

FINANCIAL SERVICES

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# The Corporate Transparency Act's Ultimate Beneficial Ownership Reporting Rule: What You Need To Know Before January 1, 2024

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# The Corporate Transparency Act's Ultimate Beneficial Ownership Reporting Rule: What You Need To Know Before January 1, 2024

# FinCEN Finalizes Rule Implementing Beneficial Ownership Reporting Requirements

- On September 30, 2022, the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") published a highly anticipated rule (the "UBO Reporting Rule") that implements the ultimate beneficial ownership information ("UBO") reporting requirements of the Corporate Transparency Act (the "CTA").
- The CTA, which is part of the Anti-Money Laundering Act of 2020 (the "AML Act") and enacted into law as a part of the National Defense Authorization Act for Fiscal Year 2021, establishes UBO reporting requirements for the vast majority of privately held corporations, limited liability companies and other similar entities created in, or registered to do business in, any of the states in the United States ("U.S."), including the District of Columbia, Puerto Rico and other U.S. Territories (collectively, "Reporting Companies").
- The UBO Reporting Rule becomes effective January 1, 2024.

# Background

- More than 2,000,000 corporations and limited liability companies are being formed annually all over the U.S. – by entrepreneurs, family businesses, and larger businesses – without having to disclose beneficial ownership data to the state incorporation, formation or registration authority.
- The Financial Action Task Force on Money Laundering (“FATF”), of which the U.S. is a member, has criticized the U.S. for failing to have legislation that addresses FATF standards on the collection of company beneficial ownership data.
- In contrast to the U.S., all 28 countries in the European Union are required to maintain corporate registries that include the UBO of the companies organized in the jurisdictions that comprise the European Union.

# Background (continued)

- Since at least 2006, there has been debate over how and whether to track beneficial ownership of privately held entities operating in the U.S., and it was the topic of hearings and investigations spearheaded by the Senate Permanent Sub Committee on Investigations.
- Proponents of sharing such information with the government (at the state level) largely cite the concern that anonymity allows bad actors to use shell companies to engage in certain illicit activity, including money laundering, terrorist financing, and other financial crimes.
- On the other hand, sharing such information presents real concerns from a privacy standpoint and cost perspective and efforts to impose legislation had been met with strong opposition from various groups, including the American Bar Association. Of primary note was the expense of maintaining databases that would be adequately protected from cyber-attacks, an equally valid concern in 2022.

# Background (continued)

- In 2016, FinCEN issued a Final Rule relating to customer due diligence (the “CDD Rule”), which amended the Bank Secrecy Act (“BSA”) regulations requiring covered financial institutions to identify and verify the identity of natural persons (known as “beneficial owners”) of certain legal entity customers.
- On January 1, 2021, the U.S. Senate passed the CTA, amending the BSA by inserting a new Section 5336, titled “Beneficial ownership information reporting requirements,” to require Reporting Companies to disclose to FinCEN personal information of their beneficial owners.
- On December 7, 2021, FinCEN published a proposed rule to implement these UBO reporting requirements and to welcome public comment.
- After considering public comment, on September 30, 2022, FinCEN issued the UBO Reporting Rule requiring certain legal entities to submit to FinCEN a report containing certain information relating to the entity, its ultimate beneficial owners, and Company Applicants (as such term is defined below).



# Compliance Dates for Initial UBO Reports

## DUE WITHIN 30 CALENDAR DAYS OF CREATION OR REGISTRATION

- Domestic Reporting Companies incorporated or formed after January 1, 2024
- Foreign Reporting Companies registered after January 1, 2024

## DUE BY JANUARY 1, 2025

- Domestic Reporting Companies incorporated or formed before January 1, 2024
- Foreign Reporting Companies registered before January 1, 2024

## DUE WITHIN 30 CALENDAR DAYS OF LOSING EXEMPTION

- Entities that no longer meet the criteria for any exemption must file an initial UBO report

*\*Exempt entities are not required to file initial UBO reports, since they are exempt from the definition of "Reporting Company."*

# Compliance Rules for Updated Reports

- *Changes to previously submitted information.*
  - Reporting Companies are required to report changes to information previously submitted to FinCEN concerning a Reporting Company or its beneficial owners, but they are **not** required to update previously reported information about their Company Applicants.
  - A change with respect to required information in an identifying document required to be reported (e.g., a passport) will be deemed to occur when the name, date of birth, address or unique identifying number on such document changes. These updated reports are due within 30 calendar days after the date on which such change occurs.
- *Deceased beneficial owners.* If an individual who is a beneficial owner of a Reporting Company by virtue of property interests or other rights subject to transfer upon death dies, a change regarding the required information will be deemed to occur when the estate of the deceased beneficial owner is settled, either through the operation of the intestacy laws of a jurisdiction within the U.S. or through a testamentary deposition, and the updated report shall, to the extent appropriate, identify any new beneficial owners.
- *Minors.* If a Reporting Company has previously reported information with respect to a parent or legal guardian of a minor child in lieu of the minor child's information, it must submit an updated report when such minor child reaches the age of majority.



