

Publications

Proposed Regulations Issued Under New Federal Law Mandating Disclosure of Owners of Private Companies

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The federal Corporate Transparency Act (CTA) was adopted on January 1, 2021, and is anticipated to go into effect sometime in 2022. It will require many domestic business entities and foreign business entities registered to do business in the U.S. to make an initial report to the federal government disclosing beneficial ownership and company applicant information (BOI) and to provide updates when their BOI changes.

The CTA itself is less than clear in many aspects, including with regard to the timing of reporting and updating BOI, and the definitions of certain crucial terms. The CTA acknowledged this by tasking the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) with issuing regulations that govern compliance with the CTA.

On December 8, 2021, FinCEN promulgated proposed regulations addressing BOI requirements (Proposed Regulations). The Proposed Regulations are open for comment, and written comments may be submitted on or before February 7, 2022. The Proposed Regulations address many questions that practitioners have raised over the past year since the CTA was enacted.

What Details Do the Proposed Regulations Provide about the CTA's Reporting Requirements?

In general, the Proposed Regulations make clear that FinCEN intends to make the CTA as broad as possible in order to further its purpose of establishing a comprehensive database of beneficial owners and applicants of reporting companies. The definitions in the Proposed Regulations summarized below reflect this.

- **What types of entities are considered "reporting companies"?** The CTA defines a reporting company to mean a corporation, limited liability company, or other similar entity created or, in the case of a foreign reporting company, 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 law of a State or Indian Tribe. The Proposed Regulations

do not separately define the phrase “other similar entity.” However, the accompanying release with the Proposed Regulations states that FinCEN interprets this phrase to likely include limited liability partnerships, limited liability limited partnerships, business trusts, and most limited partnerships, and any other type of business form created by a filing.

- **Who is considered a “beneficial owner”?** The CTA defines beneficial owners to mean those that exercise “substantial control” over a company, or that own or control not less than 25 percent of the ownership interests in a company. The Proposed Regulations define “ownership interests” to mean equity in the reporting company, as well as other types of interests. These can include capital or profit interests, convertible instruments, warrants or rights, or other options or privileges to acquire equity or other interests. The Proposed Regulations also make clear that an individual may own or control ownership interests through a trust or similar arrangement based on such individual’s position as a grantor or settlor, beneficiary, trustee, or other individual with authority over trust assets. FinCEN expects every company to have at least one beneficial owner.
- **What qualifies as “substantial control”?** The Proposed Regulations set forth several types of control to identify persons that are deemed to exercise substantial control over a reporting company. These include (1) service as a senior officer; (2) authority over the appointment or removal of any senior officer or a majority of the board of directors; or (3) direction, determination, or decision of, or substantial influence over, important matters. The Proposed Regulations also set forth a catch-all provision that intends to capture additional types of control that may not be explicitly listed above. FinCEN also explained that it intentionally did not use the definition of “significant degree of control” from the customer due diligence rule (CDD Rule) to define “substantial control,” as it interprets that the purpose of the CTA is to capture the information of every person who may exercise control over a company, rather than just one person.
- **Who is the “company applicant”?** The Proposed Regulations define company applicant to include not only the person who physically makes the filing with a secretary of state or similar office in the U.S. to form or register a reporting company, but also the person(s) who direct or control the filing of such a document. Therefore, there may be more than one company applicant for the formation of one business entity.

The CTA identified 23 specific types of companies that will be exempt from the reporting requirements. It also gave FinCEN the authority to add additional exemptions to this list, and to clarify the requirements of qualifying for existing exemptions. FinCEN does not currently plan to exempt additional types of entities beyond those already identified in the CTA.

Among others, exempt entities include the following:

- **SEC reporting issuer:** This category exempts any issuer of securities that is (a) an issuer of a class of securities registered under section 12 of the Securities Exchange Act of 1934 (Exchange Act); or (b) required to file supplementary and periodic information under section 15(d) of the Exchange Act.
- **Large operating company:** This category exempts companies that meet the following criteria: (a) employs more than 20 employees on a full-time basis in the U.S.; (b) filed in the previous year federal income tax returns in the U.S. demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate; and (c) has an operating presence at a physical office in the U.S. The Proposed Regulations

clarify that the operating presence must be a property owned or leased by the entity, rather than a residence or shared space. The Proposed Regulations also clarify that the CTA would use the Internal Revenue Service definition of “full-time employee” to determine whether a company employs more than 20 employees on a full-time basis.

