

# FinCEN Issues Long-Awaited Proposed Rule To Implement New Beneficial Ownership Reporting Requirements

12 / 17 / 21

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

One Manhattan West  
New York, NY 10001  
212.735.3000

1440 New York Avenue, N.W.  
Washington, D.C. 20005  
202.371.7000

On December 7, 2021, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a highly anticipated notice of proposed rulemaking (the Proposed Rule) to implement the beneficial ownership reporting requirements of the Corporate Transparency Act (CTA). The CTA, which was enacted on January 1, 2021, as part of the National Defense Authorization Act for fiscal year 2021 (NDAA), aims to establish a new framework for the reporting, maintenance and disclosure of beneficial ownership information and represents the culmination of years of efforts by Congress, the Treasury Department, and other law enforcement and national security agencies to increase beneficial ownership transparency. The Proposed Rule was issued in the midst of other steps the Treasury Department is taking to fight money laundering, corruption, terrorism financing and other financial crimes.<sup>1</sup> FinCEN seeks comments on the proposed rule by February 7, 2022.

The Proposed Rule follows an advance notice of proposed rulemaking announced by FinCEN on April 1, 2021,<sup>2</sup> and it is the first of three rulemakings planned to implement the CTA. FinCEN will engage in additional rulemakings to establish protocols for access to and disclosure of beneficial ownership information<sup>3</sup> and to revise FinCEN's May 2018 Customer Due Diligence Rule (CDD Rule).<sup>4</sup> While the CTA does not impose a deadline for the promulgation of regulations regarding access and disclosure, FinCEN has indicated that it will be a parallel effort to the finalization of the Proposed Rule. Further, FinCEN is required to amend the CDD Rule no later than one year after the effective date of the final version of the Proposed Rule to conform the CDD Rule to the CTA's implementing regulations.

## Who Must Report?

The CTA imposes beneficial ownership reporting requirements on "reporting companies," which include domestic and foreign corporations, LLCs and other similar entities, subject to certain statutory exemptions. The Proposed Rule describes a "domestic reporting company" as any entity that is created by the filing of a document with a secretary of state or similar office of a jurisdiction within the United States and a "foreign reporting company" as any entity formed under the law of a foreign jurisdiction that is registered to do business within the United States.

The CTA specifically exempted 23 distinct categories of entities from its definition of reporting companies, presumably because beneficial ownership information for these entities is generally available from other credible sources. Notably, while the CTA grants FinCEN the authority to exempt additional entities, the Proposed Rule does not create any additional categories of exempted entities and, but for a number of clarifications, proposes to adopt verbatim the statutory language establishing the 23 specified exemptions. Exempted entities include, among others, domestic banks, bank holding companies, savings and loan holding companies, federal or state credit unions, and FinCEN-registered money services business; certain issuers of securities registered

<sup>1</sup> In addition to this Proposed Rule, on December 6, FinCEN solicited public comments on a potential rule to address the vulnerability of the U.S. real estate market to money laundering and other criminal activity. Please refer to: <https://www.federalregister.gov/documents/2021/12/08/2021-26549/anti-money-laundering-regulations-for-real-estate-transactions>.

<sup>2</sup> <https://www.skadden.com/insights/publications/2021/04/fincen-commences-rulemaking-process>.

<sup>3</sup> While regulations regarding protocols for access to beneficial ownership information will be issued pursuant to a separate rulemaking process, FinCEN notes that it is only authorized to disclose beneficial ownership information to certain government agencies and, in limited circumstances, to financial institutions, as set forth in the CTA.

<sup>4</sup> The CDD Rule, which became effective in May 2018, requires certain U.S. financial institutions to collect beneficial ownership information from legal entity customers.

# FinCEN Issues Long-Awaited Proposed Rule To Implement New Beneficial Ownership Reporting Requirements

with the Securities and Exchange Commission; certain entities registered with the Commodities Futures Trading Commission; certain pooled investment vehicles and tax exempt 501(c)(3) organizations; investment advisers and insurance companies; registered public accounting firms; certain public utilities; and entities owned or controlled by each of the foregoing exempted entities. A reporting company similarly does not include companies that employ more than 20 employees on a full-time basis in the U.S., have filed U.S. federal income tax returns in the previous year showing more than \$5 million in aggregate gross receipts or sales, and maintain an operating presence at a physical office within the United States.

The Proposed Rule does not impose any filing requirements on entities that fall under an exemption from the definition of reporting company. However, FinCEN invited comment on whether it should require exempt entities to submit a report to FinCEN to claim an exemption, or whether FinCEN should permit exempt entities to voluntarily file exemption certifications. The Proposed Rule would require exempt entities to file a report within 30 calendar days after no longer qualifying for an exemption. FinCEN believes that 30 days should provide sufficient time for such entities to collect and report the required beneficial ownership information to FinCEN but invites comment on whether that timeframe is reasonable.

