The Corporate Transparency Act: Through a Real Estate Lens

*By Marisa N. Bocci, Kari L. Larson and Lysondra E. Ludwig**

In this article, the authors provide a few considerations about the Corporate Transparency Act for those operating in the real estate sector.

Implemented to combat the use of shell corporations and other entities to facilitate illicit activities, the Corporate Transparency Act (CTA) has prompted new and unprecedented reporting obligations. Starting January 1, 2024, domestic and foreign "reporting companies" will be required to report certain identifying information about their beneficial owners to the Treasury Department's Financial Crimes Enforcement Network (FinCEN). The CTA will likely impose a substantial compliance burden on the real estate sector, which often uses complex structures compromised of numerous legal entities that own and operate real property across many asset classes.

This article provides a few considerations about the CTA for those operating in the real estate sector.

WHAT IS A REPORTING COMPANY?

An entity-by-entity assessment is required to determine whether such entity is a "reporting company." A "reporting company" is a domestic or foreign corporation, limited liability company, or similar entity that was either formed or registered to do business in any state or jurisdiction by filing a document with a secretary of state or other similar office and which does not qualify for an exemption (Reporting Company). Due to the varying facts and circumstances related to each entity within a tiered structure, not all entities may qualify for an exemption and reporting could be required for only a portion of the entities within a tiered structure. While the exemptions generally apply to companies with heightened reporting obligations, such as publicly traded companies and most financial services institutions, any entity that satisfies all of the following criteria will also qualify for an exemption:

(i) The entity has more than 20 full-time employees;

(ii) The entity reports more than US$5 million in annual revenue to the Internal Revenue Service; and

(iii) The entity operates out of an office physically located within the United States.

*Marisa N. Bocci (marisa.bocci@klgates.com) and Kari L. Larson (kari.larson@klgates.com) are partners in the Seattle office of K&L Gates LLP. Lysondra E. Ludwig was an attorney at the firm.

In addition, subsidiaries 100% owned by an exempt entity will qualify for an exemption. However, these exemptions will likely not apply to many entities formed to own and operate real estate. For illustration, an upstream parent may qualify for an exemption (for example, if it were a public real estate investment trust); however, the exemption would not apply to a lower tiered subsidiary that was not 100% owned if such subsidiary did not directly employ workers directly, but rather engaged third-party (or affiliated) managers as is common practice.

WHAT INFORMATION MUST BE REPORTED?

A Reporting Company must disclose the individual's full legal name, complete current address, date of birth, and an identification number from an acceptable form of identification (such as a passport or driver's license number) for each beneficial owner. A "beneficial owner" generally is an individual who, directly or indirectly, (1) exercises substantial control over the entity, or (2) owns or controls not less than 25% of the ownership interests of the entity.

WHAT MAY IMPACT A REPORTING COMPANY'S ABILITY TO COMPLY?

To comply with the CTA, processes and systems will need to be put in place to analyze whether reporting is required, to track beneficial owners on an ongoing basis, and to gather and store the requisite identifying information. The legal right to receive and to provide the beneficial owners' identifying information to FinCEN on an ongoing basis, as well as obligations to update any ownership change upstream, should be considered in any negotiations.

HOW DOES THE CTA APPLY TO PARTIES HOLDING AN INTEREST IN REAL ESTATE?

The common practice in real estate transactions is to form special purposes entities (SPEs) to acquire, develop, lease, and finance real property. Often times, an SPE will hold the property to limit liability and additional SPEs may be inserted into the structure to create a preference for debt and certain equity holders. To comply with the CTA, upon formation of each SPE, a separate analysis will be required to determine whether an exemption applies or if the SPE is a Reporting Company. The "large operating company" exemption may be available for many real estate companies, and requires that an entity:

- Has an operating presence in a physical office within the United States;
- Employs more than 20 employees on a full-time basis in the United States; and
- Filed federal income tax or information return in the United States for the previous year demonstrating more than US$5 million in gross receipts or sales from U.S. sources.

In addition, ownership percentages often change substantially over the life cycle of a real estate asset. For example, during the development, the developer may be the sole owner of the real estate; however, upon completion of the project, limited partners may be introduced to capture operation returns. Thus, continuous monitoring of changes in the ownership structure to account for changes in beneficial ownership and ownership percentages is needed to ensure compliance.

WHAT SHOULD REAL ESTATE LENDERS (MORTGAGE AND MEZZANINE) BE CONSIDERING?

For mortgage and mezzanine lenders, noncompliance with the CTA adds another layer of risk and should be considered as part of the underwriting of the loan as well as covenants and obligations of the borrowers. Lenders will need to ensure that anti-money laundering protocols are aligned with the CTA requirements to ensure that reporting is done correctly and timely.

WHEN MUST A REPORTING COMPANY REPORT BENEFICIAL OWNERSHIP?

For Reporting Companies formed prior to January 1, 2024, beneficial owner information (BOI) will need to be reported to FinCEN prior to January 1, 2025. Reporting Companies that are formed or registered on or after January 1, 2024, and before January 1, 2025, are required to report BOI to FinCEN within 90 days of the acceptance of the company's formation or registration filing, and Reporting Companies that are formed or registered on or after January 1, 2025, are required to report BOI to FinCEN within 30 days of the acceptance of the company's formation or registration filing. A change in beneficial ownership or a change in exemption status would also require a filing within 30 days of such change.

Reporting obligations and exemption eligibility are dependent on the specific facts and circumstances surrounding each entity.

Note that the CTA is currently facing constitutional challenges in court. On March 1, 2024, the U.S. District Court for the Northern District of Alabama granted the National Small Business Association's motion for summary judgment holding that the CTA exceeds constitutional limits on the legislative branch and lacks a sufficient nexus to any enumerated power to be a necessary or proper means of achieving Congress' policy goals.[1] The CTA remains an active law despite its legal challenges. However, those impacted by the CTA should monitor the developments in this case as it works through the court system.

NOTE:

[1]See *Nat'l Small Bus. United v. Janet Yellen*, Case No. 5:22-cv-1448-LCB.