Financial Secrecy Under Attack in the United States: Final Regulations Issued for Beneficial Ownership Information Reporting

By J. Michael Cornett

Which country is the top enabler of financial secrecy? (a) Switzerland (b) Singapore, or (c) Luxembourg. Correct answer is none of the above. So, which country is the top enabler of financial secrecy in the world? The answer may surprise you.

The United States is now considered the most secretive financial jurisdiction in the world.[1] In an effort to address this problem, the Corporate Transparency Act (CTA) was enacted into law as part of the National Defense Authorization Act for Fiscal Year 2021.[2] To create more transparency into the ownership or control of certain types of entities, the CTA will require the reporting of certain individuals related to the entities. This article will provide background on the CTA and its reporting requirements. The article will further discuss what entities will need to do to prepare for such reporting requirements.

Background

In general, CTA requires certain domestic and foreign entities to identify and provide personal information about certain individual owners (beneficial ownership information (BOI)) to the Financial Crimes Enforcement Network (FinCEN) division of the Department of Treasury. The information collected may be shared with other government agencies, law enforcement, financial institutions, and regulators.[3] Proposed regulations were issued on December 7, 2021.[4] Final regulations were issued on September 30, 2022.[5] The new regulations are effective as of January 1, 2024.

J. MICHAEL CORNETT is a Managing Director at Cherry Bekaert.

In general, the regulations describe which domestic and foreign entities must file a report (Reporting Company) and what information must be provided about (i) the Beneficial Owners of the Reporting Company and (ii) the individuals who formed or registered the Reporting Company (Company Applicants). These requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while minimizing the burden on entities doing business in the United States.

Reporting Company

There are two types of Reporting Companies: a Domestic Reporting Company and a Foreign Reporting Company. A Domestic Reporting Company is any entity that is created by the filing of a document with a secretary of a state or similar office under the laws of a State[6] or Tribal jurisdiction.[7] A Foreign Reporting Company is any entity formed under the laws of a foreign jurisdiction and that is registered to do business within a State or Tribal jurisdiction.[8] Thus, the CTA applies to domestic and foreign corporations, limited liability companies, or other similar entities. Generally, excluded from the definition of "other similar entities" are sole proprietorships, certain types of trusts, and general partnerships as in most circumstances these forms of business are not created through the filing of a document with a secretary of state or similar office.

Not only should an entity develop processes and procedures for gathering information, but they will also need to develop procedures to gather information to update and change the Initial Report when the information changes.

There are 23 distinct categories of entities exempted from the definition of Reporting Companies[9] [*see* Chart 1].

CHART 1. EXEMPTED ENTITIES

- SEC-reporting issuers,
- Domestic governmental authorities,
- Banks,
- Domestic credit unions,
- Depository institution holding companies,
- FinCEN-registered money transmitting businesses,
- SEC-registered broker-dealers,
- 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,
- Certain accounting firms,
- Public utilities,
- Financial market utilities,
- Certain pooled investment vehicles,
- Tax-exempt entities,
- Entities assisting tax-exempt entities,
- Large operating companies,
- Subsidiaries of certain exempt entities, and
- Inactive businesses.

In general, the exemptions apply to entities that are already under regulatory oversight by Treasury or another governmental agency, such as financial institutions, publicly traded companies, public utilities, and insurance companies. For entities that are not under regulatory oversight, the Large Operating Exemption is likely to be a heavily used exemption.

A Large Operating Company is defined as an entity that (1) employs more than 20 employees on a full-time basis in the United States, (2) filed a Federal income tax return in the United States in the previous year reporting more than $5,000,000 in gross receipts or sales in the aggregate, and (3) has an operating presence at a physical office within the United States.[10] For purposes of determining whether an entity employs more than 20 employees, this is done on a stand-alone entity basis and not on a consolidated basis across affiliated entities. However, the gross receipts test is done on a consolidated basis, but excluded from this test is gross receipts or sales from sources outside the United States.

