

FinCEN Issues Proposed Rule on Beneficial Ownership under the Corporate Transparency Act

A Practical Guidance® Article by
Brian Blitz and Rayelle Washington, Duval & Stachenfeld LLP



Brian Blitz
Duval & Stachenfeld LLP



Rayelle Washington
Duval & Stachenfeld LLP

This article discusses the Department of the Treasury's Financial Crimes Enforcement Network's (FinCEN) notice of proposed rulemaking to implement the beneficial ownership reporting requirements under the Corporate Transparency Act (CTA).

FinCEN's Proposed Rule on Beneficial Ownership under the CTA

On December 7, 2021, FinCEN issued a notice of proposed rulemaking (the Proposed Rule) to implement the beneficial ownership reporting requirements of the CTA.

Enacted on January 1, 2021, the CTA requires FinCEN, among other directives, to establish reporting requirements for certain legal entities regarding their beneficial ownership information. The Proposed Rule defines (1) the types of entities subject to the reporting requirements of the CTA,

(2) the information those entities must report to FinCEN, and (3) when such disclosures must be completed, along with the penalties for failing to report the required information or willfully providing false information.

Who Must Disclose?

Under the CTA, "reporting companies" are corporations, limited liability companies, and similar entities (including limited partnerships) formed in the U.S., or non-U.S. entities registered to do business in the U.S. Reporting companies will be required to report certain beneficial ownership information relating to the company, its beneficial owners, and the "company applicant(s)." The CTA included a list of 23 categories of entities that are exempted from the CTA's reporting requirements, including public companies, banks, brokers, dealers, investment companies, investment advisors, insurance companies, not-for-profits, and pooled investment vehicles operated or advised by, among others, a bank or registered investment advisor. The Proposed Rule does not include any additional categories of exempted entities, and generally adopted the CTA's list with only some additional clarifications. In addition, entities that (1) have more than 20 full-time domestic employees, (2) have an operating presence at a physical office in the U.S., and (3) filed a federal tax return in the previous year demonstrating more than \$5 million in gross receipts or sales in the aggregate, excluding gross receipts or sales from sources outside the U.S.

Required Disclosure

Under the Proposed Rule, a reporting company must provide FinCEN with its full name, any trade names or "doing business as" names, its business street address, its jurisdiction of formation or registration, and its Taxpayer Identification Number or, if the TIN has not yet been

issued, the Dun & Bradstreet Data Universal Numbering System Number or a Legal Entity Identifier. For each “beneficial owner” and “company applicant” (the definitions of which are discussed below), their full legal name, birth date, address, and a unique identifying number from certain specified documents, including a non-expired passport or driver’s license, and a copy of such passport or license, are required.

Definition of Beneficial Owner

The Proposed Rule defines a beneficial owner as any individual who, directly or indirectly, either “exercises substantial control” over a reporting company or owns or controls at least 25% of the ownership interests of the reporting company. 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 over “important matters” affecting the reporting company; or (4) any other form of substantial control. The Proposed Rule’s list of “important matters” includes numerous business decisions that would often be subject of approval rights under a joint venture agreement, stockholders’ agreement, preferred stock certificate of designation, or similar operating agreement, including the sale of principal assets, reorganizations, dissolutions, mergers, issuances of equity, incurrence of debt, approval of operating budgets, compensation schemes, incentive compensation, and amendments of substantial governance documents.

The Proposed Rule also clarifies that the term “ownership interests” includes equity interests as well as capital or profits interests in a limited liability company or partnership, including limited and general partnership interests, convertible instruments, warrants, rights, puts, calls, or other options to acquire equity, capital, or profits interests, or other interests in the reporting company. FinCEN noted that this expansive definition is “a way of ensuring that the underlying reality of ownership . . . drives the identification of beneficial ownerships . . . [and] thwarts the use of complex ownership structures . . . to obscure a reporting company’s real owners.”