- **Subsidiary:** This category excludes companies owned or controlled by exempt entities. The Proposed Regulations narrowly interpret this exemption by requiring the subsidiary to be wholly owned by one or more exempt entities in order to qualify, rather than being only partially owned by one or more exempt entities.

Q&A

The CTA raised many questions, some of which were addressed by the Proposed Regulations. A few are summarized below.

Q. If a company falls into one of the exemption categories, will it have to apply to FinCEN to claim such exemption?

A. Likely no. The release accompanying the Proposed Regulations states that FinCEN does not have the statutory authority to require an exempt company to affirmatively apply for an exemption, although the release does invite comments on this issue.

Q. What are the components of BOI that a reporting company is required to disclose?

A. The reporting company must disclose each person’s name, date of birth, residential or business address, and a unique identifying number from an acceptable identification document, including a scanned copy of such identification document, or a unique FinCEN identifier.

Q. How does someone obtain a FinCEN identifier?

A. An individual may obtain a FinCEN identifier by submitting to FinCEN the information required to be provided by a reporting company. The individual can then provide the FinCEN identifier to a reporting company in lieu of the BOI requirements.

Q. What if a reporting company has a beneficial owner that is an exempt entity?

A. Under the Proposed Regulations, in that situation the reporting company would only be required to report the name of the exempt entity.

Q. When will a reporting company be required to submit an initial report?

A. For companies formed prior to the effective date of the final rule (Effective Date), such company is required to submit the initial report within one year of the Effective Date. For companies formed on or after the Effective Date, such company is required to submit the initial report within 14 calendar days of the date of formation.

Q. What is the required timing for submitting updates to reported information?

A. Under the Proposed Regulations, a reporting company must file an updated report within 30 calendar days after the date on which there was a change in the reported information with respect to a beneficial owner or company applicant. Reporting companies have 14 calendar days to correct inaccuracies.

Q. What if a company was not exempt from reporting at first, but becomes exempt at some point after filing an initial report?

A. Under the Proposed Regulations, this change is considered a change with respect to the information in such company's initial report, and so the company would be required to file an updated report disclosing the change.

Practical Pointers

Reporting companies, and their attorneys and other advisors, should keep in mind a few considerations:

- Those involved in the formation of legal entities (or amending entity governing documents) should consider adding language to the governing documents of the entity that would oblige each owner to provide to the entity initial and ongoing information and documents about the owner (and any indirect owners), so that the entity has the legal right to require the disclosure of the information and documents needed to satisfy its obligations under the CTA.
- If there are confidentiality obligations in governing documents or other documents binding on the entity, they should include carve-outs sufficient to permit the entity to satisfy its reporting obligations under the CTA without violating the confidentiality obligations.
- Keep in mind that, in gathering information to satisfy its CTA reporting obligations, an entity will be in possession of potentially sensitive information about its owners and indirect owners. This puts the owners and indirect owners at risk that such information will be disclosed by the entity in other circumstances, whether inadvertently, intentionally or in response to a third party subpoena. Depending on the circumstances, the participants may want to address that risk.
- Under the CTA, personal information about the "company applicant" in respect of an entity is required to be reported. The "company applicant" is the individual who files an application to form an entity under the laws of a state or registers or files an application to register a non-U.S. entity to do business in the U.S. by filing a document with a secretary of state or similar office under the laws of a state. While the language is not a model of clarity, this appears to encompass more tasks than merely being the named incorporator or organizer of the entity, and may include one or more lawyers, paralegals and services companies that facilitate the making of such filings.

The Proposed Regulations offer a preview as to what the final rule is likely to require of reporting companies. Interested parties should review the Proposed Regulations carefully, and take the opportunity to submit comments to FinCEN if so desired by February 7, 2022. The Proposed Regulations are just one of three notices of proposed rulemaking that will be issued by FinCEN related to the CTA. FinCEN also intends to release rulemaking on the protocols for access to and disclosure of BOI, and to revise the CDD Rule.

Please reach out to one of the authors of this alert or your Vorys attorney for more information.

