

ALERTS

FinCEN Issues Notice of Proposed Rulemaking Regarding Beneficial Ownership Information Reporting Requirements Under the Corporate Transparency Act

January 14, 2022

On Dec. 8, 2021, the Financial Crimes Enforcement Network, a bureau of the United States Department of the Treasury (“FinCEN”), issued a notice of proposed rulemaking (“NPRM”)[1] continuing the process of implementing regulations required under the Corporate Transparency Act (“CTA”).[2] Enacted by Congress on Dec. 31, 2020, as part of the National Defense Authorization Act, the CTA requires certain domestic and foreign companies created or registered to do business in the United States (each, a “Reporting Company”) to report certain identifying information, including their 25% or more owners and control persons, directly to FinCEN.[3] That information is to be held in a non-public database maintained by FinCEN and will be shared with law enforcement, federal regulators and financial institutions, among others.

FinCEN intends to issue three rulemakings to fully implement the requirements of the CTA — the first will implement the beneficial ownership information reporting requirements, the second will implement the CTA’s protocols for access to and disclosure of beneficial ownership information and the third will revise the existing Customer Due Diligence rule (“CDD Rule”) to align it with the new requirements imposed by the CTA. The NPRM seeks comments initially only on the beneficial ownership information reporting requirements.

The reporting obligations discussed herein will only take effect upon the promulgation of final regulations by FinCEN. The NPRM follows an advanced notice of proposed rulemaking (“ANPRM”) that was issued on April 5, 2021 and requested public comment on numerous questions relevant to the implementation of the CTA.^[4] Comments in response to the NPRM are due February 7, 2021.

Information to be Reported

The CTA requires each Reporting Company to disclose beneficial ownership information (“BOI”) regarding (1) its beneficial owners, including 25% or more owners and control persons; (2) individuals who register the Reporting Company or file the application necessary for the Reporting Company to do business in the United States (“Company Applicant”); and (3) other identifying information regarding the Reporting Company. Reporting Companies may also voluntarily report the taxpayer identification number of their beneficial owners (after receiving consent from such beneficial owners) to help ensure that the BOI is highly useful to those with access.

Beneficial Owners (Ownership and Control)

The CTA defines a “beneficial owner” as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise (i) owns or controls not less than 25% of the ownership interests of the Reporting Company (“ownership prong”) or (ii) exercises substantial control over the Reporting Company (“control prong”)(each, a “Beneficial Owner”). While not defined in the CTA, the NPRM proposes definitions for “ownership interests” and “substantial control” to clarify which individuals fall into each of the ownership and control prongs.

The CTA requires each Reporting Company to identify each of its Beneficial Owners by:

- Full legal name
- Date of birth
- Complete current residential street address
- A unique identifying number from an acceptable identification document^[5]

- Image of the document from which the unique identifying number was obtained

Ownership Prong. Ownership interests includes both equity in the Reporting Company and other types of interests, such as capital or profit interests (including partnership interests) or convertible instruments, warrants or rights or other options or privileges to acquire equity, capital or other interests in a Reporting Company. Debt instruments are included if they enable the holder to exercise the same rights as one of the specified equity or other interests, including the ability to convert the instrument into one of the specified equity or other interests. This is similar to the U.S. Securities and Exchange Commission's definition of "equity security" in 17 C.F.R. § 230. The proposed language also aims to make clear that an individual may own or control ownership interests through a trust by way of the individual's position as a grantor or settlor, a beneficiary, a trustee or another individual with authority to dispose of trust assets. An individual may reach the 25% threshold by jointly owning or controlling with one or more other persons an undivided ownership interest in a Reporting Company. FinCEN declined to follow the CDD Rule in defining ownership interests where only "equity interests" are relevant.

