

The National Defense Authorization Act for Fiscal Year 2021 (NDAA) became law on January 1, 2021, after a congressional override of then-President Trump’s veto. The NDAA included significant reforms to the U.S. anti-money laundering (AML) and countering the financing of terrorism (CFT) regime.

Division F of the NDAA consists of the Anti-Money Laundering Act of 2020, which includes the Corporate Transparency Act (CTA). Congress enacted the CTA to establish uniform beneficial ownership information reporting requirements to improve transparency for national security, intelligence, and law enforcement agencies in their efforts to detect and prevent money laundering and terrorist financing.

On September 29, 2022, the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) issued regulations regarding the beneficial ownership reporting requirements.<sup>1</sup> The final rulemaking is effective January 1, 2024. Reporting companies created or registered before January 1, 2024, will have one year (until January 1, 2025) to file their initial reports, while reporting companies created or registered after January 1, 2024, will have 30 days after creation or registration to file their initial reports. We detail below the background of the CTA, what it requires, penalties for non-compliance, and how reported information may be used.

## Background

One of Congress’s main goals in enacting the CTA is to discourage the use of shell corporations as a tool to disguise and move illicit funds. As many U.S. states do not require corporations and similar entities to disclose information about their beneficial owners, Congress concluded that federal legislation providing for the collection of beneficial ownership information for entities formed under the laws of U.S. states was necessary. Proponents of the CTA, and eventually Congress, viewed such legislation as necessary to protect vital U.S. national security interests, better enable law enforcement efforts to counter money laundering and the financing of terrorism, and bring the U.S. into compliance with international AML/CFT standards.<sup>2</sup>

## Who Must Comply with the Corporate Transparency Act?

As a preliminary matter, the CTA applies only to certain domestic companies and foreign entities that are registered to do business in the U.S.<sup>3</sup>

The term “reporting company” is defined as a corporation, limited liability company, or other similar entity that is (i) created by the filing of a document with a secretary of state or similar office under the law of a U.S. state or Indian Tribe, or (ii) formed under the law of a foreign country and registered to do business in the U.S. by the filing of a document with a secretary of state or a similar office under the laws of a U.S. state or Indian Tribe.<sup>4</sup> The CTA requires each “reporting company” to submit to FinCEN a report containing specific information about its beneficial ownership.<sup>5</sup>

The CTA and final rule set out several exemptions to the definition of a reporting company.<sup>6</sup> For example, it does not include certain financial institutions or certain issuers of securities in heavily regulated industries (e.g., banks, credit unions, broker-dealers, money services businesses registered with FinCEN, and issuers registered with the U.S. Securities and Exchange Commission), or “large operating companies” (defined in the final rule as an entity that employs more than 20 full time employees in the U.S., has an operating presence at a physical office within the U.S., and filed a federal income tax or information return in the U.S. for the previous year demonstrating more than \$5,000,000 in gross receipts or sales).<sup>7</sup> Additionally, other types of legal entities, including certain trusts, will be excluded to the extent that they are not created by the filing of a document with a secretary of state or similar office.

1 87 Fed. Reg. 59,498 (Sept. 30, 2022); 31 C.F.R. § 1010.380.

2 Indeed, FinCEN’s announcement of the final rule noted that it “addresses deficiencies in the U.S. anti-money laundering regime as identified by the Financial Action Task Force—the international standard-setting body for anti-money laundering and countering the financing of terrorism and proliferation of weapons of mass destruction standards—and delivers on commitments made by the United States ahead of the December 2021 Summit for Democracy and in the first-ever U.S. Strategy on Countering Corruption.” FATF’s 2016 Mutual Evaluation Report of the United States noted that “lack of timely access to adequate, accurate and current beneficial ownership (BO) information remains one of the fundamental gaps in the U.S. context” and “overall, the measures to prevent the misuse of legal persons are inadequate.” 87 Fed. Reg. 59,498, 59,506 (Sept. 30, 2022).

3 31 U.S.C. § 5336(a)(11) (defining “reporting company”).

4 31 U.S.C. § 5336(a)(11)(A).

5 31 U.S.C. § 5336(b)(1)(A).

6 31 U.S.C. § 5336(a)(11)(B); 31 C.F.R. § 1010.380(c)(2).

7 31 U.S.C. § 5336(a)(11)(B); 31 C.F.R. § 1010.380(c)(2).

## Who Is a Beneficial Owner and What Beneficial Ownership Information Will Reporting Companies Have to Provide?

The CTA defines a “beneficial owner” as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise:

- (i) exercises substantial control over the entity, or
- (ii) owns or controls not less than 25 percent of the ownership interests of the entity.<sup>8</sup>

FinCEN’s regulations set forth a range of activities that constitute “substantial control” of a company, including serving as a senior officer of the reporting company; having authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body); or directing, determining, or having substantial influence over important decisions made by the reporting company.<sup>9</sup> In the fact sheet it published to accompany the final rule, FinCEN noted that its approach to defining the contours of substantial control was “designed to close loopholes that allow corporate structuring that obscures owners or decision-makers.”

