

CLIENT ALERT

FinCEN Publishes First of Three Proposed Rules on Beneficial Ownership Reporting Requirements

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On December 7, the Financial Crimes Enforcement Network (“**FinCEN**”) issued a [Notice of Proposed Rulemaking](#) (the “Proposed Rule”) to implement one of the most significant features of the Anti-Money Laundering Act of 2020: the Beneficial Ownership Information (“**BOI**”) reporting requirements contained in Section 6403 of the [Corporate Transparency Act](#) (“**CTA**” or the “**Act**”).¹ The Proposed Rule defines who must report BOI, when BOI must be reported, and what information must be provided. Parties have until **February 7, 2022** to provide comments.

Beneficial Ownership Information

The CTA and the proposed regulations represent the culmination of years of efforts by Congress, the Treasury Department, other national security agencies, law enforcement, and other stakeholders to bolster the United States’ corporate transparency framework and to address deficiencies in BOI reporting. Although FinCEN’s customer due diligence rule (“**CDD Rule**”) already requires covered “financial institutions” to identify and verify the beneficial owners of certain legal entity customers when those customers open new accounts, the Proposed Rule significantly expands BOI

¹ Congress passed CTA as part of the Anti-Money Laundering Act of 2020 on January 1, 2021. As we discussed in a previous [Client Alert](#), the Anti-Money Laundering Act of 2020 significantly overhauled the Bank Secrecy Act to impose new obligations on FinCEN and other federal agencies and new reporting requirement for companies created under or registered to do business in the United States.

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reporting requirements by encompassing a broader range of companies and by requiring that these companies report BOI to the government.

Entities Required to Report BOI

The Proposed Rule generally applies to “domestic reporting companies,” which are entities that are created under the laws of the United States or an Indian Tribe, as well as “foreign reporting companies,” which are foreign entities registered to do business in the United States (collectively, the “**Reporting Companies**”). Consistent with the underlying legislation, 23 types of entities are exempt from the definition of Reporting Company, including banks, money transmitting businesses, broker-dealers, and registered investment companies and advisers. Also exempt are most large companies, which are described in the Proposed Rule as companies that employ more than 20 full-time employees in the United States, have filed a federal tax return recording more than \$5 million in gross receipts or sales in the previous year, and have an operating presence at a physical office in the United States.² As a result of the many exemptions from reporting, the focus of the Proposed Rule is on small businesses and shell companies, which are more likely to have opaque ownership structures that are susceptible to money laundering operations. While the CTA provided an option for FinCEN to exclude additional entities, FinCEN notes that it does not intend to expand the list of exemptions at this time.

There are significantly more exemptions to the BOI reporting requirements under the Proposed Rule than under the analogous provisions of the CDD Rule, which requires financial institutions to collect beneficial ownership information on their “legal entity customers,” subject to a limited number of exemptions.³

Definition of Beneficial Owner

Under the Proposed Rule, a “beneficial owner” includes *each and every* individual who (1) exercises substantial control over a Reporting Company, or (2) owns or controls at least 25 percent of the ownership interests of a Reporting Company. The breadth of the “substantial control” and “ownership interest” components result in a significantly broader scope of beneficial owners covered by the Proposed Rule than by the CDD Rule (as detailed below).

² The exemptions cover securities issuers, domestic governmental authorities, banks, domestic credit unions, depository institution holding companies, money transmitting businesses, brokers or dealers in securities, securities exchange or clearing agencies, other Securities Exchange Act of 1934 entities, registered investment companies and advisers, venture capital fund advisers, insurance companies, state licensed insurance producers, Commodity Exchange Act registered entities, accounting firms, public utilities, financial market utilities, pooled investment vehicles, tax exempt entities, entities assisting tax exempt entities, large operating companies, subsidiaries of certain exempt entities, and inactive businesses.

³ See 31 CFR § 1010.230(e)(2).

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While the CTA did not define the term “substantial control,” the Proposed Rule establishes that a person has a substantial control over an entity if they:

- (1) serve as a senior officer of the Reporting Company;
- (2) have 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) have direction, determination, or decision of, or substantial influence over, important matters affecting the Reporting Company;⁴ or
- (4) have any other form of substantial control over the Reporting Company.⁵

FinCEN notes that the catchall provision in the fourth category recognizes that control exercised in novel and unorthodox ways can still be substantial and is designed to prevent individuals from evading identification as beneficial owners by hiding behind formalisms such as job descriptions, job titles, and nominal lack of authority. Given the expansiveness of this catchall provision, and the fact that there is no limit on the number of beneficial owners for which information must be reported, we expect this provision to be the subject of criticism. In contrast, the CDD Rule requires the identification of a *single individual* with “significant responsibility” over the legal entity; *i.e.*, an executive officer, senior manager, or any other individual who regularly performs similar functions.⁶

In developing the definition of substantial control, FinCEN looked to the common law of agency and corporate law, as well as the usage of the term under other federal statutes. FinCEN also considered (among other things) the Financial Action Task Force Recommendations, established beneficial owner reporting standards in other jurisdictions, and the statutory law and administrative practice informing the Committee on Foreign Investment in the United States of activity.

