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FinCEN Issues Final Rule Implementing Corporate Transparency Act

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On September 29, 2022, the Financial Crimes Enforcement Network (“FinCEN”) issued a final rule implementing the beneficial ownership information (“BOI”) reporting provisions of the Corporate Transparency Act (the “Act”), which, on January 1, 2021, had been enacted into federal law as a new national beneficial ownership reporting regime for both US and non-US companies doing business in the United States.



In broad terms, the Act creates a national company beneficial ownership registry accessible only by law enforcement, government agencies and other officials, and requires reporting companies to provide certain identifying information of its beneficial owners and company applicants to FinCEN. The purpose of the Act is to prevent the illicit use of so-called “shell companies” to conceal illegal activity or to facilitate money laundering, tax evasion and other criminal activities.

The final rule reflects FinCEN’s careful consideration of detailed public comments and extensive interagency consultations. FinCEN largely adopted the proposed rule with minimal modifications and no mechanism for requesting an extension in meeting reporting deadlines. This article summarizes key aspects of the final BOI reporting rules.

Reporting Companies

The Act obligates a “reporting company” to report the requisite information on its beneficial owners and company applicants. The final rule also obligates a reporting company to report (i) its full legal name as well as all of its trade names and d/b/a names, (ii) the principal business address of its US operations (P.O. boxes or

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addresses of a company formation agent are insufficient), (iii) its jurisdiction of formation or, in the case of foreign reporting companies, the jurisdiction where the company first registers in the US and (iv) a tax identification number ("TIN") and foreign companies without a TIN must provide a foreign tax identification number and the name of the jurisdiction which issued the foreign tax identification number.

A reporting company is generally defined in the Act as a (i) US corporation, limited liability company or other similar entity that is created by the filing of documents with a secretary of state or some similar office or (ii) foreign (non-US) company formed under the law of a foreign country and registered to do business in the US. Pursuant to the final rule, FinCEN expects that reporting companies will include limited liability partnerships, limited liability limited partnerships and most limited partnerships, because most are formed through a filing with a secretary of state. It is not expected that general partnerships, estate planning type trusts and sole proprietorships would be reporting companies, as in most circumstances these types of entities are not created through filing a document with a secretary of state.

Under the final rule, twenty-three types of entities are exempt from the definition of reporting company. Notable types of exempt companies include (i) publicly traded companies, (ii) banks and credit unions, (iii) investment companies, (iv) accounting firms, (v) insurance companies, (vi) tax-exempt 501(c) organizations and (vii) "large operating companies." FinCEN defined a large operating company as one (a) with more than 20 full-time employees in the US, (b) which showed more than \$5 million in gross sales in its previous tax return and (c) has an operating presence at a physical office within the US. The rationale for exempting these entities from the reporting requirements is that these entities are already subject to substantial federal and state regulation where beneficial ownership disclosure is already required or they operate in highly regulated industries. No additional exemptions to the BOI reporting provisions were provided under the final rule, despite numerous comments from a wide-range of individuals and organizations requesting exclusion. In FinCEN's view, the Act's purpose is to minimize the opportunity for an illicit actor to exploit loopholes and evade the reporting requirements and ultimately law enforcement. Therefore, any additional exemptions beyond those explicitly set out in the statute must meet a high bar to overcome the Act's purpose.

Beneficial Owners

The Act generally defines a “beneficial owner” as any individual who, directly or indirectly, (i) exercises substantial control over the entity or (ii) owns or controls not less than 25% of the ownership interests of the entity.

FinCEN has made clear that the analysis of ownership is not as simple as calculating the cumulative voting rights held by an individual. While voting rights are relevant, they are not dispositive and are more important in the “substantial control” portion of the beneficial ownership analysis. FinCEN also stressed that, for companies with a single class of equity and no derivative securities, the ownership calculation will generally be quite simple. Under the final rule, when determining whether an individual owns or controls 25% or more of the ownership interests of a reporting company, the individual’s aggregated ownership interests, across all types of ownership, should be compared to the total presently outstanding ownership interests of the reporting company. If an individual or entity holds options or other derivative securities, then such securities are treated as if they have been exercised by the holder of the securities, without regard to exercise price, whether such securities are in-the-money or whether the exercise of such securities would be financially prudent.

The final rule also offered specific guidance for how to calculate the ownership interest for (i) entities that issue capital or profit interests (such as limited liability companies) and (ii) corporations. In the case of limited liability companies or other similar entities, an individual’s ownership interests are the individual’s capital and profit interests, calculated as a percentage of the entity’s total outstanding capital and profit interests. In the case of corporations, as well as other entities that issue shares of stock, the applicable percentage is the greater of (a) the total combined voting power of all of classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote and (b) the total combined value of all classes of ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests.

