

Treasury's Proposed Beneficial Ownership Reporting Requirements will Require Careful Planning for Reporting Companies and Their Applicants

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The Bottom Line:

On December 7, 2021, the Financial Crimes Enforcement Network (“FinCEN”) issued a Notice of Proposed Rulemaking (“**NPRM**”) regarding the beneficial ownership reporting requirements of the Corporate Transparency Act (“CTA”). The NPRM envisions widespread and comprehensive reporting requirements under the CTA—including an ongoing reporting requirement for changes in information. The purpose of the AMLA and the CTA provisions are to prevent bad actors from using shell companies and complex corporate structures to facilitate and disguise their illicit activity. The NPRM seeks to achieve the CTA’s goal of addressing weaknesses in the existing patchwork of state laws regarding the collection and maintenance of beneficial ownership information by establishing a clear federal standard for the collection of this information, and by requiring FinCEN to create and maintain a non-public registry to store that information. The Biden administration has recently emphasized combating global corruption, and the US Treasury Department has long acknowledged the need to limit the misuse of legal entities by building a beneficial ownership registry, consistent with efforts of the Financial Action Task Force (“FATF”)¹ and G7 and G20 leaders to curb the ability of criminal enterprises to hide behind anonymous shell companies.

As discussed below in more detail, the NPRM expansively defines who qualifies as a beneficial owner—those exercising “substantial control” and those with a 25% “ownership interest”—and amends the existing Customer Due Diligence (“CDD”) Rule. FinCEN estimates that once the regulations go into effect, at least 25 million existing companies will have to make a report under the CTA and approximately three million new entities created each year (and individuals and businesses that routinely facilitate the creation of these entities) will potentially be subject to the regulations. Failure to comply with the new reporting regime could result in civil and criminal penalties.

The Backstory:

Enacted on January 1, 2021, as part of the Anti-Money Laundering Act of 2020 (the “AMLA”), the CTA introduced sweeping reforms to US anti-money laundering (“AML”) and counter-terrorist financing (“CFT”) laws. The AMLA and CTA were intended to modernize the Bank Secrecy Act (“BSA”), thwart the use of shell companies by criminals, address emerging financial threats, reform whistleblower incentives, and improve coordination and information sharing between regulators, law enforcement, and financial institutions. While the language of the CTA requires certain corporations, limited liability companies, and other specified entities to disclose their beneficial owners to FinCEN, we have been waiting for FinCEN to issue regulations on how exactly the CTA would be implemented. The NPRM lays out FinCEN’s proposed rule on beneficial ownership information (“BOI”) reporting requirements² that describes who must file a BOI report, what information must be reported, and when such a report is due. The NPRM’s public comment period closes on February 7, 2022, at which point FinCEN will either publish its final findings along with the codified rule, or it will modify the proposed rule and enter into a new comment period.

The Full Story:

Each state has its own processes and requirements for the formation of corporations and other legal entities. The CTA is intended to close this gap in US anti-money laundering laws by requiring FinCEN to collect the names of beneficial owners at the time of entity formation. Critical to understanding who needs to file—and when—are several key defined terms in the NPRM, discussed further below.

Reporting Companies

The NPRM takes an expansive view of the CTA’s definition of “reporting companies” that must report information regarding their beneficial ownership to FinCEN. Under the proposed regulations, a “domestic reporting company” is any entity that is created by the filing of a document with a secretary of state or similar office of a jurisdiction within the US, while a “foreign reporting company” is any entity formed under the law of a foreign jurisdiction that is registered to do business within the US.

Exempt Companies

Because the CTA is focused on shell companies, the NPRM traces the CTA statute and exempts numerous categories of entities—the NPRM currently describes 23 specific exemptions—from the reporting requirement, including: publicly-traded companies; banks, federal or state credit unions; registered money transmitter businesses; broker/dealers; insurance companies; investment companies and advisers; and qualifying larger businesses. The NPRM attempts to clarify the “large operating companies” exemption for entities with a physical US office; more than 20 “full-time” employees, and which reported more than \$5 million in gross receipts or sales on its last US federal tax return.

Beneficial Owner

A “beneficial owner” is defined as someone who directly or indirectly “exercises substantial control over the entity,” or who owns or controls at least 25% of the reporting entity’s ownership interests:

1. The “*Substantial Control*” Prong

The NPRM would require a reporting company to identify any and all individuals who satisfy the “substantial control” prong. This is more expansive than the existing CDD Rule that requires a covered entity to report only one beneficial owner under the substantial control prong. Moreover, the NPRM proposes three indicators or badges 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, decision-making functions, or substantial influence over important matters of a reporting company. In the NPRM, FinCEN provides specific examples of these indicators of substantial control and anticipates that this definition will require disclosure of the identities of more individuals than is currently the case.