Definition of Company Applicant

The Proposed Rule defines company applicant (1) for a domestic reporting company, as any individual who files the formation documents and (2) for a foreign reporting company, as any individual who files the document that first registers the entity to do business in the United States. In each case, any individual who directs or controls

the filing of such documents by another person is also “company applicant.” This expansive definition presumably means that, if the Proposed Rule is adopted, what used to be a ministerial task of forming an entity that was often undertaken by parties such as lawyers, accountants, and paralegals will now result in those individuals being deemed “company applicants.”

Timeline of Disclosures and Penalties

Under the Proposed Rule, entities existing or registered before the effective date of the final rule would have one year after the effective date to file their initial report with FinCEN. For entities established or registered after the effective date, the report would be required to be filed within 14 days of formation. Updates to the disclosure would be required to be submitted by the reporting company within 30 days of any change of information previously submitted to FinCEN, including any change with respect to who is a beneficial owner of a reporting company and any change with respect to information reported for any particular beneficial owner or applicant.

The CTA and the Proposed Rule provides civil and criminal penalties for persons who “willfully provide, or attempt to provide, false or fraudulent beneficial ownership information . . . [or] willfully fail to report complete or updated beneficial ownership information to FinCEN.” Violators can be liable for a civil penalty of up to \$500 for each day the violation exists, and a criminal penalty of a fine up to \$10,000 and/or imprisonment for up to two years. The Proposed Rule clarifies that these penalties extend to beneficial owners or company applicants if they willfully provide false or fraudulent information to a reporting company to submit to FinCEN.

Comment Period

The public has until February 7, 2022, to provide written comments to FinCEN regarding this proposed rule.

Related Developments

In addition to the Proposed Rule, FinCEN issued an Advance Notice of Proposed Rulemaking on December 6, 2021, to solicit public comments on potential requirements under the Bank Secrecy Act (BSA) to collect, report, and retain information for certain persons involved in real estate transactions when involved in non-financed real estate purchases. The ultimate goal of this regulatory proposal is “to combat, to the broadest extent possible, the proliferation of anonymous shell companies that facilitate the flow and sheltering of illicit money in the United States.” FinCEN is considering regulations to address money laundering vulnerabilities presented by U.S. real estate,

and the ability of illicit actors to launder criminal proceeds through the purchase of real estate. The notice seeks comments regarding, among others, the approach that FinCEN should take with respect to regulatory treatment of residential and commercial real estate and the money laundering threats presented by these sectors.

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Brian A. Blitz, Partner, Duval & Stachenfeld LLP

Brian Blitz is a partner in the Corporate Real Estate Practice Group. Mr. Blitz focuses on all aspects of corporate transactions, including corporate real estate transactions. He routinely handles matters involving mergers and acquisitions, complex joint ventures, real estate platform transactions and creations of separately managed accounts, divestitures, carve-out transactions, corporate governance and general corporate counseling. He also has represented clients in connection with strategic investments in fund managers.

Mr. Blitz has advised clients in a range of private and publicly held companies and financial sponsors across an array of industries, including real estate, REITs, mobile housing, healthcare, aerospace, recycling, insurance, communications, retail, consumer products, and online gaming. In addition, Mr. Blitz has represented private equity funds in connection with asset acquisitions and restructuring of portfolio investments.

Mr. Blitz graduated cum laude from the University of Pennsylvania School of Law where he was the Symposium Editor of the University of Pennsylvania Law Review and received his B.A. from Cornell University. Mr. Blitz served as a law clerk to the Hon. Jan E. Dubois in the Eastern District of Pennsylvania. Mr. Blitz is admitted to practice only in New York.

Rayelle M. Washington, Associate, Duval & Stachenfeld LLP

Rayelle joined the firm in 2021 as a member of the Real Estate Practice Group. Ms. Washington graduated from Brooklyn Law School. She is admitted to practice only in New York.

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