As a catch-all, the final rule states that, when it is not possible to reliably calculate the ownership interests in a reporting company, greater than 25% ownership of any

class or type of ownership interests would qualify a person as a beneficial owner and require disclosure.

In keeping with the Act, the final rule exempts only the following five types of individuals from the definition of “beneficial owner,” namely (i) a minor child, (ii) an individual acting as a nominee, intermediary, custodian or agent on behalf of another individual, (iii) an individual acting solely as an employee of the entity and whose control over or economic benefit from such entity is derived solely from the person’s employment status, (iv) an individual whose only interests in the entity are through a right of inheritance and (v) a creditor of an entity, unless the creditor exercises substantial control over the entity or owns or controls not less than 25% of the ownership interests of the entity.

Substantial Control

A person can demonstrate “substantial control” if they (i) serve as a senior officer of the reporting company, (ii) have authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) or (iii) direct, determine or have substantial influence over important decisions made by the reporting company. However, the analysis of substantial control does not end with those three criteria. The final rule also lays out six ways in which an individual may display direct or indirect substantial control which may require BOI disclosure, namely (i) board representation, (ii) ownership or control of a majority of the voting power or voting rights of the reporting company, (iii) rights associated with any financing arrangement or interest in the reporting company, (iv) control over one or more intermediary entities that exercise substantial control over the reporting company, (v) arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees or (vi) any other contract, arrangement, understanding, relationship or otherwise.

In the final rule, FinCEN omitted the roles of corporate secretary and treasurer from the definition of senior officer, but retained the role of general counsel because, in their view, the corporate secretary and treasurer tend to entail ministerial functions with little control of the company while the general counsel’s role is ordinarily more substantial. However, the ultimate test of a senior office is whether the individual is exercising the authority or performing the functions of a senior officer.

In the final rule, FinCEN also did not include control over a “dominant minority of the board” as a way of exercising substantial control. Further, FinCEN does not envision that the performance of ordinary, arm’s-length advisory or other third-party professional services to a reporting company, such as those performed by lawyers or accountants, as those with the power to direct, determine or have substantial influence over important decisions of a reporting company. In the final rule, FinCEN explicitly rejected comments requesting they impose an upper limit on the number of beneficial owners who must be disclosed under the substantial control test as inconsistent with the CTA’s objective of establishing a comprehensive BOI database for all beneficial owners of reporting companies. Importantly, FinCEN expects that a reporting company will always identify at least one beneficial owner under the “substantial control” component even if there is no single owner above 25% ownership.

Company Applicants

A reporting company is required to report not only its beneficial owners but also any “company applicants.” Under the final rule, FinCEN clarified that no more than two people need be identified as company applicants, namely (i) the individual who directly files the document that creates the entity or, in the case of a foreign reporting company, the individual who directly files the document that first registers the entity to do business in the US and (ii) the individual who is primarily responsible for directing or controlling the filing of the relevant document by another. As currently written, it is likely that in many cases “company applicants” will include attorneys, paralegals, accountants, filing process companies and other professionals not directly affiliated with the reporting company.

With much welcomed relief, FinCEN made it clear that the final rule does not require reporting companies existing or registered as of January 1, 2024 to report its company applicants. In addition, unlike the duty to update for beneficial ownership, reporting companies formed or registered after January 1, 2024 will not be required to update company applicant information after initial submission (however, they will be required to correct information that was incorrect at the time of submission).

Required Disclosure for Beneficial Owners and Company Applicants

The final rule requires a reporting company to provide the following information for each beneficial owner and each company applicant, namely (i) their full legal name, (ii) their birth date, (iii) a current home or work street address and (iv) a unique identification number from a non-expired US passport or a state or US tribal identification document or, lacking those, a non-expired foreign passport, along with a photo of the identification document provided. The final rule omitted the proposed requirement that the home street address reported must be the address an individual uses for “tax residency” purposes and, instead, the final rule requires the individual to disclose their current home street address (which is not required to be an address in the US).

A beneficial owner, company applicant or reporting company may request that FinCEN provide such individuals and entities with a unique identifier (a “FinCEN ID”). Once issued, beneficial owners or company applicants can provide a FinCEN ID in lieu of beneficial ownership or company applicant information, provided that such information remains up to date. FinCEN ID holders are responsible for submitting corrections to their information to FinCEN and such corrections are subject to the same rules and deadlines reporting companies face when updating BOI information. FinCEN believes that offering FinCEN IDs will reduce the burden of keeping beneficial ownership information up to date and will mitigate privacy concerns, as the reporting companies will not necessarily be charged with handling sensitive private information about those deemed to be beneficial owners or company applicants.

