

The Corporate Transparency Act and Nonprofit Corporations

By Kelsey M. Doran

The Corporate Transparency Act of 2019 (the “CTA”), which took effect on January 1, 2024, requires many companies to report certain beneficial ownership information to the Financial Crimes Enforcement Network (“FinCEN”), a division of the U.S. Department of the Treasury. These requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while aiming to minimize the burden on entities doing business in the United States. What may be surprising to some is that the CTA reporting requirements apply to nonprofit corporations in certain circumstances, even though they do not have actual owners.

Background

The CTA applies to all domestic entities that are formed by filing a document with a state, and all foreign entities registered to do business in the U.S. by such a filing. This includes corporations, limited liability companies, limited partnerships, limited liability partnerships, and business trusts. The CTA does not automatically distinguish between for-profit and nonprofit entities, so nonprofits that constitute “reporting companies” under the CTA will be required to report just like other small businesses.

Assuming an exemption does not apply, companies formed during calendar year 2024 have 90 days from the date of formation to file their reports with FinCEN, and companies formed on or after January 1, 2025, have 30 days. Companies formed before January 1, 2024, have until January 1, 2025, to file their initial reports. The reporting requirement is a one-time obligation, not an annual filing, but all companies are under a continuing obligation to update their reports within 30 days of any change in information or beneficial ownership (but not with respect to information of company applicants).

Exemptions

The CTA includes 23 specific exemptions from the reporting requirements. Exemptions are generally targeted towards entities that are already subject to substantial regula-

tion and provide beneficial ownership information to government authorities. Other common exemptions include “large operating companies” with more than 20 full-time employees in the United States, more than \$5 million in gross receipts or sales (based on the federal income tax or information return for the previous year), and an operating presence at a physical office within the U.S., as well as companies that are wholly owned or controlled (directly or indirectly) by certain CTA-exempt entities.

The CTA also includes a specific exemption for “tax-exempt entities,” which includes all of the following:

1. Entities described in section 501(c) of the Internal Revenue Code of 1986 (the “Code”) (determined without regard to IRC 508(a) and exempt from tax under IRC 501(a));
2. Entities described in IRC 501(c) which were exempt from tax under IRC 501(a), but lost their tax-exempt status less than 180 days ago;
3. Political organizations, as defined in IRC 527(e)(1), that are exempt from tax under IRC 527(a), including a party, committee, association, fund or other organization organized and operated primarily for the purpose of accepting contributions or making expenditures for the purpose of influencing or attempting to influence the selection, nomination, election or appointment of any individual to public office; and
4. Charitable or split-interest trusts, as described in paragraph (1) or (2) of IRC 4947(a).

Additionally, entities that operate exclusively to provide financial assistance to, or hold governance rights over, any tax-exempt entity (as defined above) are also exempted from the CTA’s reporting requirements. To qualify, the entity must:

1. Be a United States person as defined in IRC 7701(a)(30);
2. Be beneficially owned or controlled exclusively by one or more United

States persons; and

3. Derive at least a majority of its funding or revenue from one or more United States persons.

Nonprofit entities are not limited to the tax-exempt entity exemption, and may qualify under one of many other CTA exemptions. For example, a nonprofit entity may qualify under the tax-exempt entity exemption in its own right, and also as a wholly owned subsidiary of another CTA-exempt entity, such as a large operating company or another tax-exempt entity. The reverse may also be true within a group of related companies; e.g., a for-profit corporation may be exempt if it is wholly owned or controlled by a qualifying tax-exempt entity. While wholly owned subsidiaries of tax-exempt entities are exempt under the CTA, subsidiaries of entities that operate to assist tax-exempt entities do not qualify for the wholly owned subsidiary exemption.

Tax-Exempt Status and the CTA

If an entity meets the required criteria for a CTA exemption at the time its report is due, it does not need to apply to or otherwise notify FinCEN for the exemption to be effective. Thus, most nonprofit entities formed prior to January 1, 2024, that meet the required criteria will not need to take any action or file a report under the CTA.

The 90-day deadline for newly formed entities, however, creates a unique situation for new nonprofit entities, which are typically not able to obtain their tax-exempt status from the IRS within the 90-day window. The CTA's filing requirements also do not account for the fact that once secured, an entity's tax-exempt status is considered retroactive to its date of formation. The CTA's regulations note that FinCEN received comments both supportive and critical of this approach, with some commenters arguing, for example, that the exemption should cover entities from the date of their application to the IRS for tax-exempt status throughout the waiting period for a determination. Despite its acknowledgement of these comments, FinCEN has not, as of the time of this writing, directly addressed this question.

The wording of the tax-exempt entity exemption, however, may indicate that the exemption should in fact apply from the date of formation. As noted above, the exemption covers entities described in section 501(c) of the Code, determined without regard to

section 508(a), and that are exempt from tax under section 501(a). Section 501(a) exempts from federal income tax certain organizations described in section 501(c), including organizations formed for religious, charitable, civic and educational purposes. Notably, neither section 501(a) nor section 501(c) includes a requirement that the organization apply to the IRS for tax-exempt status. That requirement is found in section 508(a), which requires new 501(c)(3) organizations to notify the IRS that they are seeking a formal determination of such tax-exempt status. The CTA, however, expressly disregards section 508(a) for purposes of determining whether the tax-exempt entity exemption applies, suggesting that the IRS determination is not what triggers applicability of the exemption.