Beneficial Owner

If you determine that an entity is a Reporting Company, the next step is to determine if there are any Beneficial Owners that must be reported. A "Beneficial Owner" is defined as an *individual* who directly or indirectly (i) exercises substantial control over a Reporting Company or (ii) owns or controls at least 25% of the ownership interests in a Reporting Company.[11] There is no limit on the number of Beneficial Owners a Reporting Company can have. Excluded from the definition of Beneficial Owner is a (i) minor child, (ii) individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual, (iii) an employee of a Reporting Company, other than a senior officer, acting solely as an employee, (iv) an individual whose only right is a future right through inheritance, or (v) a creditor of the Reporting Company.[12]

An individual has "substantial control" over a Reporting Company if the individual:

1. Serves as a senior officer of the Reporting Company;[13]
2. Has the authority to appoint or remove any senior officer or a majority of the board of directors (or similar body);
3. Directs, determines, or has substantial influence over important decision(s) made by the Reporting Company; <u>or</u>
4. Any other form of substantial control over the Reporting Company.[14]

An individual may directly or indirectly, including as a trustee of a trust or similar arrangement, exercise substantial control over a Reporting Company through (i) board representation, (ii) ownership or control of a majority of the voting power or voting rights of the Reporting Company, (iii) have influence over decisions associated with any financing arrangement or interest in a company, (iv) control over one or more intermediary entities that separately or collectively exercise substantial control over a 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.[15]

The definition of "ownership interest" is broad. In addition to equity interests in the Reporting Company, ownership interests can include capital or profits interests, convertible instruments, warrants or rights, and other options or privileges to acquire equity, capital, or other interests in the Reporting Company.[16]

Company Applicant

In addition to identifying the Beneficial Owners, the Reporting Company must also identify the Company Applicant(s).[17] For a Domestic Reporting Company, the Company Applicant is the individual who directly files the documents that form the entity. For a Foreign Reporting Company, the Company Applicant is the individual who directly files the documents that first registers the entity to do business in a State or Tribal jurisdiction. You can have more than one Company Applicant for a Domestic or Foreign Reporting Company if there is an individual who is primarily responsible for directing or controlling such filing but was not the person who actually filed the documents.[18]

Reporting Requirements

Reporting Companies created or registered before January 1, 2024 will have until January 1, 2025 (*i.e.*, by December 31, 2024), to file their Initial Report with FinCEN.[19] A Reporting Company created on or after January 1, 2024 shall file an Initial Report within 30 calendar days of the earlier of: (i) in the case of a Domestic Reporting Company, the date on which it receives actual notice that its creation is effective; (ii) for a Foreign Reporting Company, the date on which it receives actual notice that it has been registered to do business; or (iii) the date on which a secretary of state or similar office first provides public notice (*e.g.*, publicly accessible registry) that a Domestic Reporting Company has been created or a Foreign Reporting Company has been registered.[20]

A Reporting Company must update a previously filed report within 30 calendar days after the date on which information in the report changes, except for information related to the Company Applicant.[21] Further, an updated report must be provided if the entity no longer qualifies as a Reporting Company.[22]

A Reporting Company also must correct inaccurate information in a previously filed report within 30 calendar days of when the Reporting Company becomes aware or has reason to know of the inaccuracy in the filed report.[23]

The Initial Report will contain information on the Reporting Company, the Company Applicant(s), and the Beneficial Owner(s). For the Reporting Company, the following information must be provided:[24]

1. Full legal name of the Reporting Company
2. Any "trade or doing business as" name of the Reporting Company
3. Current street address
   a) The street address for the principal place of business in the United States for the Reporting Company, or
   b) If no principal place of business in the United States, the street address of the primary location in the United States where the Reporting Company conducts business.
4. State, Tribal, or foreign jurisdiction of formation of the Reporting Company
5. For a Foreign Reporting Company, the State or Tribal jurisdiction where such company first registers, and
6. Taxpayer Identification Number (TIN) issued by the Internal Revenue Service, or a tax identification number issued by a foreign jurisdiction (and the name of the foreign jurisdiction) if the Foreign Reporting Company does not have a TIN.

For each Beneficial Owner and Company Applicant[25] of a Reporting Company, the following information must be provided:[26]

1. Full legal name of the individual;
2. Date of birth of the individual;
3. Individual's residential street address;[27]
4. A unique identifying number from an acceptable identification document; and
5. Copy of the identification document from which the unique identifying number is obtained.