# Compliance Rules for Corrected Reports

- Reporting Companies are required to file corrected reports within 30 calendar days after the date on which a Reporting Company becomes aware or has reason to know that required information contained in any report it filed with FinCEN was inaccurate.
- Unlike with updated reports, this reporting obligation extends to information about Company Applicants as well as Reporting Companies and beneficial owners.

# What Information Must be Reported?

- Each Reporting Company must identify its “beneficial owners” by providing their:
  - full legal name;
  - date of birth;
  - current residential street address; and
  - unique identifying number and the issuing jurisdiction from one of the following documents (including an image of such document): (i) non-expired passport; (ii) non-expired identification document issued by a State, local government, or Indian tribe; (iii) non-expired U.S. driver’s license; or (iv) if the individual does not have any of the above-mentioned documents, a non-expired passport issued by a foreign government; **or**
  - in lieu of all the above, a “FinCEN identifier” – a unique identifying number assigned by FinCEN to an individual.
- Additionally, this information must be reported for each “Company Applicant,” which is the individual who files an application to form a corporation, limited liability company or other similar entity in the U.S., who registers or files an application to register a foreign company to do business in the U.S., and who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing of the document.

# Who is a Beneficial Owner?

- FinCEN’s UBO Reporting Rule defines a “beneficial owner,” with respect to a Reporting Company, as any individual (i.e., one or more) who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise:
  - owns or controls at least 25% of the ownership interests of such Reporting Company; or
  - exercises “substantial control” over the Reporting Company.
- An individual exercises “substantial control” over a Reporting Company if the individual:
  - serves a senior officer of the Reporting Company (e.g., president, CEO, COO, CFO, general counsel and any other officer who performs a similar function regardless of title);
  - has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body); or
  - directs, determines, or has substantial influence over important decisions made by the Reporting Company (i.e., sale or other transfer of principal assets, reorganization, dissolution, merger, major expenditures or investments, issuances of any equity, incurrence of any significant debt, approval of the operating budget, selection or termination of business lines or ventures or geographic focus, compensation schemes and incentive programs for senior officers, entering into or terminating significant contracts, or amendments of any substantial governance documents).

# Who is a *Not* a Beneficial Owner?

- FinCEN’s UBO Reporting Rule exempts from the definition of “beneficial owner” the following:
  - a minor child, as defined under the law of the State or Indian tribe in which a Reporting Company is created or registered, provided the Reporting Company reports the required information of a parent or legal guardian of the minor child;
  - an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual;
  - an employee of a Reporting Company, acting solely as an employee, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee, provided that such person is not a senior officer of the Reporting Company;
  - An individual whose only interest in a Reporting Company is a future interest through a right of inheritance; and
  - a creditor of a Reporting Company if the creditor satisfies the definition of “beneficial owner” solely through rights or interests for the payment of a predetermined sum of money, such as a debt incurred by the Reporting Company, or a loan covenant or other similar right associated with such right to receive payment that is intended to secure the right to receive payment or enhance the likelihood of repayment.

# Which Companies are Subject to Reporting Requirements?

- FinCEN's UBO Reporting Rule imposes UBO reporting requirements on Reporting Companies.
- "Reporting Company" is defined as a corporation, limited liability company, or other entity that is:
  - created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe; or
  - formed under the law of a foreign country and registered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe.
- "State" is defined as any state of the U.S., the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of Northern Mariana Islands, American Samoa, Guam, the U.S. Virgin Islands, and any other commonwealth, territory, or possession of the U.S.

# Entities Exempt from UBO Disclosure Requirements

- FinCEN has set forth 23 exemptions for entities that are not considered Reporting Companies under the CTA. Many of these are entities that are either closely regulated or already required to report their beneficial owners.
  - 1) **Large operating company exemption** – taxable entities that have:
    - more than 20 full time employees in the U.S.;
    - an operating presence at a physical office in the U.S.; and
    - filed in the previous year Federal income tax returns in the U.S. demonstrating more than \$5 million in gross receipts or sales (including income or sales by other entities that are: (a) owned by such entity, and (b) through which such entity operates).