Control Prong. The CTA requires Reporting Companies to report the BOI of each control person. There are three specific indicators of substantial control: (1) service as a senior officer of a Reporting Company; (2) authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar body) of a Reporting Company; and (3) direction, determination or decision of, or substantial influence over, important matters of a Reporting Company. The NPRM also includes a catch-all provision to make clear that substantial control can take additional forms not specifically listed. An individual may directly or indirectly exercise substantial control over a Reporting Company through a variety of means, including through board representation; through ownership or control of a majority or dominant minority of the voting shares of the Reporting Company; through rights associated with any financing arrangement or interest in a Reporting Company; through control over one or more intermediary entities that separately or collectively exercise substantial control over a Reporting Company; through arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees, or through any other contract, arrangement, understanding, relationship or otherwise. While FinCEN acknowledged concerns raised in the comments

to the ANPRM that a definition of substantial control that is too broad may cause confusion, FinCEN believes that the proposed rule provides sufficient specificity while being flexible enough to account for unique ways in which individuals can exercise substantial control over an entity. FinCEN also believes that entities are already aware of their own ownership structures, regardless of complexity and should be able to readily identify their beneficial owners. Unlike the CDD Rule, the NPRM-proposed definition could require information to be provided on more than one individual under the control prong. FinCEN considered, but decided not to follow, the CDD Rule because the limitation on the number of control persons, FinCEN says, is inconsistent with the CTA's objective of establishing a comprehensive BOI database for all beneficial owners of Reporting Companies.

Exclusions. Beneficial Owner does not include an individual acting as: (i) a nominee, intermediary, custodian or agent on behalf of another individual; (ii) an employee of a Reporting Company, acting solely as an employee and not as a senior officer, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee; (iii) an entity's creditors, unless the creditor holds at least 25% of the entity or has substantial control over the entity; (iv) an individual whose only interest in a Reporting Company is a future interest through a right of inheritance; or (v) a minor child if the information of a parent or guardian is reported.[6]

Company Applicants

A Company Applicant is defined as any individual who files a document that creates a domestic Reporting Company or who first registers a foreign Reporting Company with a secretary of state or a similar office within the United States. This includes any individual who directs or controls the filing of such a document by another person. Reporting Companies are required to disclose the same BOI for Company Applicants as for Beneficial Owners, except a business address rather than residential address may be used.

Information About the Reporting Company

While not specifically mentioned in the CTA, the NPRM proposes that each Reporting Company be required to report to FinCEN:

- Full name of the Reporting Company

- Any trade name or “doing business as” name of the Reporting Company
- Business street address of the Reporting Company
- State or tribal jurisdiction of formation of the Reporting Company
- IRS Taxpayer Identification Number (or, if not available, a DUNS number or Legal Entity Identifier)

FinCEN Identifier

The NPRM provides that an individual may obtain a FinCEN identifier by providing FinCEN with the information that the individual would otherwise have to provide to a Reporting Company if the individual were a Beneficial Owner of the Reporting Company; an entity can obtain such FinCEN identifier from FinCEN when it submits a filing as a Reporting Company or any time thereafter. This means that an individual or legal entity must still disclose information to FinCEN, but once an individual or legal entity has a FinCEN identifier, the individual or legal entity can provide the FinCEN identifier to a Reporting Company in lieu of the personal details required to be disclosed.

Reporting Companies

Subject to numerous exceptions which are designed to exclude many regulated entities and operating business, as discussed below, the CTA broadly defines a Reporting Company as any:

Corporation, limited liability company or other similar entity that is (i) created by the filing of a document with a secretary of state or a similar office under the law of a state or an Indian tribe or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a state or an Indian tribe.[7]

The NPRM breaks out Reporting Companies into domestic Reporting Companies and foreign Reporting Companies. A domestic Reporting Company is defined to include: (1) a corporation, (2) a limited liability company or (3) other entity that is created by the filing of a document with a secretary of state or a similar office under the law of a state or Indian tribe. FinCEN believes that the proposed definition of domestic Reporting Company would likely include limited liability partnerships, limited liability

limited partnerships, business trusts (a/k/a statutory trusts or Massachusetts trusts), and most limited partnerships, in addition to corporations and limited liability companies (LLCs), because such entities appear typically to be created by a filing with a secretary of state or similar office.

The NPRM defines a foreign Reporting Company as any entity that is a corporation, limited liability company, or other entity that is formed under the law of a foreign country and that is registered to do business in the United States by the filing of a document with a secretary of state or equivalent office under the law of a state or an Indian tribe.

