# Shining a Light: Understanding the Corporate Transparency Act

Enacted in 2021, the Corporate Transparency Act (CTA) became effective on January 1 of this year. While the primary goal of this new legislation is to prevent bad actors from exploiting the US financial system, its reporting requirements will impact the majority of small-business owners throughout the country. Let's delve into this new legislation and unpack its purpose, requirements, and potential impact on you.

### What is the CTA?

In simple terms, the CTA was designed to increase transparency regarding who owns and controls entities established in or registered to do business in the United States. The law created a national database, which is to be managed by the Financial Crimes Enforcement Network (FinCEN), to which businesses that meet certain criteria must submit a beneficial ownership information (BOI) report specifically identifying the entity's "beneficial owners." These individuals have either significant ownership of or significant control over the reporting company. FinCEN expects that every reporting company will be able to identify and report at least one beneficial owner, meaning that FinCEN will be able to trace every entity to the person or persons who really own and control it.

### Why was it put into effect?

The CTA is the most significant piece of anti-money laundering legislation to be enacted in the United States since the Patriot Act, bringing US laws in line with established global standards on transparency in corporate ownership. For years, the creation of anonymous shell companies has been used to facilitate criminal activities like money laundering, tax evasion, and terrorist financing. By shrouding the identity of their true owners, these companies have made it difficult for law enforcement to track illicit activity. The CTA aims to dismantle this veil of secrecy by creating a record of beneficial ownership, enabling authorities to identify potential wrongdoing.

### What are the reporting requirements?

While there are specific types of businesses that are not subject to the reporting requirements under the CTA, we expect that most small-business owners will have to file a BOI report with FinCEN. For any entity that was in existence prior to January 1, 2024, the deadline for filing this report is December 31, 2024. However, any entities that are established during calendar year 2024 will only have 90 days to file a BOI report with FinCEN.

Here is an overview of the required information:

- **Reporting Company Information:** Basic details like legal name (as well as any d/b/a names), address, tax identification number, jurisdiction of formation, and formation date.
- **Beneficial Owner Information:** Legal name, date of birth, residential address, and details of a form of identification will be required for each beneficial owner. Each beneficial owner will also be required to upload a copy of that ID. A beneficial owner is defined as someone

who owns or controls at least 25% of the company's shares or voting power or anyone who exerts significant influence over its management, such as a senior officer.

- **Company Applicant Information:** For companies that were formed on or after January 1, 2024, the report must also include details about the individuals who initially filed the formation paperwork. The applicant will be required to submit the same information as a beneficial owner.

## Isn't the CTA being challenged in court?

On March 1, 2024, a federal judge in Alabama declared the CTA unconstitutional. On March 11, FinCEN filed an appeal. Shortly thereafter, FinCEN released a statement in which they explicitly stated that they will "continue to implement the Corporate Transparency Act as required by Congress" and that the BOI reporting requirements still apply to everyone "other than the particular individuals and entities subject to the court's injunction."

Given FinCEN's position, entities that were created on or after January 1, 2024, should plan to file the required BOI report within the 90-day period regardless of the pending litigation.

## How does it affect me?

Invariably, the CTA will have an impact on business owners and those who use LLCs or other entities as part of their financial plans. Here are a few items that you should know:

- If you own or control a business, you will likely be responsible for filing the BOI report with FinCEN (pending the above-referenced court action).
- Those who have multiple entities can obtain a FinCEN ID, which will streamline the BOI reporting process.
- A new BOI report must be filed within 30 days if there is a change to the BOI or any of the beneficial owners. These subsequent reports can be triggered by seemingly simple items like name or address changes.
- The penalties for noncompliance with the CTA are stiff—up to $500 per day per entity. The act does offer a safe harbor from liability for those who voluntarily and promptly correct any inaccurate information within 90 days of initial submission.
- Accounting firms have stated that they will not handle CTA filing for their clients, as this filing is deemed to be the practice of law in many states.

