

CLIENT ALERT:**FinCEN Seeks Identifying Information with Proposed Corporate Transparency Rule**

By Gregory Paal

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The Corporate Transparency Act (“CTA”) became law in 2021 as part of the National Defense Authorization Act. Section 6403 of the CTA charges the Financial Crimes Enforcement Network (“FinCEN”) with collecting information on the beneficial owners of certain foreign and domestic entities. The information will be stored in a non-public database and used to facilitate investigations into the activities of such entities by law enforcement agencies both within the United States and internationally.

The proposed regulations target money launderers and other criminals who use shell entities to disguise their financial activities by requiring all new and existing covered business entities to disclose the identity of all individuals who have a significant financial stake in the company or exercise substantial control over it (“Beneficial Owners”). Though shell companies have several legitimate purposes, they have also been used by criminal actors to obstruct investigations and evade the law. The CTA empowers FinCEN to develop regulations that define which companies must report ownership information to FinCEN (“Reporting Companies”), what information must be reported, and who is deemed to be a Beneficial Owner under the new regulations. FinCEN is also tasked with collecting information on the individuals responsible for actually filing the formation documents with the appropriate government entity (“Company Applicants”). FinCEN’s new database will help law enforcement entities

identify links between illicit actors and Reporting Companies by cutting through the anonymity offered by intermediate legal entities and directly collecting information on the individuals who ultimately control and benefits from the entity’s activities.

FinCEN released the proposed rule for public comment in December 2021. Supplementary information in the preamble to the proposed rule identifies several possible targets of the new regulations, including Russian oligarchs evading international sanctions. That focus is likely to intensify with the implementation of the numerous sanctions targeting Russian businesses. President Biden has requested an additional \$19 million to support the security and functionality of FinCEN’s existing beneficial ownership information database for financial institutions, and at least one Senator has called for FinCEN to update its definition of beneficial ownership for existing disclosure rules to align with the definition of beneficial ownership provided by the CTA.

The final rule would provide another powerful tool to enforce the sanctions as it would help law enforcement identify which American companies are being used to shelter and launder Russian assets. It will also create a series of compliance hurdles for every existing non-exempt entity and every new covered entity formed after the effective date of the regulations. Though FinCEN has not yet announced when it expects to publish the final rule and set the effective date of the

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regulations, the notice and comment period for the final rule closed on February 8, 2022. The renewed focus on anti-money laundering efforts as part of a broader program for identifying and freezing Russian financial assets could accelerate timeline for the release of the final rule.

Reporting Companies:

The proposed rule identifies Reporting Companies that must report Beneficial Owner information (“BOI”) with FinCEN primarily by the act of filing documents with a secretary of state or other similar authority to create the entity. This broad definition covers corporations, LLCs, LLPs, and other similar entities. The final rule is therefore expected to cover all filing entities that are not otherwise exempted. **There is no requirement in the regulations for companies to report claiming an exemption, so existing companies that determine that they are not covered will not need to take action.**

The proposed rule identifies 23 kinds of entities that fit the criteria of being created by filing with a secretary of state but are exempt from reporting BOI. The filings fall into three categories. First, entities that are already **heavily regulated** and would therefore be subject to duplicative compliance burdens are not considered Reporting Companies under the proposed rule.

Second, **large operating companies** are likewise not considered Reporting Companies. The proposed rule defines large operating companies as any company that (1) employs 20 or more employees on a full-time basis (30 hours per week or 130 hours per

month, according to IRS regulations); (2) filed federal income tax returns demonstrating at least \$5,000,000 in gross receipts; and (3) has an operating presence at a physical office within the United States. An operating presence is defined as a working office owned or leased by the entity that is not a residence and is not a shared space.

Finally, **inactive businesses** are not considered Reporting Companies under the proposed rule. An entity is considered inactive if (1) it has been in existence for at least a year from the date the CTA was passed, January 1, 2021; (2) is not engaged in active business; (3) is not owned, directly or indirectly, by a foreign person; (4) has not, in the preceding 12 month period, experienced a change in ownership or sent or received more than \$1,000; and (5) does not otherwise hold assets of any type. The fourth prong is meant to prevent illicit actors from acquiring defunct entities to evade the reporting requirements. Additionally, the proposed rule fixes the date of the twelve-month period determining whether a business is considered inactive to the passage of the CTA rather than the effective date of the regulations in an effort to prevent Beneficial Owners from setting up inactive shell companies in the present for future illicit uses.