Entities Exempt from Definition of Reporting Company

The CTA provides 23 exemptions from the definition of Reporting Company, many of which are designed to exclude entities already required to disclose beneficial ownership information publicly or to federal regulators. Subject to a few clarifications and minor alterations to paragraph structure and the addition of short titles, FinCEN proposes to adopt verbatim the statutory language contained in the CTA. The exemptions include, among others^[8]:

1. An investment company^[9] that is registered with the Securities and Exchange Commission (“SEC”) under the Investment Company Act of 1940^[10] (“40 Act”).^[11]
2. An investment adviser^[12] that is registered with the SEC under the Investment Advisers Act of 1940^[13] (“Advisers Act”).^[14]
3. A venture capital fund adviser: (i) described in section 203(l) of the Advisers Act, and (ii) that has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV, or any successor thereto, with the SEC.^[15]
4. Banks.^[16]
5. Federal or state credit unions.^[17]
6. Broker-dealers.^[18]
7. Futures commission merchants, introducing brokers, swap dealers, major swap participants, commodity pool operators, and commodity

trading advisers that are registered with the Commodities Futures Trading Commission.

8. An insurance company as defined in section 2 of the 40 Act.
9. Any “pooled investment vehicle” that is operated or advised by a (i) bank, (ii) federal or state credit union, (iii) SEC-registered broker or dealer, (iv) SEC-registered investment adviser or (v) venture capital fund adviser.[19]
 1. The CTA defines a “pooled investment vehicle” to mean (i) any investment company, as defined in section 3(a) of the 40 Act;[20] or (ii) any company that (a) would be an investment company under that section but for the exclusion provided from that definition by paragraph (1) or (7) of section 3(c) of the 40 Act,[21] and (b) is identified by its legal name by the applicable investment adviser in its Form ADV (or successor form) filed with the SEC.
10. Large operating companies that (1) employ more than 20 employees on a full-time basis in the United States; (2) who have “filed in the previous year Federal income tax returns in the United States demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate,” including the receipts or sales of other entities owned by the entity and through which the entity operates; and (3) who have “an operating presence at a physical office within the United States.

The CTA also provides for a “subsidiary exemption”—a truncated filing for Beneficial Owners of Reporting Companies that are, themselves, exempt from the definition of Reporting Company. If an entity that is exempt from the definition of Reporting Company is a Beneficial Owner of a Reporting Company, the Reporting Company is only required to report the name of the exempt entity Beneficial Owner and need not report any other information with regard to that exempt entity.[22] The NPRM proposes that in order to take advantage of this “subsidiary exemption,” the entity must be owned entirely by one or more specified exempt entities. While the subsidiary exemption provides for simpler filings than required in other instances, complex entity structures with many subsidiaries may have to file many truncated reports, including the same Reporting Company as the only beneficial owner. FinCEN did not consider ways to simplify the reporting process for such complex entity structures.

While commenters to the ANPRM proposed adding additional exemptions to the definition of Reporting Company, including for certain commodity pools, additional pooled investment vehicles, additional investment advisors, and family offices, FinCEN did not include those exemptions, but welcomed additional comments on whether to adopt exemptions beyond those specifically required by statute.

Exemptions to the Definition of Reporting Company Relevant to Investment Funds and Investment Advisers

The exemptions to the definition of Reporting Company include most private investment funds and their advisers, relieving most funds and advisers from reporting their beneficial ownership information to FinCEN. More specifically, the CTA exempts from the definition of Reporting Company: a mutual fund; an SEC-registered investment adviser; a venture capital fund adviser, as defined under Rule 203(l)-1; and a pooled investment vehicle that is formed under the laws of the United States that is operated or advised by a bank, a credit union, a broker-dealer, an SEC-registered investment adviser or a venture capital fund adviser. Each of these entities is not required to submit a report to FinCEN with BOI.

Certain advisers that are not registered with the SEC, such as state-registered investment advisers and advisers relying on the “private fund adviser exemption,” as defined under Rule 203(m)-1, available to advisers that solely advise private funds if the adviser has assets under management in the United States of less than \$150 million, are not currently exempt from the definition of Reporting Company. As presently drafted, such advisers will be required to report beneficial ownership information to FinCEN unless another exemption applies. For example, an investment adviser that is not otherwise exempt may be able to rely on the exemption available for an entity that employs more than 20 employees on a full-time basis in the United States, has more than \$5 million in gross receipts or sales in the aggregate and maintains a physical office presence within the United States.