2. The “Ownership” Prong

The NPRM also expands the “25% of ownership interest” rule. Again, taking a broader view than the CDD rule for financial institutions, the NPRM does not restrict the 25% ownership interest rule to just equity owners, but envisions other types of legal interests to be qualified as beneficial owners. The NPRM describes multiple types of ownership interests that vary in terms of ease of definition. At one end of the spectrum, equity and stock interests, capital or profits interest, and proprietorship interests can be, under the right circumstances, straightforward. However, the NPRM also defines the term “ownership interest” to include a host of future conversions of ownership interests that are not easily defined and will likely depend on retrospective analysis that will provide no comfort when reporting companies are making difficult judgments on who to include.³

Company Applicant

In the case of a domestic reporting company, the “company applicant” is the individual who files the document that forms the entity; for foreign reporting companies, the company applicant is the individual who files the document that registers the entity to do business in the United States.

The NPRM tracks the CTA’s definition of “company applicant” of a reporting company. The NPRM, however, does add that in addition to the person filing the entity formation or registration document, a reporting company must also report “any individual who directs or controls the filing of such document by another person.” This requirement is designed to ensure that the reporting company provides information on individuals who are responsible for the decision to form a reporting company. FinCEN believes that this information will be useful to investigate the submission of inaccurate information if it is able to identify both the individual who submitted the report and the person who directed or controlled that activity.

What Information Must be Reported & When Must the Report be Filed

A reporting company must timely submit a report to FinCEN. The required reports must include each beneficial owner and each company applicant’s full legal name, date of birth, current residential or business address⁴, and a unique identifier from either an acceptable identification document or a previously-assigned FinCEN identifier.

For reporting companies formed or registered after the effective date, the proposed regulations provide that the initial report must be submitted within 14 calendar days of the date the entity was formed or first registered. For reporting companies in existence prior to the effective date, FinCEN proposes that a report be filed within one year after the effective date of the regulations. The proposed regulations also state that if an exempt entity becomes subject to the CTA reporting

requirements, it is required to file a report with FinCEN within 30 calendar days after the date on which it no longer meets the exemption criteria.

The NPRM also outlines timeframes for companies that need to file updated and corrected reports. Reporting companies must file updated reports within 30 days “after the date on which there is any change with respect to any information previously submitted to FinCEN.” Unfortunately, this 30-day deadline appears to start on the day the change occurred regardless of whether the reporting company has actual or constructive knowledge of the change. Conversely, for filing a corrected report, a reporting company has 14 days from the date that it “becomes aware or has reason to know that any required information contained in any report ... was inaccurate when filed and remains inaccurate.”

Odds and Ends:

Notably, given the sensitivity of the reportable information, the central beneficial ownership registry will not be public. The law authorizes FinCEN to disclose the beneficial ownership information it collects for only two purposes: 1) to facilitate important national security, intelligence, and law enforcement activities, and 2) to confirm beneficial ownership information provided to financial institutions to facilitate their compliance with applicable anti-money laundering and customer due diligence requirements. FinCEN may also disclose beneficial ownership information to financial institutions to facilitate compliance with the CDD Rule so long as it has the reporting company’s consent.

The CTA provides that any willful violation of beneficial ownership reporting requirements can lead to penalties including (1) civil penalties of up to \$500 per day that a violation has not been remedied; and (2) criminal penalties of up to \$10,000 and imprisonment of up to two years. The NPRM adopts this penalty framework, clarifying that liability can be for direct or indirect violations, and for acts (*i.e.*, reporting of inaccurate information) or omissions (*i.e.*, failure to provide or update any required information). Accordingly, any person who willfully fails to file complete beneficial ownership information, who files false or fraudulent information, or who knowingly makes an unauthorized disclosure or use of beneficial ownership information obtained from FinCEN is subject to civil and criminal liability.

Reporting companies already in existence when the regulations take effect will have two years to comply, and those formed after the effective date must comply upon formation. Reporting companies must also notify FinCEN within 30 days of any changes in beneficial ownership that occur after making their initial reports.

In addition to the CTA and its beneficial ownership disclosure requirements, the AMLA also provides for expanded whistleblower incentives and protections, additional (and stronger) BSA violations and penalties, and expanded subpoena power for the government, along with numerous other changes that will warrant watching as they are implemented.

Footnotes

¹ Notably, FATF has specifically identified the United States’ lack of beneficial ownership reporting requirements as a critical shortcoming of the U.S. AML regime.

² The NPRM is the first of three required rulemakings related to the CTA. FinCEN will ultimately issue

two additional rulemakings for the purposes of: 1) creating a secure central database and establishing the rules for which individuals and entities may access BOI, for what purposes, and what safeguards will be required to protect this information; and 2) revising and conforming FinCEN's existing Customer Due Diligence Rule for financial institutions.

³ FinCEN notes in the NPRM that in developing the proposed definitions of "beneficial ownership" and "substantial control," it considered common law and usage of the terms in other statutes, as well as FATF recommendations, established beneficial ownership reporting regimes in other jurisdictions such as the U.K., and other administrative laws and practices. It is not clear under the NPRM whether concepts of beneficial ownership developed under other regulatory regimes, such as SEC or IRS regulations, will be applied by analogy if not explicitly defined in FinCEN's final rule.

⁴ The NPRM clarifies that company applicants that provide a business service as a corporate or formation agent may report their business address rather than a residential address.

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