Beneficial Owners:

The primary goal of the proposed rule is to identify any individual who possesses a substantial ownership interest in a Reporting Company or exercises direct or indirect control over its activities. To that end, the proposed rule specifies two broad categories of individuals deemed to be Beneficial Owners of a Reporting Company who must

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therefore identify themselves as such to FinCEN. **The proposed rule does not place a limit on the number of individuals who can be identified as a Beneficial Owner.** FinCEN expects every Reporting Company to identify at least one Beneficial Owner.

The first category identifies any individual who owns or controls at least 25% of all ownership interests in the Reporting Company under all the facts and circumstances as a Beneficial Owner. Ownership interests are broadly defined to include equity in the Reporting Company, as well as any other type of interest, convertible instrument, or other options to acquire equity, capital, or other ownership interests.

The second category encompasses any individual who exercises substantial control over the entity. This prong includes both *de jure* control, requiring Reporting Companies to identify all senior officers as Beneficial Owners, and *de facto* control, requiring Reporting Companies to identify individuals who have authority over the direction, determination, or decision of, or substantial influence over, important matters of the Reporting Company, regardless of whether they are also a senior officer. Senior officers are defined as anyone holding or exercising the authority of the following positions within the Reporting Company: president, secretary, treasurer, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.

Critically, the analysis of whether an individual is a Beneficial Owner applies through intermediate companies. If a shell

company is wholly owned by another company, for example, then the shell company's Beneficial Owners will be the Beneficial Owners of the parent company, not the parent company itself – the Beneficial Owner is the individual person or persons who exercise control over the company, regardless of how many legal entities stand between the individual and the Reporting Company. Individuals may also be considered Beneficial Owners when their ownership interest is held in a trust and the individual is the sole beneficiary of the trust, or has the right to demand a distribution or otherwise withdraw substantially all of the trust's assets. Trustees may also be Beneficial Owners when the trustee has authority to dispose of trust assets.

The proposed rule excludes five categories of individuals from being identified as Beneficial Owners. Minor children cannot be considered Beneficial Owners. If a minor meets the 25% ownership test, FinCEN directs that a parent or legal guardian of the minor be identified as the Beneficial Owner. Nominees, intermediaries, and custodians are likewise excluded, with FinCEN directing that the party exercising control through the nominee be treated as the Beneficial Owner. Employees who are not senior officers or acting as senior officers and whose control over and economic benefit from a Reporting Company arise solely from their employment status are not considered Beneficial Owners. Individuals who have an interest in the company based on inheritance rights are also excluded, as their beneficial ownership interest is merely a future interest. Finally, creditors who have no right to convert the right to repayment into any other form of

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ownership interest in the Reporting Company are excluded from the proposed rule.

Reported Information:

Reporting Companies that are not otherwise exempt from the regulations must report specified BOI and other information to FinCEN. Reporting Companies must provide information that identifies the Reporting Company, the Beneficial Owners of the Reporting Company, the Company Applicant, and the person who directed the Reporting Company's initial filing, if that individual is not the Company Applicant.

Reporting Companies: Under the proposed rule, FinCEN will seek the following information regarding Reporting Companies:

- (1) the full name of the Reporting Company;
- (2) any trade name or d/b/a name of the Reporting Company;
- (3) the business address of the Reporting Company;
- (4) the state or tribal jurisdiction in which the Reporting Company was formed or, if the Reporting Company is foreign, where it first registered; and
- (5) the Reporting Company's Taxpayer Identification Number ("TIN").

Reporting Companies that have received an Employer Identification Number ("EIN") may report that number to FinCEN. If a TIN has not yet been issued, the Reporting Company may identify itself with either a Dun & Bradstreet Data Universal Numbering

System ("DUNS") number, or a Legal Entity Identifier ("LEI") number.

BOI: FinCEN will also collect the following BOI for anyone identified as the Beneficial Owner of a Reporting Company:

- (1) the full legal name of the Beneficial Owner;
- (2) the birth date of the Beneficial Owner;
- (3) the Beneficial Owner's current address used tax residency purposes;
- (4) a unique identifying number found on an approved government-supplied document that identifies the Beneficial Owner; and
- (5) a sufficiently recognizable and legible image of the document from which the unique identifying number in (4) was obtained.

The document showing the Beneficial Owner's unique identifying number may be a non-expired passport from the United States; a non-expired identification document issued by a state, local, or Tribal government; a non-expired driver's license issued by a state; or, if the Beneficial Owner has no other approved document, a non-expired passport issued by a foreign government.