Similarly, the pooled investment vehicles advised by advisers that are neither registered with the SEC nor advisers relying on the venture capital exemption may not be exempt from the definition of Reporting Company. For example, a pooled investment vehicle advised by an adviser relying on the “private fund adviser exemption” available to advisers that solely advise private funds if the adviser has assets under management in the United States of less than \$150 million, may be required to submit a report

to FinCEN with beneficial ownership information. Moreover, pooled investment vehicles managed by commodity trading advisers are not currently exempt from the reporting requirements.

The CTA provides a modified reporting requirement for foreign pooled investment vehicles. The NPRM proposes that if an entity would be a Reporting Company but for the exemption provided for pooled investment vehicles operated or advised by a bank, credit union, broker or dealer, or SEC-registered investment company or adviser, or venture capital fund adviser (“Exempt Pooled Investment Vehicle”), and is formed under the laws of a foreign country, such entity shall be deemed a Reporting Company, but only required to provide information to FinCEN with respect to an individual who exercises substantial control over the entity. Under this modified reporting requirement, such entity would be required to report information with respect to “the individual who has the greatest authority over the strategic management of the entity.” It is unclear if this modified reporting requirement is intended to apply only to foreign pooled investment vehicles that are Exempt Pooled Investment Vehicles and meet the definition of “foreign reporting company,” which is limited to entities formed under the law of a foreign country and registered to do business in the U.S., or if it is intended to apply more broadly to an Exempt Pooled Investment Vehicle that is formed under the laws of a foreign country. If the latter approach is the intended approach, then the modified reporting requirement would apply, for example, to all foreign-domiciled pooled investment vehicles operated or advised by an SEC-registered investment adviser.

Because private investment fund managers often advise numerous funds and special purpose vehicles, both foreign and domestic, it is important for them to understand the CTA’s requirements and FinCEN’s implementing regulations, once promulgated, and incorporate any applicable reporting obligations into their compliance functions.

Report Timing

The timing requirements to file an initial report with FinCEN differ based on whether the Reporting Company is formed before or after the effective date of the CTA’s implementing regulations. FinCEN proposes in the NPRM that:

- Any domestic Reporting Company formed on or after the effective date of the final rule shall file a report within 14 calendar days of the date it was formed as specified by a secretary of state or similar office. Similarly, any entity that becomes a foreign Reporting Company on or after the effective date of the final rule shall file a report within 14 calendar days of the date on which it first becomes a foreign Reporting Company.
- Any domestic Reporting Company created before the effective date of the final rule and any entity that became a foreign Reporting Company before the effective date of the final rule shall file a report not later than one year after the effective date of the final rule.
- Any entities that are no longer Reporting Companies by virtue of one or more exemptions are required to file a report within 30 calendar days after the date on which the entity no longer meets any exemption criteria.

FinCEN proposes that Reporting Companies be required to file an updated report within 30 days after the date on which there is any change with respect to any information previously submitted to FinCEN, including any change with respect to who is a beneficial owner of a Reporting Company, as well as any change with respect to information reported for any particular Beneficial Owner. If a Reporting Company becomes exempt after filing an initial report, this change will require an updated report.

FinCEN also proposes requiring Reporting Companies to file a report to correct inaccurately filed information within 14 days after the date on which the Reporting Company becomes aware or has reason to know that any required information contained in any report that the Reporting Company filed with FinCEN was inaccurate when filed and remains inaccurate. This would include information about any Beneficial Owner and the Reporting Company.

Penalties

The CTA prescribes penalties for failing to report or reporting inaccurate or incomplete information. Any person who (i) willfully provides, or attempts to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document; or (ii) willfully fails to report, complete or update beneficial ownership information (a) shall be liable for a civil penalty of not more than \$500 for

each day that the violation continues or has not been remedied and (b) may be fined not more than \$10,000, imprisoned for not more than two years or both.[23] The NPRM clarifies that this applies to individuals, including Beneficial Owners, as well as Reporting Companies. However, there is a safe harbor if a report that contains inaccurate information is voluntarily corrected within 90 days, so long as the inaccurate report was not submitted to evade the reporting requirements or with actual knowledge of its inaccuracy.[24]

Conclusion

The CTA is an important step toward revealing BOI often used to hide money laundering and terrorist financing. The centralized BOI database will provide law enforcement, financial regulators and financial institutions with important information that Congress has determined necessary in order to combat financial crime.