Additionally, some types of 501(c) organizations, including those described in section 501(c)(4), (5) and (6) as well as schools and "churches," are typically not required to seek a formal IRS determination and can instead self-declare their exempt status. This creates a similar open question as to whether and when these entities qualify for the CTA tax-exempt entity exemption.

To date, FinCEN has not provided additional guidance on these ambiguities, beyond acknowledging comments submitted in connection with its Notice of Proposed Rulemaking for the CTA. FinCEN's current position is that it ultimately lacks enough information to expand the tax-exempt entity exemption beyond its current scope. Given the ambiguity and the penalties for non-compliance, newly incorporated nonprofits may want to consider filing their initial CTA reports within 90 days of formation, as would a for-profit corporation. Once the new nonprofit entity obtains its tax-exempt status, it can then file an updated report claiming the tax-exempt exemption. The CTA requires reporting companies to file an amended or updated report within 30 days of any change in reported information. Thus, an updated report claiming the tax-exempt entity exemption should be filed within 30 days of the nonprofit corporation obtaining its IRS Determination letter of tax exempt status.

Loss of Tax-Exempt Status

Once an exemption applies, an entity is relieved of its filing obligations under the CTA unless and until it loses eligibility for the previously applicable exemption. This could occur as a result of an IRS revocation

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following an audit or through an automatic revocation due to failure to file the required annual information returns or notices (e.g., Form 990) for three consecutive years. If a nonprofit's tax-exempt status is revoked, it must reapply for tax-exempt status and will not be exempt from federal income tax until such status is reinstated.

Although, as discussed above, most changes in information must be reported to FinCEN within 30 days, the CTA's tax-exempt entity exemption establishes a grace period for entities which were exempt from tax but lost their tax-exempt status less than 180 days ago. In other words, if the entity's tax-exempt status is reinstated within 180 days, it does not need to report the change to FinCEN. Given that delays between revocation and reinstatement are common, entities may not be able to reinstate their tax-exempt status within the 180-day period and should be prepared to file a CTA report with FinCEN upon the expiration of that period.

Reporting Requirements for Entities Not Exempt Under the CTA

If an exemption does not apply, or if a previously exempt company needs to file a CTA report, the entity should be prepared to report certain beneficial ownership information to FinCEN about the company itself, all "beneficial owners" of the company and, for companies formed on or after January 1, 2024, each "company applicant."

Identifying Beneficial Owners and Company Applicants

Beneficial owners include all individuals who (1) own or control 25% or more of the ownership interests of the reporting company; and/or (2) exercise "substantial control" over the entity. The term "company applicant" includes all individuals who file a document creating a reporting company or who are responsible for directing or controlling the filing of such a document by another person. "Substantial control" for purposes of the CTA includes service as a senior officer or director; substantial influence or decision-making authority over the reporting company's business; ownership or control of a majority of voting power; control over intermediary entities that exercise substantial control over the reporting company; and any other contract, arrangement, understanding, relationship or otherwise.

The CTA's final rules, as well as other guidance materials published by FinCEN, give additional details and examples for identifying a company's beneficial owners based on ownership interests and substantial control. At a minimum, however, each reporting company must report at least one beneficial owner under the "substantial control" component, even if all other individuals are subject to an exception. If a beneficial owner is an entity, its individual beneficial owners' information must in turn be reported. In other words, the reporting company's beneficial ownership (whether by way of equity ownership or via substantial control) must be traced up the chain until at least one natural person is identified as a beneficial owner; *provided, however*, that this does not apply to CTA-exempt entities. A reporting company may list an entity as a beneficial owner if that entity owner is itself exempt from the CTA.

Contents of Reports

The reporting company itself must provide its full legal name, any assumed or trade names, address of its principal place of business in the U.S., jurisdiction of formation, and its TIN or EIN. Each company applicant and beneficial owner must report his or her full legal name, date of birth, current address, and an image of and unique identifying number from an acceptable identification document (typically a U.S. driver's license, state ID, or passport). Entities formed prior to January 1, 2024, are not required to report company applicant information.

Alternatively, beneficial owners and company applicants can submit the required information to FinCEN to obtain a unique number called a FinCEN identifier, which can be used for reporting purposes rather than submitting their information to the reporting company.

A reporting company may file its Beneficial Ownership Information Report online on FinCEN's BOI E-Filing System.

Penalties for Noncompliance

Willful failure to comply with the Act's reporting requirements, or to provide complete and accurate information regarding beneficial ownership, carries potential civil and criminal penalties, including civil penalties of up to \$500 per day that the violation continues, or up to \$10,000 in criminal penalties and/or imprisonment for up to two years. Potential violations may include willfully filing or providing inaccurate or false

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information to FinCEN, willfully failing to update information as required, or willfully causing a reporting company's failure to submit complete or updated information to FinCEN. Both individuals and entities may be held liable for willful noncompliance, including the reporting company itself, as well as its senior officers, beneficial owners, company applicants, or any person who willfully files a false or fraudulent CTA report on the company's behalf.

Conclusion

The CTA is being challenged on many different fronts, in many different courts, and has even been struck down in certain jurisdictions. However, at least for the time being, it remains a requirement that practitioners need to keep in mind even for their tax-exempt clients.



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