## So what do I do now, and how can Rockwood help?

Our advisory teams are familiar with both the CTA and the pending litigation. During the first quarter of 2024, we have been reviewing the structure of our clients' various business entities and when those entities were created. We will be continuing that work this quarter. Over the course of the third and fourth quarters, we will endeavor to support you in fulfilling your obligations under the CTA.

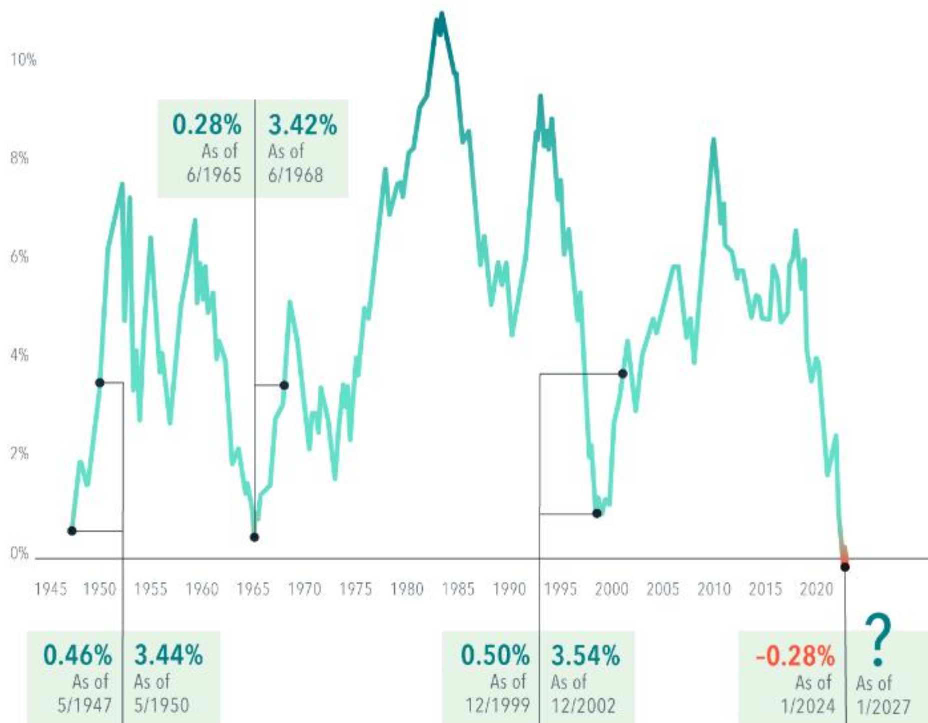
If you have any questions about the CTA and how it may apply to your specific situation—or if you recently created a new entity—please reach out to your Rockwood advisory team.

## Encouraging Data from Value's Past and Present

The 20-year relative return of US small cap value stocks versus the S&P 500 Index dipped negative recently for the first time in US stock market history. Two decades is a long time for an expected premium not to show up. Outliers on the negative side are never pleasant, but we can look to other previous outliers for some encouragement.

Many in the industry will recall the disappointing stretch at the end of the 1990s when US small cap value's trailing 20-year return was statistically indistinguishable from the S&P 500's. Less familiar might be the periods in 1947 and 1965 when the trailing 20-year premium was similarly flat. In all three cases, small value staged a rapid turnaround. We can see this by measuring each of the trailing 20-year return spreads again three years later. For example, we compare the observation on December 31, 1999, with the trailing 20-year return difference as of December 31, 2002. In all three previous cases, small cap value's advantage jumped to more than three percentage points annualized.

No one can say whether we'll get a similar turnaround this time. But history suggests giving up on small cap value after its worst stretches would have been a mistake. Past performance doesn't upend the logic of expecting a higher return for stocks with low prices relative to their book equity. And for any remaining skeptics, it's worth noting that small value's struggles in the United States have not been shared by developed ex-US or emerging markets, where small cap value stocks have outperformed their large cap counterparts by 2.7% and 4.0%, respectively, over the past 20 years.



