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The Corporate Transparency Act and its Potential Impact on Kentucky Businesses

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On January 1, 2024, the Corporate Transparency Act (CTA) will go into effect, which has a potential impact on many of Kentucky's small businesses. This new law requires nearly all business entities to report their beneficial owners to the federal government. While this legislation has the potential to affect many of Kentucky's small businesses, many have never heard of this legislation, much less the potential financial implications of non-compliance, or the time allowances given for compliance. According to The Federal Register (87 FR 59498), this law will impact approximately 32.6 million domestic entities as of January 2024, with an additional 5 million companies that come into existence in years 2-10. In this article, we do not intend to provide a full detailed accounting of the specifics of the CTA or even if your business is required to report under it, much less the mechanisms involved with being compliant with reporting. Instead, we hope to increase awareness of the potentiality of CTA compliance for Kentucky businesses and encourage those individual business owners who are required to report under the CTA to seek qualified counsel from their respective professional advisors.

Nestled into the National Defense Authorization Act (enacted after the Congressional override of a Presidential veto), the Corporate Transparency Act became law on the first day of January 2021 with an effective date of January 1, 2024. The CTA was created to help provide law enforcement with more information about beneficial owners of companies in the United States that may be potentially useful in their efforts to combat money laundering, tax fraud, and terrorism among other illicit activities. Within the CTA, entities that are required to report under the act are called reporting companies. Reporting companies can be domestic or foreign. In general, domestic reporting companies are corporations, limited liability partnerships, LLCs, or any other business entity structure that is formed by filing with the secretary of state or other state/Indian tribe laws. Foreign reporting companies are defined similarly but with some differences.

Currently, there are 23 exemptions to the CTA. In general, there are already highly regulated companies (i.e. banks). However, there are employee and gross receipt bright-line tests that also may qualify a company not to report under this act. Specifically, an operating company that has annual gross receipts exceeding \$5mil, has 20 or more full-time employees and has previously filed a U.S. tax return, with a physical presence in the U.S. may be exempt from reporting.

The CTA defines a beneficial owner as any individual who directly or indirectly owns/controls at least 25% of ownership interests of the company OR exercises substantial control over the reporting company regardless of the ownership percentage. If you have a company that is defined by the CTA

as a reporting company any individuals who meet the beneficial owner test must report to the Financial Crimes Enforcement Network (FinCEN) under the United States Department of the Treasury.

There are 2 main initial reporting timeframes that companies need to be aware of:

1. All entities formed before January 1, 2024, must file their initial reports with FinCEN before January 1, 2025.
2. All entities that are formed after January 1, 2024, must file their initial report with FinCEN within 30 days after receiving notification that the company has been formed. In other words, if you form an entity in Kentucky after January 1, 2024, you have essentially 30 days after filing with the secretary of state to submit your report to FinCEN. FinCEN has proposed extending the reporting deadline for companies formed in 2024 to 90 days. At this time, the comment period has closed but a final rule is yet to be released.

There is also an ongoing timeline that companies must be aware of. After the initial report is filed, any changes to any of the information that is contained in the report must be reported to FinCEN within 30 days of the change. An example of the information that must be reported is the name, address, date of birth, and an identifiable number of the beneficial owner(s) (i.e. driver's license or passport number). For example, under the reporting requirements, after the initial report has been filed and a beneficial owner changes addresses, the address change must be reported within 30 days.

For example, let's assume that Farmer A and Farmer B are married and are currently operating a sole proprietorship in Kentucky. These farmers have been farming for many years but are growing and have received legal counsel that they should consider forming an LLC. To minimize the bookkeeping aspect of this change in business structure, Farmer A and Farmer B are going to "ring in the new year," by forming an LLC that will be treated as a partnership for taxation purposes, with each of them having 50% ownership. Their gross receipts are less than \$5mil per year and they have only 1 full-time employee. On January 2, 2024, their appropriate documents will be filed with the Kentucky Secretary of State, and their newly formed business will be official. Under the CTA, both Farmer A and Farmer B will be considered beneficial owners and must file their initial report with FinCEN no later than February 2, 2024, or face the civil penalties listed below. Farmer A and Farmer B plan to build a new house on their farm and their address will change for 911 purposes. Once the house is complete Farmer A and Farmer B will establish their new house with their new address as their primary residence. Upon that change, Farmer A and Farmer B will once again have a 30-calendar day window to update their FinCEN information or once again face steep financial penalties. This is just one simple example of how this law could affect a hypothetical situation.

The authors of this article are concerned that this new legislation has the potential to catch many business owners and possibly even some lawyers and CPAs "off guard." There are significant penalties associated with non-compliance and the CTA. Specifically, there is a \$500/day penalty, up to a maximum of \$10,000 per non-compliant event and jail time is also a possibility (up to 2 years). This is concerning given that it is theoretically possible for beneficial owners to rack up significant civil penalties without even knowing they are in violation. At this point, it is unclear who has the unofficial burden of informing affected parties. Ultimately, it is the beneficial owner's responsibility to be in compliance. Ideally, the attorney that (if applicable) forms a new business will inform the beneficial owners of their need to file their initial reports. CPAs and tax preparers are often unaware of new entities being formed until the 30-day window has passed for initial reporting for companies formed post-January 1, 2024. At this point, it is unclear how effective the educational outreach will be regarding companies formed prior to January 2024 that have until January 1, 2025, to file their initial report. It cannot be overstated that this article is simply to give a very high-level view of potentially impactful legislation. It is for educational purposes only and anyone who may be

affected by the legislation should seek out the appropriate qualified counsel to determine their responsibilities of compliance. For more information, please visit: <https://www.fincen.gov/news/news-releases/fincen-issues-compliance-guide-help-small-businesses-report-beneficial-ownership>.

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