The goal of the CTA is to require BOI be reported to FinCEN where that information is not available elsewhere. However, as noted in Schulte Roth & Zabel's comment letter to the ANPRM, [25] there are several types of entities which we suggest should be exempt from reporting BOI when that information is available elsewhere to regulators. Those include exempt reporting advisers relying on Section 203(m) of the Advisers Act and the funds they operate or advise and pooled investment vehicles operated or advised by CFTC-registered commodity pool operators or commodity trading advisers. It remains to be seen whether FinCEN will exempt those entities.

The full impact of the CTA will not be clear until FinCEN concludes this and its two other rulemakings in connection with the CTA. Although this NPRM provides some clarity regarding FinCEN's interpretation of the CTA, many issues remain unclear. For example, how FinCEN will share information in the BOI database with authorized government authorities and financial institutions and how the CDD Rule will be adjusted based on the CTA implementing regulations. FinCEN is also seeking comment from the public on (1) the need for additional special reporting rules, (2) the practicality of the proposed timing of reports and relevant updates and (3) the effective date of the rule. Clients that may be affected by the CTA should monitor the continued rulemaking process in the meantime for additional clarification from FinCEN.

Schulte Roth & Zabel's lawyers are available to assist you in addressing any questions you may have regarding these developments. Please contact the Schulte Roth & Zabel lawyer with whom you usually work, or any of the following attorneys:

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] NPRM, Beneficial Ownership Information Reporting Requirements, 86 Fed. Reg. 69,920 (Dec. 8, 2021), available here (hereinafter, "NPRM").

[2] National Defense Authorization Act for Fiscal Year 2021 (CTA §§ 6401-03), available here.

[3] For more information regarding the CTA and AML Act generally, please see our prior *Alert* "Passage of Anti-Money Laundering Act of 2020 Includes Comprehensive BSA/AML Reform Measures."

[4] For more information regarding the ANPRM, please see our prior *Alert* "FinCEN Commences Rulemaking Process for Implementation of Corporate Transparency Act Requiring Disclosure of Beneficial Ownership Information."

[5] Acceptable identification documents include: (1) a non-expired passport issued by the United States government; (2) a non-expired identification document issued by a state, a local government or an Indian tribe for the purpose of identifying the individual; (3) a non-expired driver's license issued by a state; or (4) a non-expired passport issued by a foreign government.

[6] CTA § 6403 (adding 31 USC § 5336(a)(3)(B)).

[7] CTA § 6403 (adding 31 USC § 5336(a)(11)(A)).

[8] For a full list of exemptions see CTA § 6403 (adding 31 USC § 5336(a)(11)(B)).

[9] As defined in section 3 of the Investment Company Act of 1940 (15 USC § 80a-3).

[10] 15 USC § 80a-1, *et seq.*

[11] CTA § 6403 (adding 31 USC § 5336(a)(11)(A)(x)).

[12] As defined in section 202 of the Advisers Act (15 USC § 80b-2).

[13] 15 USC § 80b-1, *et seq.*

[14] CTA § 6403 (adding 31 USC § 5336(a)(11)(A)(x)).

[15] CTA § 6403 (adding 31 USC § 5336(a)(11)(A)(xi)).

[16] As defined in (i) section 3 of the Federal Deposit Insurance Act (12 USC § 1813); (ii) section 2(a) of the 40 Act (15 USC § 80a-2(a)); and (iii) section 202(a) of the Advisers Act (15 USC § 80b-2(a)).

[17] As defined in section 101 of the Federal Credit Union Act (12 USC § 1752).

[18] That is registered under section 15 of the Securities Exchange Act (“Exchange Act”). 15 USC § 78o (and as defined in 15 USC § 78c).

[19] CTA § 6403 (adding 31 USC § 5336(a)(11)(A)(xviii)).

[20] 15 USC § 80a-3(a).

[21] *Id.*

[22] CTA § 6403 (adding 31 USC § 5336(b)(2)(B)).

[23] CTA § 6403 (adding 31 USC § 5336(h)).

[24] *See* CTA § 6403 (adding 31 USC § 5336(h)(4)(3)(C)(i)).

[25] *For more information, please see the full Comment Letter.*

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