office to register to do business in the United States and unless otherwise exempt by one of the twenty-three (23) specific exemptions set forth in the CTA, that entity is required to file a CTA report with FinCEN.

Examples of exemptions include but are not limited to: large-operating companies; tax-exempt entities; subsidiaries of exempt entities; and companies otherwise subject to government reporting and oversight (such as banks, insurance companies, and certain investment vehicles), among others.

Bankruptcy and restructuring professionals are best served by carefully examining the exemptions available and ensuring strict compliance if they will be relied upon for declining to participate in this reporting process.

Beneficial Ownership

This area may be of the most importance to court appointed trustees (chapter 7 or chapter 11) and estate-retained (pre- or post-confirmation) officers. “Beneficial Owners” are defined as those individuals who have “Substantial Control” over a Reporting Company or own at least twenty-five percent (25%) of the ownership interest in a Reporting Company, whether directly or indirectly. “Substantial Control” is a fact-specific analysis and varies depending on the company structure. Examples of substantial control include, but are not limited to:

- Individuals within the organization who direct or otherwise influence “important decisions” whether because of their role, by agreement, a special arrangement or otherwise;
- Senior officers or C-suite executives serving the Reporting Company (e.g., general counsel, chief financial officer); and
- Those individuals with authority over the appointment or removal of any senior officer of a Reporting Company or a majority of the board of directors (or similar body) of a Reporting Company.

“Substantial Control” may include a Chief Restructuring Officer

(CRO) retained by a company pre- or post-petition in a chapter 11 case, pre-petition court-appointed receivers, post-petition chapter 7 or chapter 11 trustees, and other estate fiduciaries given the ability to oversee, administer, collect, or otherwise dispose of or control all or substantially all of the estate's assets; provided, however, that each have broad powers and an ability to make key decisions on behalf of the Reporting Company. Certain exemptions may apply.

It is the responsibility of the Reporting Company's management to see that CTA reports are timely filed.

As of the date of this article, in one case, *In re YLG Partners*,¹ the applicability of the CTA to panel trustees has been challenged. The U.S. Department of Treasury's request for an extension of time to respond was granted, and interested parties anxiously await a decision from the bankruptcy court. It seems likely that we will see similar challenges in bankruptcy cases throughout the country.

Timeline for Filing CTA Reports with FinCEN (and Company Applicants)

Reporting Companies formed on or after January 1, 2024, have ninety (90) days from the date of formation or organization to file their initial report with FinCEN, which must include:

(i) entity-specific information about the Reporting Company, including: (a) the name of company; (b) the business address of the company; (c) EIN/TIN; (d) country of organization/formation; and (e) the state of formation/organization or if foreign, state of qualification to conduct business;

(ii) personal information for each Beneficial Owner, including: (a) full legal name; (b) current residential address; (c) date of birth; (d) unexpired identification number, which may include either a valid U.S. driver's license or passport. Each Beneficial Owner must also submit a photo of their form of identification. A Company may have an unlimited number of Beneficial Owners; and

(iii) personal information about the person or persons who filed or directed the filing of the documents that created the domestic company or registered foreign company to conduct business in the United States (a "Company Applicant"), including: (a) full legal name; (b) current business address; (c) date of birth; (d) unexpired identification number, which may include either a valid U.S. driver's license or passport. Each Company Applicant must also submit a photo of their chosen form of identification. A company may have up to two (2) Company Applicants. Following the filing of the initial report, FinCEN does not require that updates be made to then accurate Company Applicant information.

Reporting Companies formed before January 1, 2024 have until January 1, 2025 to file their initial report and are exempt from providing the information set forth in (iii) above regarding Company Applicants. Updated reports must be timely filed with

FinCEN within thirty (30) days of the change in circumstance that triggered the updated reporting requirement. Notable changes include, but are not limited to, changes in control or ownership, change in address and/or expiration of a license or other identifying document.

By way of example, it seems that the appointment or retention of a CRO to a company that qualifies as a Reporting Company would constitute a change in the Beneficial Owners requiring an updated filing with FinCEN. This prediction assumes that the CRO exercises substantial control over the Reporting Company from the date of his or her appointment and, therefore, qualifies as a Beneficial Owner. This analysis should apply to other Reporting Company fiduciaries, arguably whether they are in bankruptcy or not.

Another example which would likely require an updated reporting requirement is a creditor whose claim is evidenced by a document permitting an exchange of equity for debt, if the debt of that creditor is later converted to equity in the Reporting Company and the equity is in excess of the (25%) or more threshold.

Penalties for Failure to File

The CTA imposes civil and criminal penalties on those entities and their principals who do not comply. Companies that file incomplete or incorrect information may be subject to daily fines of \$591.00 per day. In the case of a willful failure to file, provide complete or updated information, or fraudulent conveyance of false information, Reporting Companies may be subject to a penalty of up to \$10,000.00 per infraction and two-year imprisonment.

It is not yet known whether penalties for failure to comply with the CTA will be treated as priority claims under 11 U.S.C. § 507(a) (8), or mere general unsecured claims.

Recent Challenges to the CTA

As noted above, in at least one known bankruptcy case, a chapter 7 trustee challenged the applicability of the CTA to panel trustees.² In *YLG Partners*, the trustee filed a motion to determine that the CTA does not apply to bankruptcy trustees. In February 2024, the Bankruptcy Court entered an order *sua sponte* directing the United States Department of Treasury to file a response within fourteen (14) days. The Department of Treasury moved for an extension of time to respond, and the deadline was extended through May 10, 2024.

The CTA faced an additional challenge in Alabama by way of a lawsuit alleging that the enactment of the law exceeded the Constitutional limits on Congress' power.³ Judge Liles C. Burke of the U.S. District Court for the Northern District of Alabama ruled in *National Small Business United v. Yellen* on March 1, 2024, that the CTA is unconstitutional. Application of Judge Burke's ruling is believed to apply only to the plaintiffs in the case, and not at large to all potential Reporting Companies nationwide.

Additional challenges should be expected and watched carefully.

¹ See *In re YLG Partners, Inc.*, 23-10709 (BAK) (U.S.B.C. M.D.N.C., Greensboro Div.) (chapter 7 trustee filed motion to determine that chapter 7 trustee has no duty to report debtor's beneficial ownership information to the U.S. Department of the Treasury).

² See *In re YLG Partners, Inc.*, 23-10709 (BAK) (U.S.B.C. M.D.N.C., Greensboro Div.).

³ *National Small Business United et al v. Yellen et al*, No. 5:2022-cv-01448.

Conclusion

Each Reporting Company's situation will prove unique and will require a fact-specific analysis to determine when reports must be filed (if ever), what information should be included (if any), whether any updates should be made to FinCEN, and which individuals are responsible for the foregoing. Understanding the impact of the CTA and ensuring compliance is a potentially added responsibility for CROs, trustees, and company leadership of financially distressed entities during the course of a bankruptcy case and after—making timely filings (and updates) even more crucial. Practitioners should continue to familiarize themselves with the CTA requirements and any changes in the compliance landscape.

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