Engine

April 30, 2024

Re: "Under the Microscope: Examining FinCEN's Implementation of the Corporate Transparency Act"

Dear Chairman Williams, Ranking Member Velázquez, and members of the House Committee on Small Business,

Thank you for taking the time to hold a hearing on the implementation of the Corporate Transparency Act. As a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups, Engine devotes attention to the outsized impact many federal laws and regulations can have on the startup ecosystem, particularly for startups in their early stages. The Corporate Transparency Act and its implementation is no exception.

Under the requirements of the Corporate Transparency Act, almost all private companies in the U.S., including startups, are required to report beneficial ownership information (BOI) to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), unless they qualify for an exemption. Though the CTA went into effect in 2021 with BOI requirements beginning this year, most companies remain unaware of their new obligations to FinCEN. In fact, for many startups, reporting BOI will likely be their first interaction with the agency.[1] The constitutionality of the law is additionally being challenged in multiple jurisdictions.

The CTA will require most startups to collect and report information about themselves and each of their beneficial owners (those that have or control a significant ownership interest (at least 25%) in, or exert direct or indirect substantial control over, a reporting company) and could have a significant impact on the startup ecosystem. While most large companies are well equipped to address new and evolving regulations, both in terms of resources, staff, and time, many startups will likely struggle to meet reporting requirements, especially as they will have to be continuously updated in a short time frame if there are any changes to their company or beneficial owners that should be reflected in the report. And founders have reported concerns, especially as states, including New York, are also beginning to require BOI reporting.[2] Regarding the disclosure of BOI, one startup told Engine, "I think any additional regulatory burden makes life harder for those with less resources, such as startups. Going forward, the

[1] Engine, *The Corporate Transparency Act: What it is, where are we now, and what startups should know* (Mar. 15, 2024), https://engineadvocacyfoundation.medium.com/the-corporate-transparency-act-what-it-is-where-we-are-now-and-what-startups-should-know-626770d40392.
[2] Sandra Feldman, *New York enacts a revised version of the LLC Transparency Law* (Mar. 7, 2024), https://www.wolterskluwer.com/en/expert-insights/new-york-enacts-llc-transparency-act.

experience of a founder—especially founders with less connections and resources—will be highly variable depending on the state where they base their company."[3]

As we indicated in a recent blog post (also attached below), startups especially may struggle with the requirements of the CTA, "particularly if a beneficial owner is an entity rather than an individual, which would require another layer of parsing out who owns/controls the entity."[4] Moreover, "some startups may have more trouble than others parsing out who amounts to a beneficial owner depending on the composition of their cap table (for example, those with SAFEs on their cap table),[5] and may have to submit frequent updates as noted above."[6] For other startups, their small size will ultimately result in having to submit information about their entire board. This may give pause to some companies and investors alike, given the cybersecurity implications and concerns about which agencies have access to the information contained in the reports.

As we previously mentioned, most startups are likely unaware of their obligations under the CTA—in a recent hearing in the House Financial Services Committee, FinCEN reported that just 500,000 companies of 32 million required to report have done so.[7] Another study found that 90 percent of independent businesses surveyed were not aware of the CTA's requirements for BOI reporting.[8] While FinCEN has indicated they do not intend to target those who unknowingly do not comply, penalties for non-compliance may be significant, and many startups may face fines and more for failing to submit a report.[9] An improved information campaign from FinCEN or other government agencies—one which includes accurate, up to date information regarding nuances created by ongoing legal challenges—is clearly needed to improve awareness.

Congress should continue to examine the impact of the CTA's requirements, keeping the needs of startups in mind, as the drivers of innovation and job creation in the U.S. Attached, you will

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[3] Imani Webb, *#Startups Everywhere: San Antonio, TX* (April 26, 2024), https://www.engine.is/news/startupseverywhere-sanantonio-tx-legalmente.

[4] Seth W. Ashby et al., *Corporate Transparency Act: Beneficial Ownership Challenges for Business Startups* (Jan. 8, 2024), https://natlawreview.com/article/corporate-transparency-act-beneficial-ownership-challenges-business-startups.

[5] Adam Hayes, *What is a Simple Agreement for Future Equity (SAFE)* (Jan. 23, 2024), https://www.investopedia.com/simple-agreement-for-future-equity-8414773.

[6] Alon Y. Kapen, *Corporate Transparency Act Risks for Startups and Venture-Backed Companies* (Jan. 8, 2024), https://www.nyventurehub.com/2024/01/08/corporate-transparency-act-risks-for-startups-and-venture-backed-companies/.

[7] See Hearing Entitled: Oversight of the Financial Crimes Enforcement Network (FinCEN) and the Office of Terrorism and Financial Intelligence (TFI), available at: https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409139.

[8] Lurah Lowery, *90% of businesses surveyed unaware of strict corporate reporting requirements beginning Jan. 1* (Nov. 17, 2023), https://www.repairerdrivennews.com/2023/11/17/90-of-businesses-surveyed-unaware-of-strict-corporate-reporting-requirements-beginning-jan-1/.

[9] See Hearing Entitled: Oversight of the Financial Crimes Enforcement Network (FinCEN) and the Office of Terrorism and Financial Intelligence (TFI), available at: https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=409139.

find the referenced blog post, which provides more information on the impact of the CTA on the startup ecosystem. As always, Engine is happy to serve as a resource to the committee on the needs and constraints of the startup ecosystem.