The acceptable identification documents are (i) non-expired passport issued by the United States, (ii) non-expired identification document issued by a State, local government, or Indian tribe, (iii) non-expired driver's license issued by a State, or (iv) non-expired passport issued by a foreign government if the individual does not possess any of the three prior documents.

An individual or Reporting Company can apply for a unique identification number from FinCen ("FinCen Identifier").[28] A FinCEN Identifier is an identifying number that FinCEN will issue to individuals or Reporting Companies upon request, subject to certain conditions. For individuals, FinCEN will issue a FinCEN Identifier if an individual submits to FinCEN the same information as required in an Initial Report. The FinCen Identifier can be used in lieu of providing the information above when the Reporting Company files its Initial Report.

Penalties

There are potential civil and criminal penalties for persons who "willfully provide, or attempt to provide, false or fraudulent beneficial ownership information" to FinCEN or "willfully fail to report complete or updated beneficial ownership information to FinCEN." A person fails to report if the person either causes the failure or is a senior officer of the entity at the time of the failure. Person is defined as any individual, Reporting Company, or Company Applicant. Civil penalties can be up to $500 per day, while criminal penalties can be up to $10,000, imprisoned for not more than 2 years, or both.

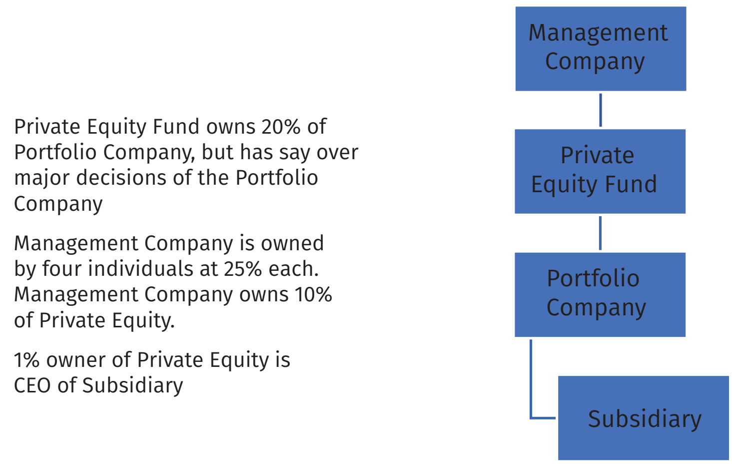
Next Steps

Existing entities should determine if they are a Reporting Company or not. They will need to determine if they meet the requirements of a Domestic Reporting Company or a Foreign Reporting company and whether any exemptions apply. They should prepare documentation to support that determination. If they determine they are a Reporting Company, they need to begin taking the steps to gather the necessary information to file an Initial Report.

A Reporting Company will have to perform an analysis to determine who its Beneficial Owners are. This may be relatively easy, but given that there can be multiple Beneficial Owners it could take significant amount of time and cost depending on the complexity of the ownership structure of a Reporting Company and the management structure at each entity in the ownership structure.

In Chart 2 is a simple private equity ownership structure involving all domestic entities. For each entity in that structure, a determination will need to be made as to whether that entity is a Reporting Company. For purposes of this discussion, it is assumed that all entities

CHART 2. SUBSTANTIAL CONTROL



are Domestic Reporting Companies unless otherwise indicated.

The Management Company would have four Beneficial Owners as each owner owns 25%.[29] If there are any 25% owners of the Private Equity Fund, they would be Beneficial Owners of the Private Equity Fund. In addition, the four owners of the Management Company could be Beneficial Owners of the Private Equity Fund depending on whether they exercise, in their individual capacity, substantial control over the Private Equity Fund. Other employees of the Management Company or the Private Equity Fund could also be Beneficial Owners if they exercise substantial control over the Private Equity Fund.

The Private Equity Fund has control over major decisions of the Portfolio Company. Thus, the Beneficial Owners of the Portfolio Company could be the same as those for the Management Company or for the Private Equity Fund. The Portfolio Company may have senior officers who also would be considered Beneficial Owners.