# Entities Exempt from UBO Disclosure Requirements (continued)

2) **Subsidiary exemption** – any entity whose ownership interests are **entirely** controlled or wholly owned, directly or indirectly, by one or more of the following entities,\* which are described more specifically in the slides that follow (i.e., direct or indirect subsidiaries of any of the following exempt entities):

- Securities reporting issuers;
- Governmental authorities;
- Banks;
- Federal or state credit unions;
- Bank holding companies;
- Brokers or dealers in securities;
- Securities exchange or clearing agencies;
- Other entities registered under the Securities Exchange Act of 1934 (the “Exchange Act”);
- Investment companies or investment advisers that are registered with the Securities and Exchange Commission (the “SEC”)
- venture capital fund advisors;
- insurance companies;
- state-licensed insurance producers;
- entities registered under the Commodity Exchange Act (“Commodity Act”);
- Accounting firms;
- Regulated public utility entities;
- Financial market utilities;
- Tax-exempt entities; or
- Large operating companies.

\* Entities partially owned by exempt entities would not qualify for the subsidiary exemption.



# Entities Exempt from UBO Disclosure Requirements (continued)

3) **Dormant entity exemption** – any corporation, limited liability company or other similar entity that:

- was in existence on or before January 1, 2020;
- is not engaged in active business;
- is not owned by a foreign person, whether directly or indirectly, wholly or partially;
- has not experienced any change in ownership in the preceding 12-month period;
- has not sent or received any funds in an amount greater than \$1,000, either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding 12-month period; and
- does not otherwise hold any kind or type of assets, whether in the U.S. or abroad, including any ownership interest in any corporation, limited liability company, or other similar entity.

# Entities Exempt from UBO Disclosure Requirements (continued)

**Highly Regulated Entities** (including publicly traded entities):

4) Banks, as defined in:

- section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);
- section 2(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)); or
- section 202(a) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)).

5) State or Federal credit unions, as those terms are defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752).

6) Bank holding companies, as defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841), or a savings and loan holding company, as defined in section 10(a) of the Home Owners' Loan Act (12 U.S.C. 1467a(a)).

7) Money services businesses registered with FinCEN under to 31 U.S.C. 5330 and 31 CFR 1022.380, respectively.

# Entities Exempt from UBO Disclosure Requirements (continued)

- 8) Brokers or dealers, as those terms are defined in section 3 of the Exchange Act (15 U.S.C. 78c).
- 9) Securities reporting issuers – entities that are registered under section 12 of the Exchange Act (15 U.S.C. 78l).
- 10) Securities exchanges or clearing agencies, as those terms are defined in section 3 of the Exchange Act (15 U.S.C. 78c), registered under sections 6 or 17A of the Exchange Act (15 U.S.C. 78f).
- 11) Other Exchange Act registered entities – any other entities not already described that are registered with the SEC under the Exchange Act (15 U.S.C. 78a).

# Entities Exempt from UBO Disclosure Requirements (continued)

12) Investment companies (as defined in section 3 of the Investment Company Act of 1940 (the “Investment Act”) (15 U.S.C. 80a-3), or investment advisers (as defined in section 202 of the Investment Advisers Act of 1940 (the “Advisers Act”) (15 U.S.C. 80b-2) that are registered with the SEC under the Investment Act or the Advisers Act.

13) Insurance companies, as defined in section 2 of the Investment Act (15 U.S.C. 80a-2).

14) Insurance producers that are authorized by a State and subject to supervision by the insurance commissioner or a similar official or agency of a State and that have an operating presence at a physical office in the U.S.

# Entities Exempt from UBO Disclosure Requirements (continued)

15) Registered entities, or futures commission merchants, introducing brokers, swap dealers, major swap participants, commodity pool operators, or commodity trading advisers or retail foreign exchange dealers registered with the Commodity Futures Trading Commission under the Commodity Act.

16) Public accounting firms registered in accordance with section 102 of the Sarbanes-Oxley Act of 2002 915 U.S.C. 7212).

17) Public utility providers of telecommunications services, electrical power, natural gas, or water and sewer services within the U.S.

