Miller & Chevalier

FinCEN Proposed Rule Outlines Beneficial Ownership Reporting Obligations

Litigation Alert
12.16.2021

On December 8, the Financial Crimes Enforcement Network (FinCEN) issued its much-anticipated Notice of Proposed Rulemaking regarding Beneficial Ownership Reporting Requirements (Proposed Rule). The Proposed Rule, the first of three formal rulemaking processes to be undertaken by FinCEN to implement the Corporate Transparency Act (CTA), will require affected companies to report a broad range of beneficial owners. The Proposed Rule will not only require companies to take a much more fact-intensive approach to reporting beneficial ownership than has been required under the Customer Due Diligence (CDD) Rule, but also foreshadows a broader shift to the CDD rule, which will be the subject of a separate rulemaking process. Below we describe key aspects of the Proposed Rule, which remains open for comment until February 7, 2022.

Background

As previously reported, in January 2021, Congress enacted the CTA as part of the William M. (Mac) Thornberry National Defense Authorization Act (NDAA) for Fiscal Year 2021. The CTA directed FinCEN to promulgate regulations by the end of 2021 regarding the creation of a beneficial ownership registry for U.S. entities and foreign entities registered to do business in the U.S. In April 2021, FinCEN began the rulemaking process with an Advanced Notice of Proposed Rulemaking that sought public comment on the regulations generally and on 48 questions in particular. FinCEN received and reviewed 220 comments and on December 8, 2021 issued its Proposed Rule. The Proposed Rule addresses only the reporting requirements for beneficial ownership information. FinCEN intends to issue additional regulations to implement the CTA's protocols for access to and disclosure of the beneficial ownership information and to update the CDD Rule. The public has 60 days to submit comments on the Proposed Rule.

Who must report: Under the CTA, a "reporting company" has to provide to FinCEN identifying information for all of its beneficial owners. A "reporting company" is defined as any corporation, limited liability company, or other entity that is created by the filing of a document with a secretary of state or created outside the U.S. but is registered to do business in any state. Though the definition of "reporting company" broadly reaches any company created in the U.S. or registered to do business in the U.S., the law contains 23 exemptions, many of which are quite broad. For example, exempted companies include SEC reporting issuers, banks, insurance companies, and large operating companies that employ more than 20 full-time employees, have a physical office within the U.S., and have filed federal tax returns demonstrating more than $5 million in gross receipts. In exempting these companies from the reporting requirements, FinCEN explained that the law sought to avoid imposing duplicative requirements on entities that are already heavily regulated. FinCEN was authorized to create additional exemptions but declined to do so in the Proposed Rule.

What must be reported: Reporting companies must provide FinCEN with identifying information about all beneficial owners and the "company applicant." The "company applicant" is the individual who files the document that creates or registers the company to do business in the U.S. As discussed in more detail below, "beneficial owners" are individuals who either exercise substantial control over the company or own at least 25 percent of the company. In general, reporting companies must provide for each beneficial owner and company applicant: name, date of birth, address (residential address for owners and business address for applicants), and a scanned copy of an identification document. If the beneficial owners and company applicants have obtained a FinCEN identifier, then that number can be provided in lieu of the identifying information. In addition to the information about owners and applicants, reporting companies must provide basic information about the company itself, including all names of the company, business street address, jurisdiction of formation, and IRS Taxpayer Identification Number.

When must companies report: The reporting of beneficial ownership is not imminent: FinCEN is continuing to develop technical aspects of the database and preexisting companies have one year after the Proposed Rule is finalized to submit an initial beneficial ownership report to FinCEN. However, after the rule goes into effect, the reporting timeline is quite short for new companies or companies required to update information. For example, new companies must file a report within 14 days from the date they qualify as a reporting company. In addition, all companies must update information within 30 days if there are changes to the information previously provided.

What are the consequences for non-compliance : Under the CTA, any "person" who willfully provides or attempts to provide false or fraudulent beneficial ownership information or willfully fails to report complete or updated beneficial ownership information can be punished with up to two years imprisonment and a civil penalty of up to $500 for each day that the violation continues. The Proposed Rule clarifies that the term "person" includes any individual, reporting company, or other entity, and that a person can violate the statute by willfully providing false information to FinCEN directly or indirectly, including by providing information to a person for purposes of making a report.

Key Takeaways from the Proposed Rule

FinCEN's Proposed Rule signals a change in how companies think about beneficial ownership reporting. The change is relevant for all reporting companies who are potentially liable under the CTA and could foreshadow larger changes to beneficial ownership due diligence requirements. A few aspects of the Proposed Rule are particularly noteworthy:

