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Corporate Transparency Act and Tax-Exempt Entities

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October 29, 2024

This alert provides an overview of the Corporate Transparency Act (CTA) and explains the procedures that a newly formed tax-exempt entity must undertake in order to comply with the CTA.

CTA Overview

As of January 1, 2024, many business entities are required to file reports with beneficial ownership information (BOI) to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). The stated purpose of the CTA is to assist law enforcement in combating money laundering, tax fraud, financing of terrorism, and other illicit activity through anonymous shell companies. The reporting requirements encompass domestic entities created by the filing of a document with a secretary of state or any similar office under the law of a state (31 C.F.R. § 1010.380(c)(1)(i)). These domestic entities are known as "reporting companies" for purposes of the CTA.

Reporting companies must provide company information (such as the legal name, trade names, and taxpayer identification numbers) as well as a BOI report. This BOI report includes the beneficial owners name, date of birth, address, as well as a unique identifying number from a document such as a passport or state-issued driver's license. A person is considered a beneficial owner if they: (1) exercise substantial control over the reporting company; or (2) own or control 25 percent or more of the ownership interests (31 C.F.R. § 1010.380(d)).

Any reporting company created prior to 2024 has until January 1, 2025, to file its initial BOI report. However, any reporting company created during 2024 must file its initial BOI report within 90 calendar days of formation. Furthermore, any reporting company formed after January 1, 2025, must file a BOI report within 30 calendar days of formation.

The federal regulations provide a list of exemptions for entities that are not considered "reporting companies" for CTA purposes, including an exemption for tax-exempt entities (31 C.F.R. § 1010.380(c)(2)). Under this provision, there are three types of tax-exempt entities that satisfy the exemption and are excluded from the definition of a "reporting company." This article addresses one of those exemptions for an "organization that is described in section 501(c) of the Internal Revenue Code of 1986 (Code) (determined without regard to section 508(a) of the Code) and exempt from tax under section 501(a) of the Code."

Newly Formed Charitable Entities

Unlike other tax-exempt entities that become exempt once they satisfy the requirements for tax exemption, entities seeking Section 501(c)(3) status as charitable organizations do not become tax exempt until the IRS formally approves their Form 1023 application through the issuance of a tax determination letter. Although the entity may be legally "formed," the tax-exempt application may not be approved by the IRS within the applicable 90-day (or 30-day) deadline for filing a BOI report. While an IRS determination letter is often retroactive to the date of formation if approved, the deadline to file a BOI report may pass prior to the time the IRS issues a retroactive determination letter. Therefore, since the newly formed entity is not yet considered a Section 501(c) entity until the issuance of the tax determination letter, the entity risks violating the CTA reporting requirements if it fails to timely file a BOI report.

To avoid a possible violation, a newly formed entity awaiting their tax-exempt determination letter should file a BOI report within the 90-day (or 30-day) filing period. Once the determination letter is issued by the IRS, the newly formed Section 501(c) entity must then file another BOI report. An updated BOI report for a newly exempt entity will only require that the entity: (1) identify itself; and (2) check a box noting its newly exempt status.

While this solution may be cumbersome, it aligns with FinCEN's discussion of the final BOI regulations prior to codification. In a 2022 report, FinCEN noted that many commenters had requested that the exemption rule apply to entities that were still awaiting an IRS determination letter (87 Fed. Reg. 59498 (Sep. 30, 2022) at 594541). While FinCEN acknowledged the request, the final promulgated rule did not include any concession to newly formed entities waiting for Form 1023 approval (C.F.R. § 1010.380(c)(2)(xix)). Therefore, in order to fully comply with the CTA as written, a newly formed tax-exempt entity should file a BOI report within 90 days of formation if they have not already received their official tax-exempt status from the IRS.

Loss of Tax-Exempt Status or Change of Classification

If a tax-exempt entity, whether a charitable organization or otherwise, loses its tax-exempt status, the CTA has addressed the necessary steps the entity must take. The entity will have a 180-day grace period beginning on the date of the loss of their tax-exempt status (C.F.R. § 1010.380(c)(2)(xix)(A)). The CTA exemption expires at the end of the 180-day period, and the entity will then have 30 days to file a BOI report. If the entity regains its tax-exempt status during the 180-day period, the CTA exemption will remain in effect and no filing will be required. The manner in which a tax-exempt entity loses its tax-exempt status (e.g., IRS or court decision or otherwise) is irrelevant. If the tax-exempt status of a reporting entity is forfeited, it must try to regain its tax-exempt status during the 180-day period or begin CTA reporting.

Subsidiary Filings

The CTA also provides that taxable and tax-exempt subsidiaries of exempt entities (to include tax-exempt entities under 31 C.F.R. § 1010.380(c)(2)(xix)) will also be exempt from CTA reporting requirements. A subsidiary is defined as any entity "whose ownership interests are controlled or wholly owned, directly or indirectly" by one of the enumerated exempt entities (C.F.R. § 1010.380(c)(2)(xxii)). Since the statute did not address the meaning of "controlled," there was initially some uncertainty about whether partially controlled subsidiaries could qualify for the subsidiary exemption. However, FinCEN directly addressed this issue in an FAQ post where they stated: "[i]f an exempt entity controls some but not all of the ownership interests of the subsidiary, the subsidiary does not qualify. To qualify, a subsidiary's ownership interests must be **fully, 100 percent** owned or controlled by an exempt entity" (FinCEN Ownership Information, FinCEN.gov, emphasis added).

If the subsidiary ceases to be wholly controlled by an exempt entity, then the subsidiary will lose its subsidiary exemption. It will then be treated as a reporting company, unless another reporting exemption applies, and will be required to file its initial BOI report with FinCEN within 30 days. If a subsidiary that was a reporting company qualifies for the subsidiary exemption after it files its initial BOI report (for example, if 100 percent of its ownership interests are acquired by an exempt entity) the subsidiary must file an updated BOI report with FinCEN within 30 days of becoming exempt, indicating that it is now exempt.

Non-Profit Organizations

Just because an entity is a "non-profit" does not mean that the entity qualifies for the Section 501(c) exemption from the CTA reporting requirements. The term "non-profit" typically refers to an organization formed pursuant to the non-profit laws of a particular state. Some non-profit organizations are also described in Code Section 501(c) and exempt from tax under Code Section 501(a); other non-profit organizations are not. Unless the non-profit organization meets the requirements of at least one of the 29 types of entities listed in Code Section 501(c), the non-profit organization will not be a tax-exempt entity described in Code Section 501(c) and will not qualify from the Section 501(c) exemption from the CTA reporting requirements (*Community Associations Institute v. Yellen*, No. 1:24-cv-1597 (MSN/LRV) (E.D. Va. Oct. 24, 2024).

If you have questions or concerns regarding this alert please reach out to Jacqueline A. Henson, Brock M. Lavely, or any member of Baker Donelson's Tax Group.