Generally, a reporting company must provide in its report the following pieces of information about each beneficial owner of the applicable reporting company and, for companies created or registered after January 1, 2024, each applicant with respect to that reporting company: full legal name; date of birth; complete current address; a unique identifying number and the issuing jurisdiction from an acceptable identification document, and an image of the document from which the unique identifying number was obtained.<sup>10</sup> If an individual has obtained a FinCEN identifier and provided that FinCEN identifier to a reporting company, the reporting company may include the FinCEN identifier in its report in lieu of the information required for that individual.<sup>11</sup>

Again, this information must be provided for each beneficial owner – for every individual that exercises substantial control and for every individual that owns or controls not less than 25 percent of the ownership interests.<sup>12</sup> Note, though, that less information may be required for certain entities such as foreign pooled investment vehicles, or if an exempt entity has or will have a direct or indirect ownership interest in a reporting company.

8 31 U.S.C. § 5336(a)(3)(A). The definition of “beneficial owner” does not include the following: a minor child; an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual; an individual acting solely as an employee of the entity and whose control over or economic benefits from such entity is derived solely from the person’s employment status; an individual whose only interests in the entity are through a right of inheritance; or a creditor of an entity, unless the creditor exercises substantial control over the entity or owns or controls not less than 25 percent of the ownership interests of the entity. 31 U.S.C. § 5336(a)(3)(B).

9 31 C.F.R. § 1010.380(d)(1).

10 31 U.S.C. § 5336(b)(2)(A); 31 C.F.R. § 1010.380(b)(1)(ii). A “company applicant” means the individual who files the document that creates or registers the reporting company, or the individual who is primarily responsible for directing or controlling the filing if more than one individual is involved in the filing of the document. 31 C.F.R. § 1010.380(e); see also 31 C.F.R. § 1010.380(b)(2)(iv) (“... if a reporting company was created or registered before January 1, 2024, the reporting company shall report that fact, but is not required to report information with respect to any company applicant.”).

11 31 C.F.R. § 1010.380(b)(4)(ii).

12 87 Fed. Reg. 59,498, 59,525 (Sept. 30, 2022) (“Each reporting company will be required to identify as a beneficial owner any individual who satisfies either of these two components of the definition, unless the individual is subject to an exclusion from the definition of ‘beneficial owner.’ ”); 31 U.S.C. § 5336(b)(2)(A) (reports must identify “each beneficial owner”).

13 31 U.S.C. § 5336(b)(5).

14 31 C.F.R. § 1010.380(a)(1)(iii).

15 31 C.F.R. § 1010.380(a)(1)(i).

16 31 C.F.R. § 1010.380(a)(1)(ii).

17 31 C.F.R. § 1010.380(a)(2).

18 31 C.F.R. § 1010.380(a)(3).

19 31 U.S.C. § 5336(h)(3)(C).

## When Must Reporting Companies Start Complying with the CTA?

The CTA’s requirements will take effect on the effective date of the regulations prescribed by FinCEN, which is January 1, 2024.<sup>13</sup> The exact deadlines for filing reports will depend on when a reporting company was created or registered, and there are also deadlines for submitting updated reports with new information or reports correcting erroneous information.

- Domestic reporting companies created or foreign reporting companies registered to do business in the U.S. before the effective date of the final regulations will have one year from the effective date of the final regulations to file their initial report with FinCEN. Therefore, such companies have until January 1, 2025, to file their initial reports.<sup>14</sup>
- Any domestic reporting company created on or after January 1, 2024, shall file a report within 30 calendar days of the earlier of the date on which it receives actual notice that its creation has become effective or 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.<sup>15</sup>
- Any entity that becomes a foreign reporting company on or after January 1, 2024, shall file a report within 30 calendar days of the earlier of the date on which it receives actual notice that it has been registered to do business or the date on which a secretary of state or similar office first provides public notice, such as through a publicly accessible registry, that the foreign reporting company has been registered to do business.<sup>16</sup>
- If there is a change in the information previously reported to FinCEN under these regulations, a reporting company has 30 calendar days to file an updated report.<sup>17</sup>
- If a reporting company filed information that was inaccurate at the time of filing, the reporting company must file a corrected report within 30 calendar days after the date on which such reporting company becomes aware or has reason to know of the inaccuracy.<sup>18</sup> The CTA provides a safe harbor to any person that has reason to believe that any report submitted by the person contains inaccurate information, and consistent with FinCEN’s regulations, submits a report containing corrected information no later than 90 days after the date on which the person submitted the inaccurate report.<sup>19</sup>

This safe harbor is only available, however, for reporting companies that file corrected reports no later than 90 days after submission of an inaccurate report, and does not extend to reports corrected more than 90 days after they are filed, even if a reporting company files a correction promptly after becoming aware or having reason to know that a correction is needed.<sup>20</sup>

## Penalties for Non-Compliance

The CTA sets forth multiple penalties for non-compliance, providing for both criminal and civil penalties.<sup>21</sup> Any person who provides false information, or fails to report complete or updated information, is subject to a civil penalty of not more than \$500 for each day that the violation continues, and may face fines not more than \$10,000, imprisonment for not more than two years, or both.<sup>22</sup> Separate from the CTA, persons could face criminal liability under the federal criminal code, which prohibits knowingly and willfully providing false information or concealing a material fact to any of the three branches of the federal government.<sup>23</sup>

## Use of Collected Beneficial Ownership Information

In acknowledgment of the sensitive nature of the beneficial ownership information that FinCEN will collect, the CTA mandates that such information will be available only to authorized government authorities, subject to effective safeguards and controls. The U.S. Department of the Treasury will maintain the information in a secure, nonpublic database. Importantly, however, the collected information may also be available to financial institutions so that they can confirm beneficial ownership information provided by their customers.