## What Information Must Be Reported?

The Proposed Rule requires a reporting company to submit to FinCEN certain information with respect to: (1) the reporting company; (2) each beneficial owner; and (3) the company's applicant(s). Under the Proposed Rule, each person filing a report with FinCEN shall certify that the report is accurate and complete. The definitions of "beneficial owner" and "company applicant" are discussed in the following section.

A reporting company must report its full name, any alternative names through which the company engages in business, its business street address, its jurisdiction of formation or registration, and its Taxpayer Identification Number (TIN), or where a reporting company has not yet been issued a TIN, a Dun & Bradstreet Data Universal Numbering System Number or a Legal Entity Identifier.

For each beneficial owner and company applicant, reporting companies must disclose the individual's full legal name, date of birth, current residential or business street address, and a unique identifying number from an acceptable identification document (e.g., a valid passport or driver's license). A reporting company is also required to provide a scanned copy of the identification

document from which the unique identifying number of the beneficial owner or company applicant is obtained. The Proposed Rule provides that in lieu of specific information about an individual, the reporting company may provide the individual's FinCEN identifier — a unique identifying number assigned by FinCEN to a person. The Proposed Rule explains that an individual may obtain a FinCEN identifier by submitting to FinCEN an application containing the information about themselves that would be required in a report filed by a reporting company. Similarly, a reporting company may obtain a FinCEN identifier by submitting to FinCEN an application at or after the time that the entity submits an initial report to FinCEN. FinCEN notes that, in certain cases, the FinCEN identifier may provide a substitute to individuals who do not wish to provide their names, birth dates or addresses to a reporting company.

Further, the Proposed Rule describes "highly useful" information that reporting companies are encouraged, but not required, to provide for each beneficial owner or company applicant, such as the individual's TIN. FinCEN has specifically sought comments on whether there are other categories of information that FinCEN should collect about beneficial owners and company applicants, taking into consideration the statutory language of the CTA.

## Definition of 'Beneficial Owner' and 'Company Applicant'

The CTA defined a "beneficial owner" as any individual who, directly or indirectly, either exercises "substantial control" over the entity or owns or controls 25% or more of the "ownership interests" of the entity. The meaning that FinCEN proposes to ascribe to the terms, "substantial control" and "ownership interests," which had remained undefined in the CTA, would substantially broaden the universe of individuals who may qualify as "beneficial owners," beyond those currently captured by the CDD Rule.

## The 'Substantial Control' Prong

According to the Proposed Rule, "substantial control" includes: (1) service as a senior officer of the reporting company; (2) authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of directors (or similar body); (3) direction, determination or decision of, or substantial influence over, important matters affecting the reporting company; or (4) any other form of substantial control over the reporting company.

While the first category of "substantial control" is intended to cover individuals with nominal legal authority, the second and third categories are designed to capture individuals with factual authority. The fourth, catch-call category, in particular, appears

# FinCEN Issues Long-Awaited Proposed Rule To Implement New Beneficial Ownership Reporting Requirements

to leave the door open to an ad hoc assessment of “substantial control” by the applicant and, potentially, FinCEN in the context of an investigation or enforcement action. FinCEN notes that this final category “recognizes that control exercised in novel and unorthodox ways can still be substantial.” Significantly, each and every person who exercises “substantial control” under any of these four categories is considered a “beneficial owner” under the Proposed Rule. This is in stark contrast to the CDD Rule pursuant to which only one single “beneficial owner” is required to be disclosed under the control prong.<sup>5</sup> FinCEN expects that a reporting company would identify at least one beneficial owner under the “substantial control” prong regardless of whether (1) any individual satisfies the ownership prong, or (2) exclusions to the definition of beneficial owner apply, but seeks comment on whether that expectation is reasonable.

Consequently, reporting companies could theoretically be required to provide information with respect to a large number of beneficial owners, given that FinCEN has not capped the number of beneficial owners for which information must be reported as it did in the context of the CDD rule. FinCEN has indicated that a reporting company would not need to spend significant time assessing which of its beneficial owners would be the most appropriate to report under the substantial control prong. Rather, entities should simply report all persons in substantial control as beneficial owners, with no need to distinguish among them. FinCEN has solicited comments on the usefulness of the catch-all provision of substantial control. We expect that the inclusion of this broad provision will receive substantial criticism.