# Entities Exempt from UBO Disclosure Requirements (continued)

18) **Pooled investment vehicles** that are operated or advised by a bank, federal or state credit union, a broker or dealer that is registered under the Exchange Act, an investment company or investment adviser registered with the SEC under the Investment Act or the Advisers Act or an investment adviser (described under section 203(l) of the Investment Act) that acts as an investment adviser solely to one or more venture capital funds, which is defined to include any private fund that meets certain conditions as follows:

- (i) represents to investors and potential investors that it pursues a venture capital strategy;
- (ii) immediately after the acquisition of any asset, other than qualifying investments or short-term holdings, holds no more than 20% of the fund's aggregate capital contributions;
- (iii) does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage of more than 15% of the fund's aggregate capital contributions for a non-renewal term of no longer than 120 calendar days;
- (iv) only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; *and*
- (v) is not registered under section 8 of the "Investment Act" and has not elected to be treated as a business development company pursuant to section 54 of the "Investment Act").

# Entities Exempt from UBO Disclosure Requirements (continued)

## Tax-Exempt Entities:

- 19) Tax-exempt organizations described in section 501(c) of the Internal Revenue Code of 1986 (the “IRS Code”) that have not been denied tax-exempt status (noting that if tax-exempt status is lost, tax-exempt status will continue for the 180-day period beginning on the date of such loss).
- 20) Tax-exempt political organizations under section 527(e)(1) of the IRS Code (e.g., a political party, committee, or association).
- 21) Trusts described in paragraph (1) or (2) of section 4947(a) of the IRS Code (e.g., trusts that have only charitable interests).



# Entities Exempt from UBO Disclosure Requirements (continued)

## Entities Assisting Tax-Exempt Entities:

22) Any corporation, limited liability company or other similar entity that:

- operates exclusively to provide financial assistance to, or hold governance rights over, any 501(c) tax-exempt entity, a tax-exempt political organization, or a charitable trust;
- is formed in the U.S.;
- is beneficially owned or controlled exclusively by one or more U.S. persons that are U.S. citizens or lawfully admitted for permanent residence; and
- derives at least a majority of its funding or revenue from one or more U.S. persons that are U.S. citizens or lawfully admitted for permanent residence.

23) Tax-exempt political organizations under section 527(e)(1) of the IRS Code (e.g., a political party, committee, or association).

24) Trusts described in paragraph (1) or (2) of section 4947(a) of the IRS Code (e.g., trusts that have only charitable interests).

# Entities Exempt from UBO Disclosure Requirements (continued)

## Other Entities:

25) Entities that are established under the laws of the U.S., an Indian tribe, a State, or a political subdivision of a State, or under an interstate compact between two or more States and exercise governmental authority on behalf of the U.S. or any such Indian tribe, State, or political subdivision.

26) Any additional entities that FinCEN may determine should be exempt on an ongoing basis.

- This would be an entity or class of entities that the Secretary of the Treasury, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has, by regulation, determined should be exempt because requiring beneficial ownership information would not (i) serve the public interest and (ii) be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud or other crimes.

# Will UBO be Publicly-Disclosed?

- The CTA identifies UBO collected pursuant to the CTA as confidential, subject to disclosure only in limited circumstances.
- UBO reports submitted to FinCEN will be stored and maintained solely with FinCEN and will not be made publicly available nor made generally available to the States.
- The CTA expressly provides that UBO collected by FinCEN may only be used for:
  - Facilitating national security, intelligence, and law enforcement activities; and
  - Confirming UBO provided to financial institutions to facilitate AML compliance, **with the consent of the Reporting Company**.
- The CTA requires FinCEN to maintain UBO in a secure, nonpublic database, using information security methods and techniques appropriate to protect non-classified information systems at the highest security level; and to take all steps (including auditing) to ensure that government authorities access the information only for authorized purposes consistent with the CTA. *FinCEN is developing the Beneficial Ownership Secure System (“BOSS”) to receive, store and maintain UBO.*

# Retention and Scope of Disclosure of UBO

- FinCEN will hold all UBO reported for no less than 5 years after the date on which the Reporting Company is terminated or dissolved.
- FinCEN may, upon request, disclose UBO to:
  - a **federal agency** engaged in national security, intelligence, or other law enforcement activity, for use in furtherance of such activity;
  - a **State, local, or Tribal law enforcement agency**, if a court of competent jurisdiction, including an officer of such court, has authorized the law enforcement agency to seek the information in a criminal or civil investigation;

# Retention and Scope of Disclosure of UBO

- a **federal agency** responding to (i) *a law enforcement agency, prosecutor, or judge of a foreign country under an international treaty, agreement, convention* (collectively, “Treaty”), or (ii) *an official request made by law enforcement, judicial, or prosecutorial authorities in trusted foreign countries when no there is no Treaty* (disclosure in either case must comply with provisions of applicable Treaty or limit its use for any purpose other than the authorized investigation, or national security or intelligence activity);
- a **financial institution** subject to customer due diligence requirements, *with the consent of the Reporting Company*, to facilitate the CDD Rule compliance; or
- a request made by a **Federal functional regulator** or other appropriate regulatory agency if the agency is expressly authorized to receive such information under the CTA, uses the information *solely to assess a financial institution’s compliance with CDD Rule requirements*, and enters into an agreement with the Secretary of the Treasury providing for appropriate protocols governing the safekeeping of the information.

