

Ready or Not, It's Time for Transparency

FinCEN Proposes Rules to Implement Beneficial Ownership Reporting Requirements

December 17, 2021

Proposed regulations promulgated on December 8, 2021 by the Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Department of the Treasury, bring the beneficial ownership reporting rules of the Corporate Transparency Act¹ (the "CTA") one step closer to life. Though only proposed and not effective until a date to be specified in the final regulations, these rules represent a meaningful step in the fight against money laundering, tax fraud, terrorism, and other national security risks. FinCEN's action also responds to decades-long criticism from the Financial Action Task Force (an intergovernmental body comprised of 37 members, including the United States) that the United States has been dilatory and deficient in its duty to promote the transparency in legal entity ownership believed to be necessary to counter such unlawful conduct.

Upon finalization and entry into effect of these regulations, countless corporations, limited liability companies, and certain other entities will have to report detailed information regarding their beneficial owners and incorporation agents to FinCEN and will have an ongoing obligation to keep the agency abreast of changes.

The Broad and Sweeping Rules

The CTA sets out to create a consolidated repository of beneficial ownership information to, among other things, "better enable critical national security, intelligence, and law enforcement efforts to counter money laundering, the financing of terrorism, and other illicit activity."² The proposed regulations implement Congress's instructions for building and maintaining a beneficial ownership repository to close the information gap. The database will be populated by requiring certain entities to report pertinent information to FinCEN:

- **Who Must Report.** Many entities will be subject to the reporting obligations. Any domestic or foreign "reporting company", broadly defined, must file a report with FinCEN in the form and manner to be prescribed in forthcoming forms and instructions.
 - A *domestic reporting company* is a corporation, limited liability company, or other entity that is created by the filing of a document with a secretary of state or any other similar office under the law of a State or Indian tribe. FinCEN believes this definition likely includes various types of partnerships (LPs, LLPs, LLLPs) and business trusts.
 - A *foreign reporting company* is a corporation, limited liability company, or other entity formed under the law of a foreign country and registered to do business in any state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office.

¹ Pub. Law. 116-283, §§ 6401-03 (Jan. 1, 2021), codified as 31 U.S.C. § 5336.

² *Id.* at § 6402 (describing Congress's intent).

While a non-business, non-statutory trust would generally fall outside the “reporting company” definition, information regarding a trust, its grantor, and its beneficiaries may nevertheless end up on a report if the trust owns a reporting company, as described below.

The rules adopt the CTA’s list of twenty-three types of entities that are to be exempt from reporting, with clarification where necessary. In doing so, FinCEN commented that many of these entities are already subject to substantial Federal or state regulation under which their beneficial ownership may be known (*e.g.*, banks, credit unions, Securities Act of 1934 entities, tax-exempt organizations). Of note, “large operating companies”—*i.e.*, entities employing more than 20 full-time employees in the United States, reporting more than \$5 million in gross receipts on its prior year’s Federal tax return, and having an operating presence at a physical office in the United States—are exempt. Small and medium sized businesses with similar indicia of no malintent in using the corporate-form, however, must bear the reporting obligations. As proposed, an exempt entity does not need to file its claim of exemption with FinCEN, but if a reporting entity later becomes an exempt entity, the change must be reported.

- **What Must Be Reported.** Reports will require information regarding three sets of persons:
 - The reporting entity itself (*e.g.*, full name, DBA names, business address, formation jurisdiction, IRS TIN or alternative identifier);
 - Each beneficial owner (*e.g.*, full legal name, date of birth, residential address, unique identifying number such as a passport or driver’s license number, and an image of the document containing the identifying number); and
 - Each company applicant (*e.g.*, same information as for beneficial owner, with substitution of business for residential address permitted in some situations).

A “beneficial owner” is an individual who directly or indirectly (1) exercises substantial control over the reporting entity or (2) owns or controls at least 25% of the ownership interests of such reporting company. “Substantial control” ranges from providing service as a senior officer to having authority over appointment of senior officers to making decisions or exercising substantial influence over important matters. “Ownership interests” range from equity or stock to profits interest to certain convertible interests to certain puts, calls, straddles, or other options or privileges of buying any of the enumerated interests. The rules for determining beneficial ownership are detailed, but clearly intend to pick up a great number of individuals potentially involved with the reporting entity.