Certification

Each person filing a report with FinCEN is required to certify that the report is true, correct and complete. While FinCEN recognizes that individuals file reports on behalf of reporting companies, it is the responsibility of the reporting companies to verify the information they receive from their beneficial owners and company applicants before reporting such information to FinCEN. Reporting companies are not entitled to rely on information received from beneficial owners in good faith. FinCEN is still examining how to handle situations where a reporting company reports an individual’s FinCEN ID in lieu of the required BOI information, which situations FinCEN intends to address before the final rule’s effective date.

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Reporting Deadlines

The regulations contained in the final rule will become effective on January 1, 2024. Reporting companies created or registered before January 1, 2024 will have one year to file their initial reports (i.e. until January 1, 2025), while reporting companies created or registered on or after January 1, 2024 will have 30 days (instead of 15 days as under the proposed rule) after receiving notice of their creation or registration to file their initial reports. The final rule now specifies a trigger to commence the 30-day period within which an initial report must be filed by new companies created or registered on or after January 1, 2024. That trigger is the earlier of the date on which the reporting company receives actual notice that its creation or registration has become effective and the date on which a secretary of state or similar office first provides public notice, such as through a publicly accessible registry, that the domestic reporting company has been created or the foreign reporting company has been registered.

Moreover, reporting companies will have 30 days to report changes to the disclosures in their previously filed reports and must correct inaccurate information in previously filed reports within 30 days after the reporting company first knows or has reason to know of the inaccuracy of information in earlier reports. FinCEN declined to provide for any longer period of time beyond 30 days to file the initial report, a corrected reporting or an updated report despite a number of comments requesting the same. FinCEN also declined to provide for any extensions to file such reports.

Non-reporting companies are not required to file with FinCEN any of these reports. If a company was not previously a reporting company, but then becomes one, then it must provide beneficial ownership information within 30 days after the date on which it became a reporting company (except in the first year of the final rule's implementation, during which reporting companies have until the later of 30 days following the date they cease to be exempt and December 31, 2024 to file their beneficial ownership reports). Conversely, a reporting company that becomes eligible for one of the twenty-three company reporting requirement exemptions must file a report with FinCEN updating FinCEN of its exempt status in order to avail itself of the exemption.

Filings Costs

The Act does not require a filing fee. FinCEN notes, however, the costs it has estimated for a reporting company to prepare and submit a BOI report depend on the complexity of the beneficial ownership structure of an entity. For entities with a simple structure, FinCEN estimates that it will cost a reporting company \$85.14 to prepare and submit an initial BOI report. On the other end of the spectrum, FinCEN estimates that it will cost a reporting company more than \$2,600 on average for entities with complex beneficial ownership structures to prepare and submit an initial filing. Despite FinCEN's estimates, it is very likely that these estimates are significantly understated.

Penalties

The Act makes it unlawful for any individual, reporting company or other entity to willfully provide false or fraudulent BOI to FinCEN, or to willfully fail to report complete or updated BOI to FinCEN. Though only reporting companies are required to provide reports to FinCEN, individuals or other entities that are providing information about themselves to reporting companies are still subject to liability under the CTA. A violation of the CTA subjects the reporting company, and those individuals and other entities, to civil and criminal penalties. FinCEN intimates in its comments that whether false information was willfully filed would depend on all of the facts and circumstances based on existing case law, but as a general matter, FinCEN does not expect that an inadvertent mistake by a reporting company, an individual or other entity, acting in good faith after diligent inquiry, would constitute a willfully false or fraudulent violation. The final rule does not provide any other penalty relief, other than to say that FinCEN will monitor the situation and consider publishing FAQs in the future.

Next Steps

FinCEN expects to have the infrastructure in place for reporting companies to electronically file their initial reports by the first filing deadline under the Act. With final rules now confirming the due dates for filings, it is time for domestic and international companies and their advisors to start identifying all of the reporting companies in their organizational structures and gather information and the necessary documentation on all of the beneficial owners and future company

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applicants. With no ability to request an extension and no specific relief from penalties at this time, it is important to avoid non-compliance. Looking down the road, FinCEN has stated that it will engage in additional rulemaking where, among other things, they plan to address the record keeping of beneficial ownership information from a security perspective.

We will continue to monitor developments of the Act and its implementation. We are available to answer your questions in an effort to assist you with compliance with the Act and the final rules.

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