## The Future of FinCEN's Customer Due Diligence Requirements for Financial Institutions

FinCEN issued a customer due diligence (CDD) rule in 2016 (effective in 2018) to strengthen CDD requirements for certain financial institutions. Part of this amended rule included a new requirement for those financial institutions to identify and verify the beneficial owners of legal entity customers, subject to certain exemptions.<sup>24</sup> The CTA requires the Secretary of the Treasury to revise these requirements for financial institutions so that the 2016 rule conforms to the CTA. However, the CTA notes that such a mandate should not be construed as authorizing the Secretary of the Treasury to repeal the requirement that financial institutions identify and verify a legal entity's beneficial owners.

FinCEN views the CDD rule and beneficial ownership information reporting at entity formation as distinct requirements.<sup>25</sup>

The CTAs "control" prong differs slightly from FinCEN's current CDD requirements for the information customers must provide to banks. Currently, in addition to collecting information on individuals with 25 percent ownership, banks only have to collect information on a single individual with significant responsibility to control, manage, or direct a legal entity. The CTAs final rule, however, does not limit the reporting of individuals in substantial control to one person, but rather a reporting company must list any and all individuals who satisfy the definition. Therefore, the CTA may require certain entities to disclose beneficial ownership information on more and different individuals than they are accustomed to under the control prong of the current CDD rule. FinCEN determined that replicating the CDD rule's approach, which includes a numerical limitation on beneficial owners, "would primarily benefit more complex entities, with the foreseeable consequence of allowing illicit actors to easily conceal their ownership or control of legal entities."<sup>26</sup> FinCEN concluded that adopting the 2016 CDD rule's definition of beneficial ownership in the final rule for the CTA thus would undermine the purpose of the CTA.<sup>27</sup>

## What's Next?

FinCEN will engage in additional rulemaking regarding access to beneficial ownership information and revising FinCEN's CDD rule. The former will focus on establishing rules governing who may access beneficial information, for what purposes, and what safeguards will be established to ensure that information is secure and protected. The latter will revise FinCEN's CDD rule for financial institutions to bring the CDD rule into conformance with the CTA final rulemaking, account for financial institutions' access to beneficial ownership information filed by reporting companies under the CTA, and reduce any burdens on financial institutions and legal entity customers that are, in light of the CTA, unnecessary or duplicative.

FinCEN is also continuing to develop relevant infrastructure, such as the information technology system that will be used to store beneficial ownership information, the Beneficial Ownership Secure System (BOSS). Finally, FinCEN plans to publish in the Federal Register for public comment the reporting forms persons will use to comply with their reporting obligations and is anticipating developing guidance to assist reporting companies in complying with the final rule, including a Small Entity Compliance Guide.

<sup>20</sup> 87 Fed. Reg. 59,498, 59,513 (Sept. 30, 2022).

<sup>21</sup> 31 U.S.C. § 5336(h).

<sup>22</sup> 31 U.S.C. § 5336(h)(3)(A).

<sup>23</sup> 18 U.S.C. § 1001.

<sup>24</sup> See 81 Fed. Reg. 29,398 (May 11, 2016) (final CDD rule).

<sup>25</sup> 86 Fed. Reg. 66,920, 69,953 (Dec. 8, 2021) ("FinCEN has long viewed the CDD Rule and BOI reporting at entity formation as distinct").

<sup>26</sup> 87 Fed. Reg. 59,498, 59,562 (Sept. 30, 2022).

<sup>27</sup> 87 Fed. Reg. 59,498, 59,562 (Sept. 30, 2022); 87 Fed. Reg. 59,498, 59,528 (Sept. 30, 2022) ("FinCEN has concluded that incorporating the 2016 CDD Rule's numerical limitation for identifying beneficial owners via substantial control is inconsistent with the CTAs objective of establishing a comprehensive BOI database for all beneficial owners of reporting companies. FinCEN believes that limiting reporting of individuals in substantial control to one person, as in the 2016 CDD Rule—or indeed imposing any other numerical limit— would artificially restrict the reporting of beneficial owners who may exercise substantial control over an entity, and any such artificial ceiling could become a means of evasion or circumvention. Requiring reporting companies to identify all individuals who exercise substantial control would—as the CTA envisions—provide law enforcement and others a much more complete picture of who makes important decisions at a reporting company.").

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