A “company applicant” is any individual who, for a domestic reporting company, files or directs or controls the filing of creation documents and, for a foreign reporting company, files or directs or controls the filing of doing business registration documents.

The proposed rules provide that a reporting entity need not report any minor children, any indirect beneficial owners if their ownership flows through an exempt entity (instead the exempt entity would just be listed), and deceased company applicants.

Rather than provide required personal information to a reporting company, beneficial owners and company applicants can instead provide the information directly to FinCEN. FinCEN will then issue a “FinCEN Identifier” number to the individual. Any reporting company required to list the individual can simply report the individual’s FinCEN Identifier instead of their personal information. The FinCEN Identifier may prove particularly popular with service providers that get swept up in the company applicant category and would prefer not to share certain personal information (*e.g.*, a passport copy) with the reporting company.

- **Timing of Reporting.** Reporting will have tight deadlines and be ongoing. Pre-existing domestic or foreign reporting companies will have 1 year from the effective date of the final rules (to be determined) to file an initial report with FinCEN. New entities will have 14 calendar days from qualifying as a domestic or foreign reporting company to file an initial report with FinCEN. The quick turnaround for new entities is aimed at making beneficial ownership reporting a standard step in the business incorporation and/or doing business registration processes.

Any change to information previously reported must be updated within 30 calendar days of the change. Transitioning from a reporting company to an exempt company constitutes a reportable change. When a beneficial owner dies, a change is not considered to occur until the estate is settled. Any inaccurate information previously reported must be corrected within 14 days of becoming aware or having reason to know of the inaccuracy.

- **Penalties.** Hefty civil and criminal penalties—up to \$500/day while the violation continues and up to \$10,000 and/or up to 2 years imprisonment, respectively, apply to willful failures to report and willful provision of false or fraudulent information. The proposed rules aim to clarify, not to mention emphasize, that in addition to reporting companies, individuals including beneficial owners and company applicants may be subject to penalty if they provide false or fraudulent information to the reporting company. It remains unclear whether such individuals have an affirmative obligation to reach out to reporting companies to provide information and make sure the report is filed. A safe harbor exists for voluntary corrections of reports within 90 days of filing.

Accessing the Forthcoming Wealth of Information

Congress entrusted FinCEN with the management and maintenance of the repository of information gathered pursuant to the CTA, which must be retained for at least 5 years after the termination of a reporting company.

FinCEN may disclose beneficial ownership information to the following persons for limited, specified uses upon request through appropriate, yet-to-be determined, protocols:

- Federal agencies engaged in national security, intelligence, or law enforcement activity, *for use in furtherance of such activity*;
- Financial institutions subject to customer due diligence requirements *with the consent of the reporting company and to facilitate the required due diligence*;
- Federal functional regulators or other appropriate regulatory agencies *to assess a financial institution's compliance with requirements*; and
- Foreign law enforcement agencies, prosecutors or judges *when requested through a Federal agency, and required to comply with a treaty (e.g., an income tax treaty or tax information exchange agreement) or limited to use in an authorized investigation or national security or intelligence activity*.

Requests may be rejected in circumstances outlined in the statute, which broadly include “other good cause.” Beneficial ownership information will also be accessible for inspection or disclosure to officers and employees of the Department of the Treasury (presumably including the Internal Revenue Service) whose official duties require it.

Civil and criminal penalties similar to those applicable to unauthorized use and disclosure of tax return information apply to employees or officers of the requesting agency for violation of protocols and misuse of information.

Just the Beginning, but Forward Motion and No Turning Back

While the proposed regulations must go through a comment period before finalization, entities, beneficial owners, and company applicants alike should use this time productively to gain an understanding of their future obligations. Gathering information and educating individuals for whom personal information must be reported will surely be resource- and time-intensive.

There's also no sign of FinCEN slowing down. Extensive comments have been requested and must be submitted by February 7, 2022. Regulation packages implementing protocols for access to and disclosure of beneficial ownership information and revising the existing Customer Due Diligence Rule are forthcoming.

Arguably the biggest remaining question is the effective date of the reporting requirements. FinCEN has requested views on timing and potential factors to be considered, but is steadfast in its commitment to identify the earliest possible effective date after publication of the final rules.

For more information concerning this Alert, please contact a member of [Caplin & Drysdale's International Tax](#) or [Private Client](#) groups.

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