## The ‘Ownership Interests’ Prong

Similarly, the ownership prong under the Proposed Rule is broader than under the CDD rule. While under both rules there can be anywhere between zero and four beneficial owners, depending on the distribution of ownership within the company, the Proposed Rule considers a wider range of assets in determining levels of ownership. Whereas the CDD rule only considers equity interests, the term “ownership interests” under the Proposed Rule includes equity interests as well as other interests, such as, for example, capital or profit interests, convertible instruments, warrants or rights, or other options or privileges to acquire equity, capital or other interests in a reporting company. While the Proposed Rule contemplates a calculation whereby an individual’s ownership interests across all categories would be compared to the “undiluted ownership interests of the company,” FinCEN is seeking comments on the approach to calculating the 25% threshold across different categories of ownership interests, as companies may face practical challenges in performing this calculation.

<sup>5</sup> See 31 C.F.R. 1010.230(d)(2).

## Exceptions to Definition of Beneficial Owners

The Proposed Rule further describes five exceptions to the definition of beneficial owners that had been outlined by the CTA. These are: (1) a minor child; (2) an individual acting as a nominee, intermediary, custodian or agent on behalf of another individual; (3) an employee of a reporting company, acting solely as an employee and not as senior officer, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee; (4) an individual whose only interest in the reporting company is a future interest through a right of inheritance; and (5) a creditor of a reporting company.

## Who Is a Company Applicant?

Moreover, the Proposed Rule defines who is a company applicant. In the case of a domestic reporting company, a company applicant is the individual who files the document that forms the entity. In the case of a foreign reporting company, a company applicant is the individual who files the document that first registers the entity to do business in the United States. The Proposed Rule specifies that a company applicant includes anyone who directs or controls the filing of the document by another.

## Reporting Timeframes

Under the Proposed Rule, reporting companies created or registered to do business in the United States before the effective date of the final rule would have one year from the effective date to file their initial report with FinCEN.<sup>6</sup> Reporting companies created or registered to do business in the U.S., for the first time, on or after the effective date would be required to file their initial report with FinCEN within 14 calendar days of the date on which they are created or registered, respectively. If there is a change in the information previously reported to FinCEN, reporting companies would have 30 calendar days to file an updated report. Finally, if a reporting company filed information that was inaccurate at the time of filing, the reporting company would have to file a corrected report within 14 calendar days of the date it knew, or should have known, that the information was inaccurate.

While FinCEN did not propose an effective date for the final version of the Proposed Rule, it requested comments on the timing of the effective date and any potential factors to be considered. Specifically, FinCEN asked how much time may be needed before the rule is effective to enable jurisdictions within the United States, reporting companies and other stakeholders to incorporate any necessary changes into their systems and other procedures in tandem with other routine updates, and thereby enable reporting companies to reduce implementing costs. At the same time,

<sup>6</sup> We note that this is a shorter timeframe than the maximum timeframe that the CTA would have permitted.

# FinCEN Issues Long-Awaited Proposed Rule To Implement New Beneficial Ownership Reporting Requirements

FinCEN stressed that it is committed to identifying the “soonest possible effective date after publication of the final rule.”

## Penalties for CTA Violations

The CTA lays out civil and criminal penalties for persons who “willfully provide, or attempt to provide, false or fraudulent beneficial ownership information ... to FinCEN” or “willfully fail to report complete or updated beneficial ownership information to FinCEN.” Such persons shall be liable for a civil penalty of up to \$500 for each day a violation continues or has not been remedied, and may be fined up to \$10,000 and imprisoned for up to two years, or both, for a criminal violation. The Proposed Rule clarifies that the term “person” includes any individual, reporting company or other entity. While only reporting companies are

required to file reports with FinCEN, FinCEN highlights that it is “essential” that individual beneficial owners or company applicants be liable if they willfully provide false or fraudulent information to a reporting company for submission to FinCEN.

## Next Steps

Given that FinCEN continues to solicit detailed feedback on the Proposed Rule and its plan to engage in further rulemakings to implement the CTA, there remains uncertainty as to the exact structure and timing of a final rule. Nevertheless, businesses may want to begin taking steps to facilitate the collection and reporting of beneficial ownership information. The deadline for comments on the Proposed Rule is February 7, 2022.

---

## Contacts

### Jamie L. Boucher

Partner / Washington, D.C.  
202.371.7369  
jamie.boucher@skadden.com

### Eytan J. Fisch

Partner / Washington, D.C.  
202.371.7314  
eytan.fisch@skadden.com

### Ondrej Chvosta

Associate / Washington, D.C.  
202.371.7579  
ondrej.chvosta@skadden.com

### Vartan Shadarevian

Associate / Washington, D.C.  
202.371.7363  
vartan.shadarevian@skadden.com

### Javier A. Urbina

Associate / Washington, D.C.  
202.371.7376  
javier.urbina@skadden.com