# Department of Treasury Access

- UBO will be accessible for inspection or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure.
- Officers and employees of the Department of the Treasury may obtain access to UBO “for tax administration purposes.”
- On December 15, 2022, FinCEN issued a Notice of Proposed Rulemaking (NPRM) that covers who may have access to the database that FinCEN is constructing (“Access Rule”) to hold UBO information:
  - Federal agencies and state, local, tribal, and foreign governments under certain circumstances
  - Financial Institutions, for purposes of complying with their CDD obligations, **with the express authorization of their customer**

# FinCEN Identifier

- FinCEN will be required to issue a FinCEN identifier (“FinCEN ID”) to any person (individual or Reporting Company) that submits UBO.
- The FinCEN ID must be used when updating a Reporting Company’s UBO and is exclusive to that individual or Reporting Company (FinCEN will not issue more than one FinCEN ID to the same individual or to the same Reporting Company, including any successor entity).
- Use of a FinCEN ID in lieu of providing UBO
  - **FinCEN ID – Individuals:** individuals required to report their UBO may instead provide their FinCEN ID.
  - **FinCEN ID – Entities:** if an individual is a beneficial owner of a Reporting Company through an interest that individual holds in an entity that, directly or indirectly, holds an interest in the Reporting Company, the Reporting Company may provide the FinCEN ID of the entity in lieu of the individual’s UBO.



# Penalties for Non-Compliance

- The CTA provides for civil and criminal penalties. Specifically, persons who:
  - willfully provide, or attempt to provide, false or fraudulent UBO, including a false or fraudulent identifying photograph or document to FinCEN; or
  - willfully fail to report complete or updated UBO to FinCEN;
  - will be subject to civil fines of no more than \$500 for each day the violation continues and may be fined up to \$10,000 and/or imprisoned for up to 2 years.
- Additionally, any person who knowingly discloses or knowingly uses the UBO obtained by the person through either a report submitted to FinCEN or a disclosure made by FinCEN pursuant to the CTA, shall be liable for fines of up to \$500 each day the violation continues and may be fined up to \$250,000 and/or imprisoned for not more than 5 years; **or** if while violating another U.S. law or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period, such person may be fined up to \$500,000 and/or imprisoned for up to 10 years.
- Further, there is no indication in the language of the CTA that the federal government will consider any actions taken by a non-complying Reporting Company to be null and void based on the Reporting Company's non-compliance with the CTA. Thus, the failure to comply with reporting requirements will not vitiate the formation of the applicable entity or prohibit a non-complying Reporting Company from conducting business or commencing action in federal court.

# Safe Harbor from Penalties for Non-Compliance

- The CTA provides a safe harbor from civil or criminal penalties for a person who submits inaccurate beneficial ownership information *if* such person:
  - **has no actual knowledge** that any information contained in the report is inaccurate;
  - is not trying to evade the reporting requirement; **and**
  - **submits a report correcting the information no later than 90 days after the initial report was filed.**
- Although negligent violations are not included in the safe harbor provision, the CTA does not make negligent violations punishable (noting that the House Bill for the CTA provided a safe harbor from civil and criminal penalties to persons who negligently failed to provide complete or updated beneficial ownership information to FinCEN).

# What's Next?

- FinCEN's UBO Reporting Rule is one of three rulemakings planned to implement the CTA.
- The CTA requires FinCEN to revise portions of the CDD Rule within one year after the effective date of the UBO Reporting Rule (by January 1, 2025) to, among other things:
  - bring the CDD Rule into conformity with the AML Act as a whole, including the CTA;
  - account for financial institutions' access to UBO reported to FinCEN in order to confirm the UBO provided directly to the financial institutions for AML/CFT and customer due diligence purposes; **and**
  - reduce any burdens on financial institutions and legal entity customers that are unnecessary or duplicative considering the CTA.
- The CTA also requires FinCEN to establish rules for (i) who may access UBO, (ii) what purposes, and (iii) what safeguards will be required to ensure that the information is secured and protected.
  - FinCEN continues to develop the infrastructure to administer these requirements in accordance with the strict security and confidentiality requirements of the CTA, including the information technology system that will be used to store UBO, known as BOSS.

## SPEAKERS

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