⁴ This authority includes, but is not limited to: (1) the nature, scope, and attributes of the business of the Reporting Company, including the sale, lease, mortgage, or other transfer of any principal assets of the Reporting Company; (2) the reorganization, dissolution, or merger of the Reporting Company; (3) major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the Reporting Company; (4) the selection or termination of business lines or ventures, or geographic focus, of the Reporting Company; (5) compensation schemes and incentive programs for senior officers; (6) the entry into or termination, or the fulfillment or non-fulfillment of significant contracts; and (7) amendments of any substantial governance documents of the Reporting Company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures.

⁵ FinCEN notes that the catchall provision in the Proposed Rule recognizes that control exercised in novel and unorthodox ways can still be substantial and is designed to prevent individuals from evading identification as beneficial owners by hiding behind formalisms such as job descriptions, job titles, and nominal lack of authority.

⁶ See 31 CFR § 1010.230(d)(2).

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The definition of “ownership interest” under the Proposed Rule 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.⁷ The CDD Rule, in contrast, is only concerned with equity interests: it requires the identification of each individual who owns 25 percent or more of the equity interests of a legal entity customer.⁸ FinCEN explained that the broader definition of “ownership interest” under the Proposed Rule is meant to ensure that the underlying reality of ownership, not the form it takes, drives the identification of beneficial owners. The approach also thwarts the use of complex ownership structures and ownership vehicles other than direct equity ownership to obscure a Reporting Company’s real owners.

Under the Proposed Rule, a Reporting Company would also need to identify the “company applicant,” which is the individual who files the entity-forming document in the case of a domestic Reporting Company, and the individual who files the first registration document allowing the entity to do business in the United States.⁹ In requiring company applicants to be disclosed, FinCEN is sending a clear message that it is not only interested in learning who is behind elicit shell companies, but that it also wants to know who is assisting beneficial owners in forming such entities.

Information Required To Be Reported

In a BOI report to FinCEN, the Proposed Rule would require a Reporting Company to provide name, birthdate, address, and a unique identifying number from an acceptable identification document (and the image of such document) for each beneficial owner and company applicant. If an individual provides his or her BOI to FinCEN, the individual can obtain a “FinCEN identifier,” which can then be provided to FinCEN in lieu of other required information about the individual. Beneficial owners and company applicants may also provide a Taxpayer Identification Number (“**TIN**”) of a beneficial owner on a voluntary basis. Such information would help to ensure that the BOI database functions efficiently, as the TIN will allow database users such as FinCEN, law enforcement, and financial institutions to cross-reference other databases and more easily verify an individual’s information.

Timing of Report

The timing of the report depends on (1) when a Reporting Company was created or registered, and (2) whether the report at issue is an initial report, an updated report providing new information, or a report correcting erroneous information in a

⁷ See 31 CFR § 1010.380(d)(3)(i).

⁸ See 31 CFR § 1010.230(d).

⁹ In addition, the Proposed Rule reflects the five types of individuals that the CTA exempts from the definition of beneficial owner: (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 a 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 a Reporting Company is a future interest through a right of inheritance; and (5) a creditor of a Reporting Company.

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previous report. Domestic Reporting Companies created before the final rule goes into effect have one year to file their initial reports, while those created on or after the effective date must submit BOI within 14 days after formation. Existing and newly registered foreign Reporting Companies have the same respective deadlines. Reporting Companies would have 30 days to file updates to their previously filed reports, and 14 days to correct inaccurate reports after they discover or should have discovered the reported information is inaccurate.

Comments

Parties have until February 7 to submit comments. FinCEN has requested that parties submit comments on several specific issues, including the scope of required BOI, voluntary submission of information outside the scope of the CTA, and the reporting requirement burden on newly formed entities.

What Comes Next?

The CTA directed the Secretary of the Treasury to promulgate regulations implementing the beneficial ownership reporting-related requirements by January 1, 2022. However, given that the Proposed Rule is only the first of three rulemakings that FinCEN plans to release in order to implement these requirements, and the fact that FinCEN has solicited comments on the Proposed Rule through February 2022, the timing and content of the final rule remains unclear. Despite this uncertainty, companies that are not exempt may wish to begin taking steps to enable them to collect and report beneficial ownership information.

FinCEN intends to issue two more sets of rulemaking to implement the requirements of the CTA, which is aimed at preventing money laundering and other illicit activities through the use of shell companies by requiring certain entities to report beneficial ownership information to FinCEN and for FinCEN to maintain that information in a non-public, secure database. In addition to the beneficial ownership reporting requirements of Section 6403, FinCEN will also implement (1) the Act's protocols for access to and disclosure of beneficial ownership information; and (2) revise the existing CDD Rule to align it with the Proposed Rule.¹⁰ As discussed above, the scope of the individuals that would qualify as "beneficial owners" under the Proposed Rule is significantly broader than under the CDD Rule, and there are various other inconsistencies between the two rules. Accordingly, the ultimate revisions to the CDD Rule to align it with the Proposed Rule may be substantial.

¹⁰ FinCEN notes that it will issue proposed rules regarding the other aspects of Section 6403 of the CTA and will seek public comments on the implementation of those aspects through publication in the Federal Register.

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