## 3 Common Investment Mistakes

Many people start out managing their own investments. But as their earnings and assets grow, their financial needs and challenges become more complex—and continuing to go it alone could prove costly in terms of investing miscues. Consider three common mistakes that can reduce returns and increase anxiety:

### 1. Trying to Time the Market

Investors may be tempted to cash out of the stock market to avoid a predicted downturn. But forecasting the market's direction in order to time when to buy and sell is a guessing game. Missing only a brief period of strong market performance can drastically affect your lifetime wealth.

For example, the chart below shows a hypothetical investment in the Russell 3000 Index, a broad US stock market benchmark. Over the entire 25-year period ending December 31, 2023, a $1,000 investment in 1999 turned into $6,449. But what if you pulled your cash out at the wrong time? Missing the best week, month, three months, or six months would have significantly reduced the growth of your investment.

Rather than trying to predict when stocks will rise and fall, investors can hold a globally diversified portfolio and, by staying invested, be better positioned to capture returns whenever and wherever they occur.

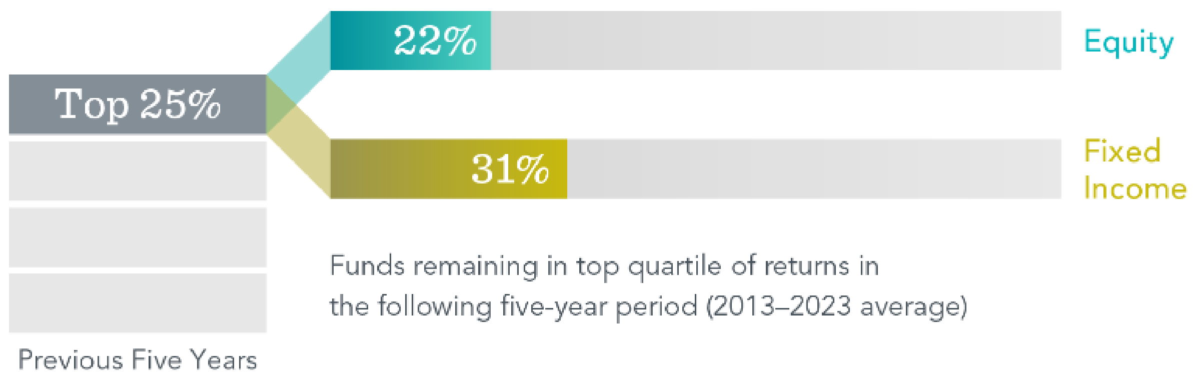
## 2. Focusing on the Headlines

Investors may become enamored with popular stocks based on recent performance or media attention and overconcentrate their portfolio holdings in these companies. One example is the rise of the large US technology companies known as the Magnificent 7 (Alphabet, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla). But the chart below shows that many fast-growing stocks have stopped outperforming after becoming one of the 10 largest stocks in the United States. On average, companies that outperformed the market on the way up failed to outperform in the years after making the top 10 list.

The lesson? Rather than load up on a handful of stocks that have dominated the market, you can own many stocks through mutual funds or ETFs. Diversifying across industries and global markets can help reduce overall risk and position investors to potentially capture the returns of future top-performing companies.

### 3. Chasing Past Performance

You might be inclined to select investments based on past returns, expecting top-ranked funds to continue delivering the best performance. But can they maintain that outperformance? Research shows that most funds ranked in the top 25% based on five-year returns didn't remain in the top 25% in the next five years. In fact, only about one in five equity funds stayed in the top-performing group, and only about a third of fixed income funds did. The lesson? A fund's past performance offers limited insight into its future returns.




Avoiding these mistakes can improve the odds of reaching your long-term investment goals. That's why we design a diversified, research-backed investment strategy based on your long-term goals and comfort level with risk.

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