Company Applicants: FinCEN is also seeking to draw connections between Reporting Companies, Beneficial Owners, and the Company Applicants who are responsible for filing the necessary formation or registration documents with the appropriate authority. This category includes both the individual who actually files the documents, and the

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individual who directs or controls the filing by another. **Company Applicants are required to supply FinCEN with the same information as Beneficial Owners**, with two key differences. First, Company Applicants must supply a business address rather than the address used for tax residency purposes if the filing is done in the course of the Company Applicant's business. For example, a lawyer filing documents on behalf of a client would be required to identify the law firm's business address.

The second difference is that every non-exempt Reporting Company is required to report the initial Company Applicant, regardless of when the initial documents were filed. While all Beneficial Owners must be living people, the Company Applicant may be deceased, as is likely the case if the Reporting Company was formed in the distant past. If the Company Applicant is no longer alive at the reporting deadline, the company should report all known information about the Company Applicant and note that they are deceased.

Reporting Companies, Beneficial Owners and Company Applicants who provide FinCEN with identifying information may request a unique FinCEN identifying number. **Practitioners who repeatedly act as Company Applicants will be able to provide future clients their FinCEN number in lieu of identifying information and their corresponding documents.** While this will obligate the practitioner to update FinCEN when any of their identifying information changes, it will also allow practitioners to avoid having to repeatedly share sensitive personal information with their clients.

Timeline for Reporting:

The deadline for registration is tied to the effective date of the final rule, which has not yet been released. **When the final rule is released, existing Reporting Companies will have one year from the final rule's effective date to provide FinCEN with information regarding the Reporting Company, the Company Applicant(s), and all of its Beneficial Owners.** Reporting Companies formed after the effective date or formed in a foreign jurisdiction and filing in the United States after the effective date will have 14 days from their filing date to report the necessary information. FinCEN estimates that approximately 26,000,000 entities will file in the first year the regulations are effective and expects about 3,000,000 entities to file annually thereafter.

Reporting Companies will also be faced with ongoing compliance burdens. Reporting Companies will be required to report changes to their BOI within 30 days, even if the change is transitory. This includes any turnover among their senior officers, and any event in which an individual acquires at least 25% ownership over the company or begins to exercise substantial control over the company. Companies that do not initially file because they are exempt will have 30 days to file once the Reporting Company no longer meets any exemption criteria. If a Beneficial Owner dies, the 30-day time frame will begin at the time the Beneficial Owner's estate is settled and their property interest is legally transferred by intestacy or testamentary disposition, not at the time of the Beneficial Owner's death. Anyone who has requested and received a FinCEN number must report changes to the information reported to

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FinCEN, such as change of business address, within 30 days.

The CTA provides substantial civil and criminal penalties for failure to report or for reporting incorrect information. Reporting entities have a 14-day safe harbor to cure errors from the date the error is discovered, though the safe harbor expires 90 days after the report is filed regardless of when an error is discovered. The safe harbor does not apply if FinCEN finds that the reporting entity purposefully provided false information to evade reporting requirements, however.

Looking Ahead:

The proposed regulations radically alter the relative anonymity provided by American business entities. Though FinCEN's database will be non-public, it will provide a powerful tool for investigations and enforcement actions. On the other hand, the proposed rule creates substantial compliance burdens both in the short term as business entities assess who qualifies as a Beneficial Owner and gather the necessary information from their Company Applicants, and in the long-term, as business entities will have to incorporate FinCEN reporting into several ordinary transactions, such as turnover among senior officers, a change to BOI such as the Beneficial Owner changing home addresses, or transactions in which the creditor can exercise an option to take control of part of the Reporting Company.

The element of the rule requiring Reporting Companies to gather both sensitive data and supporting documents from Beneficial Owners and Company Applicants also triggers data security concerns – virtually

every U.S. state has adopted data breach laws that cover the information displayed on a driver's license, for example. Companies that gather and retain such information face heightened risks in the event of a data breach. Therefore, they should take appropriate steps to safeguard such information as long as it is in their possession and encourage the use of FinCEN identifying numbers to mitigate data security risks.

While there is not yet an effective date for the proposed regulations, the final rule may be accelerated to support anti-money laundering actions, including the now numerous international sanctions on Russian oligarchs and businesses. Companies should consult counsel to determine whether they are a Reporting Company under the proposed rule and begin identifying their Beneficial Owners and Company Applicants, as appropriate. Practitioners who regularly file on behalf of companies will likely want to request a FinCEN number as soon as possible to limit having to provide Reporting Companies with sensitive information. Even if the reporting deadlines are changed in the final rule to be less onerous, all individuals and entities who file with FinCEN will have to incorporate reporting to FinCEN as a standard practice going forward.

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