For the Subsidiary, the CEO of Subsidiary has substantial control and would be a Beneficial Owner even though the CEO only owns 1%. Whether any individual owners in any of the other entities above Subsidiary would be treated as Beneficial Owners of Subsidiary depends on whether they are viewed as having substantial control over the Subsidiary. If the Subsidiary qualifies for the large company exemption, it would not be a Reporting Company. The fact that Subsidiary is not a Reporting Company would not prevent the entities above it from being a Reporting Company.

As illustrated by this example, determination of Beneficial Owners for a Reporting Company can be a complex undertaking. Thus, each Reporting Company needs to develop processes for collecting the information it needs to report. They may need to obtain information from entities in the ownership chain above a Reporting Company to identify potential Beneficial Owners further up the chain of ownership.

Further, the Reporting Company will need to ensure that the data collected is protected and that the Reporting Company complies with applicable data privacy laws given that the information being obtained relates to individuals. A Reporting Company's policies and procedures should also incorporate a regular review of BOI to make timely filings for updates and corrections.

Existing and newly formed Reporting Companies may need to modify the relevant formation documents to ensure that individuals determined to be Beneficial Owners are required to provide BOI necessary for the Initial Report. Reporting Companies may need to include in their formation documents financial penalties for Beneficial Owners who do not provide the necessary information needed for the Initial Report.

Conclusion

The good news is that the rules are not applicable until January 1, 2024, and in the case of entities in existence before January 1, 2024, not until January

1, 2025. Thus, entities have time to prepare for these rules. Because process and procedures need to be developed to obtain the necessary information, existing entities should not wait. Further, businesses that are forming entities on a regular basis should also develop their process and procedures for the future. Not only should an entity develop processes and procedures for gathering information, but they will also need to develop procedures to gather information to update and change the Initial Report when the information changes. Finally, they need to develop procedures to make sure that the information gathered is protected and that all privacy laws are complied with as a data breach could be costly.

ENDNOTES

1. *See e.g.*, This Day, *US Ranked World's Most Secretive Financial Jurisdiction for Illegal Money* (Oct. 20, 2022); Bloomberg, *World's Top Enabler of Financial Secrecy Is the United States* (May 16, 2022).
2. The CTA is Title LXIV of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. 116-283 (Jan. 1, 2021). Division F of the NDAA is the Anti-Money Laundering Act of 2020, which includes the CTA.
3. FinCen is currently working on regulations to establish rules who may access BOI and the safeguards necessary to ensure that information is secured and protected.
4. 86 FR 69920 (Dec. 8, 2021).
5. 87 FR 59498 (Sep. 30, 2022).
6. The term "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, and any other commonwealth, territory, or possession of the United States.
7. Reg. §1010.380(c)(1)(i).
8. Reg. §1010.380(c)(1)(ii).
9. Reg. §1010.380(c)(2).
10. Reg. §1010.380(c)(2)(xxi).
11. Reg. §1010.380(d).
12. Reg. §1010.380(d)(3).
13. A senior officer is an individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function. Reg. §1010.380(f)(8).
14. Reg. §1010.380(d)(1).
15. Reg. §1010.380(d)(1)(ii).
16. Reg. §1010.380(d)(2).
17. Reg. §1010.380(e).
18. For example, consider a law firm partner who controlled the filing of incorporation documents, and a person at the law firm who filed the documents. Both would be Company Applicants.
19. Reg. §1010.380(a)(1)(iii).
20. Reg. §1010.380(a)(1).
21. Reg. §1010.380(a)(2).
22. Reg. §1010.380(b)(3).
23. Reg. §1010.380(a)(3).
24. Reg. §1010.380(b)(1)(i).
25. For a Reporting Company created or registered before January 1, 2024, the Reporting Company is not required to report any information with respect to any Company Applicant. *See* Reg. §1010.380(b)(2)(iv).
26. Reg. §1010.380(b)(4).
27. A Company Applicant who is in the trade or business of forming or registering an entity can use the street address of the business.
28. Reg. §1010.380(a)(2).
29. Note, if the Management Company may have other Beneficial Owners. For example, a senior office that does not own an equity interest in the Management Company would be a Beneficial Owner of the Management Company.