Broad definition of substantial control : A reporting company must report beneficial ownership information for **all** beneficial owners. Unlike the CDD Rule, under this Proposed Rule, companies will not need to identify a single beneficial owner who substantially controls the company. Instead, companies will need to report all individuals who exercise substantial control. FinCEN adopted this approach because it viewed limiting reporting to a single individual in control of the company could become a means of evasion. However, the broad definition of "substantial control" may create practical challenges for companies attempting to comply with the requirements. "Substantial control" includes senior officers of the reporting company, authority over the appointment or removal of senior officers, "direction, determination, or decision of, or substantial influence over, important matters affecting the reporting company," and "any other form of substantial control over the reporting company." This broad definition may create uncertainty about whether companies have adequately reported all beneficial owners and could lead to over-inclusive filings by risk-adverse companies. FinCEN sought to further narrow the definition in its explanation of the Proposed Rule, saying that it agreed that a property manager who makes decisions that influence the operations of the property but is hired by the owners of the property is not a beneficial owner under the rule. "The ordinary execution of day-to-day managerial decisions with respect to one part of a reporting company's assets or employees typically should not, in isolation, cause the decision-maker to be considered in substantial control of a reporting company, unless that person satisfies another element of the 'substantial control' criteria," FinCEN clarified in the Proposed Rule. But such an example highlights the difficulties that companies could have in determining everyone who maintains substantial control over the company.

Broad definition of ownership beyond equity : The definition of beneficial owner also includes those who directly or indirectly own or control at least 25 percent of the ownership interests of the reporting company. Ownership is not limited to equity ownership but also includes other types of interests such as capital or profit interests, including partnership interests, options to acquire equity or profits, or other interests. FinCEN said that this approach "requires reporting companies to consider all facts and circumstances when making determinations about who owns or controls ownership interests." The goal of this fact-intensive approach is to "thwart[] the use of complex ownership structures and ownership vehicles other than direct equity ownership to obscure a reporting company's real owners," but as with substantial control, making the inquiry one that requires companies to consider the totality of facts and circumstances will impose additional burden on companies seeking to identify all beneficial owners.

Expanded reporting for interests held in trust : Regarding trusts, the Proposed Rule also takes a broad, fact-specific approach. Instead of instructing the reporting company to report the trustee for ownership held in trust, which is the approach taken by the CDD rule, the Proposed Rule requires reporting of: (1) the trustee or other individual with the authority to dispose of trust assets, which could include the protector, for example; (2) a beneficiary who is the sole permissible recipient of income and principal from the trust or has the right to demand or distribution of substantially all trust assets; and (3) the grantor or settlor who has the right to revoke the trust or withdraw the assets. FinCEN acknowledged that "these concepts do not map easily onto every trust or similar arrangement" and is seeking comments, in particular, on the approach to ownership of assets in trust.

Short timeframe to update beneficial ownership information : As discussed above, the timeframe for updating beneficial ownership information is short. Once the rule goes into effect and companies have submitted their initial reports, reporting companies will have 30 days after any changes to update the information provided. By contrast, the statutory language in the CTA only requires companies to update changed information "in a timely manner, and not later than one year after the date on which there is a change." FinCEN shortened that window substantially, stating, "keeping the database current and accurate is essential to keeping it highly useful, and . . . allowing reporting companies to delay mandatory updates by more than 30 days — or allowing them to report updates on an annual basis — could cause a significant degradation in accuracy and usefulness of the [beneficial ownership information]." However, whereas an annual reporting would allow companies to simply check their beneficial ownership records once a year, a 30-day reporting requirement will require companies to proactively monitor beneficial ownership information for potential changes. The short timeframe to update reports will likely require companies to develop controls that will allow them to process changes to their beneficial ownership on a regular basis. This could be particularly complex for companies complicated ownership structures or a significant number of employees who exercise substantial control over the company.

Lack of clarity around FinCEN's approach for verifying exemptions : As described above, the Proposed Rule exempts a broad range of companies from the contemplated reporting requirements. However, the Proposed Rule does not address how FinCEN will undertake to verify that entities correctly claimed exemptions. In the Proposed Rule, FinCEN suggests that it may lack authority to affirmatively require companies to file an exemption certificate and invited comment on the appropriateness of requesting companies to file a voluntary exemption certificate. Given the broad range of companies that potentially qualify for an exemption, the way in which FinCEN administers verifying exemption claims will likely have a widespread impact.

Possible foreshadowing of changes to the CDD Rule : In the Proposed Rule, FinCEN underscores that, in creating the Proposed Rule, it was not limited by the approach adopted in the CDD Rule. FinCEN also repeatedly noted the forthcoming rulemaking process that it will undertake to revise the existing CDD Rule. As discussed above, the approach taken in this Proposed Rule is a significant expansion from the CDD Rule currently in place. Given the treatment of the CDD rule, this Proposed Rule may indicate a desire on the part of FinCEN to broaden the CDD Rule as well to harmonize it with the requirements in the Proposed Rule.

Conclusion

FinCEN's Proposed Rule makes several substantial changes to the U.S. beneficial ownership reporting regime. The Proposed Rule takes a fact-intensive approach to beneficial ownership reporting and requires reporting of a broader number of beneficial owners than previous beneficial ownership reporting requirements. The Proposed Rule also requires companies to report changes to those beneficial owners within 30 days. These are some of the most significant aspects of the proposed implementing regulations. Companies that wish to comment on these or any other aspects of the Proposed Rule must submit those comments by February 7.

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