Sincerely,
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The Corporate Transparency Act: What it is, where we are now, and what startups should know

By Jennifer Weinhart, Senior Policy Advisor, Engine

A law went into effect this year impacting tens of millions of startups and small businesses, and it should have the attention of founders across the country — but few know about it. That law, The Corporate Transparency Act, was ruled unconstitutional earlier this month, and the government appealed that ruling this week. Startup founders should understand what the Corporate Transparency Act is and what it means for them so they can act accordingly.

What is the Corporate Transparency Act?

The Corporate Transparency Act (CTA) went into effect in 2021 as part of an effort to target illicit finance and terrorist financing. The law will have far reaching impact — as of 2024 it requires many private companies, including most startups, to file beneficial owner reports to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). These reports must include identifying information on those that have or control a significant ownership interest (at least 25%) in, or exert direct or indirect substantial control over, a reporting company. A small number of individuals(for example, minor children and creditors of the reporting company) are excluded from the definition of beneficial owner.

What is FinCEN?

The Financial Crimes Enforcement Network (FinCEN) is a bureau falling under the jurisdiction of the Department of Treasury. The mission of FinCEN is to "safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities." For many startups, reporting beneficial ownership information will be their first interaction with FinCEN.

Who is required to submit to beneficial ownership information (BOI) reporting?

Most private companies in the U.S. are required to report BOI — including LLCs and corporations — unless they are eligible for one of 23 exemptions, which includes large operating companies that employ more than 20 full time employees with more than $5 million in gross receipts or sales for the previous year. Other companies that are exempt from reporting include publicly traded companies, venture capital fund advisors, tax exempt entities, banks, and broker dealers, among others. That means almost all startups will be required to report BOI. Foreign companies are also subject to reporting requirements if they are registered to conduct business in the U.S.

What information must be reported?

The CTA requires reporting companies to submit various pieces of information — about the reporting companies and each of their beneficial owners (those that have or control a significant ownership interest (at least 25%) in, or exert direct or indirect substantial control over, a reporting company). Companies established in 2024 or later must also report their company applicants.

For companies, this information includes: company name, trade name(s), address, jurisdiction of formation, taxpayer identification number, and employer identification number.

For beneficial owners, this information includes: legal name, date of birth, address, unique identifying number and image from an official document like a U.S. license or passport.

Until when do startups have to comply?

Companies that were established before January 1, 2024 will have a full calendar year to submit their first BOI report to FinCEN. Companies created in 2024 have just 90 days following formation to comply and those created in 2025 and later will have 30 days to comply. Companies will also have 30 days to submit an updated BOI report in the event that information regarding beneficial owners or the company that must be included in a report, has changed. The requirement to provide updated reports is especially important for many startups, and may add additional layers of paperwork to fundraising and capitalization table management as "the set of persons whose details must be disclosed may change each time a derivative security expires, equity interests are sold, additional funds are raised, or the ownership structure of a corporate investor changes."

What are the penalties for failure to comply?

While FinCen has indicated that they intend to only pursue penalties for willful violations, penalties for failure to report or update BOI can be significant and include criminal penalties and/or civil penalties of up to $500 per day of violation.

What does the CTA mean for startups?

Most U.S. startups would be subject to BOI reporting requirements under the Corporate Transparency Act. While many larger, private companies are well suited, both in terms of resources and manpower, to comply with ever evolving regulatory requirements, many startups are limited in terms of their ability to navigate new regulations and the cost associated with compliance, particularly if a beneficial owner is an entity rather than an individual, which would require another layer of parsing out who owns/controls the entity. And some startups may have more trouble than others parsing out who amounts to a beneficial owner depending on the composition of their cap table (for example, those with SAFEs on their cap table), and may have to submit frequent updates as noted above. Moreover, given the small size of many startups, they may ultimately have to provide information about their entire board.

Many companies are also likely unaware of their obligations under the CTA. As previously mentioned, reporting BOI will likely be the first interaction many startups have with FinCEN. As reported by FinCEN, just roughly 500,000 reporting companies of an estimated 32 million required to submit a report have done so. While FinCEN argues they are undertaking education efforts to make reporting companies aware of their obligations, according to a National Federation of Independent Businesses survey, 90% businesses were unaware of the requirements of the law.

Finally, startups will have to ensure that the data they collect is secure, and they may have broader cybersecurity concerns regarding which agencies/actors will have access to the reported information. Some beneficial owners themselves may share this sentiment and may be reluctant to supply necessary information.

Where are we now?

In early March, a U.S. District Court Judge in Alabama sided with the National Small Business Association (NSBA) in their challenge to the CTA and its BOI requirements, finding the law unconstitutional and that it amounts to Congressional overreach. The Justice Department has appealed the ruling. The full impact of the initial ruling is varied — as it stands, it narrowly applies to the 65,000 members of the National Small Business Association and FinCEN has stated that it is moving ahead with the CTA's requirements for all other companies who were not members of the NSBA as of March 1, 2024. These companies generally already have until January 1, 2025 to comply, allowing time for the court process to unfold.

Legislators have also challenged the BOI reporting requirements, arguingthey exceed what was prescribed under the passage of the CTA, for example by requiring the submission of more than 50 data points that will be collected in a database. They also expressed concerns about the security of that data and who will have access to the database, which could include several federal agencies.

Startups should be mindful of the CTA and its requirements as the court case unfolds, as it will impact an outsized portion of the startup ecosystem.

Disclaimer: This post provides general information related to the law. It does not, and is not intended to, provide legal advice and does not create an attorney-client relationship. If you need legal advice, please contact an attorney directly.

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues.