

Beneficial Ownership Information Rules and Regulations: How It May Impact You

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On September 29, 2022, the Financial Crimes Enforcement Network ("FinCEN") issued a final rule (the "Rule"), the first of three planned rulemakings implementing the beneficial ownership information reporting rules of the Corporate Transparency Act of 2021 ("CTA"). The Rule—located at 31 C.F.R. § 1010.380—details the required reporting by certain companies of information related to their beneficial owners and their company applicants. The CTA and the Rule aim to help national security, intelligence, and law enforcement agencies prevent "drug traffickers, fraudsters, corrupt actors such as oligarchs, and proliferators from laundering or hiding money and other assets in the United States" from using shell and front companies. See 87 Fed. Reg. 59498, 59596.

FinCEN drafted the Rule broadly and, when the reporting requirements take effect on January 1, 2024, they will reach a wide range of companies, with FinCEN estimating that 32.6 million legal entities will need to file reports under the new Rule. See 87 Fed. Reg. 59498, 59549.

Who must report under the rule?

The new Rule will affect both United States entities and foreign entities transacting business in the United States. Under the Rule, any United States entity created by the filing of a document with the secretary of state or similar office of any state or other governmental agency must report information on itself, its beneficial owners, and its company applicants. The same reporting is required for any foreign entity (an entity formed under the laws of a foreign country) that is registered to do business in the United States by the filing of a document with the secretary of state or similar office.

While the Rule requires a broad range of companies to report, it also carves out 23 exceptions for companies involved in highly regulated industries. Examples include insurance, banking, utilities, accounting, and more. "Large operating companies"—those companies with more than 20 full time employees in the United States or its territories, an operating presence at a physical office in the US, and more than \$5 million in gross receipts or sales—are also exempt under the rule. Notably, any entity which is owned or controlled by one or more exempt entities is also exempt from the reporting requirements under the rule.

What information must be reported?

A range of information will need to be reported under the Rule about the reporting company itself, the beneficial owners of the reporting company, and the company applicants for the reporting company.

The reporting company must report information about itself, including:

- The full legal name of the reporting company
- Any trade name or "doing business as" name of the reporting company
- Current address of its principal place of business or primary location in the United States
- Jurisdiction of formation or registration of the reporting company
- Taxpayer identification number

The Rule defines beneficial owner and company applicant broadly. Beneficial owner under the Rule is defined as any individual who either exercises substantial control over the entity or owns or controls at least 25 percent of the ownership interests of the entity.

First, any individual who exercises "substantial control" is a beneficial owner under the Rule. Substantial control under the Rule includes a wide range of activities, including, among others, serving as a senior officer or having authority over appointment of members of the Board of Directors of the entity. In general, anyone who can make important decisions on behalf of an entity exercises substantial control for purposes of the Rule. See FR 59594. Even further, the Rule dictates that substantial control can be exercised indirectly, through "formal or informal arrangements" with other individuals.

Second, any individual who owns or controls at least 25 percent of the ownership interests of the entity is a beneficial owner under the Rule. The Rule provides mechanistic formulas for determining whether the ownership interest of the individual exceeds 25 percent of the total ownership interests of the entity. The broad definition of ownership interest casts a wide net, including not only ownership of equity or capital and profit interests, but also extending to ownership of convertible interests (such as a warrant) and options. Further, the Rule treats options, warrants, or other similar interests as exercised for purposes of the calculation. If an individual owns more than 25 percent of the total voting power *or* the total value of the entity, that individual is a beneficial owner for purposes of the Rule.

Likewise, the Rule defines "company applicant" broadly. Any individual who directly files the document first forming or registering a reporting company is a company applicant under the Rule and must be included in the reporting. But the definition goes further, deeming any individual who is "primarily responsible for directing or controlling" the filing to be a company applicant.



A reporting company must report certain information about any beneficial owner or any company applicant, including:

- Full legal name
- Date of birth
- Complete current address
- A unique identifying number and issuing jurisdiction (e.g., a passport or social security card)
- An image of the document containing the unique identifying number

When must reports be made?

Starting on the effective date of the Rule, January 1, 2024, reporting companies created before and after that date must comply with the reporting requirements. Any reporting company created or registered prior to January 1, 2024, will have one year—until January 1, 2025—to file their initial reports. For reporting companies created or registered after January 1, 2024, the reporting company must file the required report within 30 days of receiving notice of company creation or registration.

The reporting requirements do not stop after the filing of the initial report, however, as reporting companies have an ongoing obligation to maintain the accuracy of their reports. If any of the information filed in the initial report changes or the company becomes aware of inaccurate information, the company must report those changes or correct the inaccurate information within 30 days of becoming aware of the change or the inaccuracy.

Reporting Violations and Penalties

Failure for a company to satisfy a reporting obligation will result in civil and criminal penalties. Proposed 31 CFR 1010.955(f)(3) lists the CTA's enumerated civil and criminal penalties. It provides civil penalties in the amount of \$500 for each day a violation continues or has not been remedied and criminal penalties of up to \$250,000 or imprisonment for up to 5 years, or both. There are also enhanced criminal penalties if a person commits a violation while violating another law of the United States or as part of a pattern of any illegal activity that involves more than \$100,000 in a 12-month period, including a fine of up to \$500,000, imprisonment of not more than 10 years, or both. See Fed. Reg. 77424.

The statute is clear regarding who may be held liable for willful violations with respect to compliance. The final rule states that a person is considered to have failed to report complete or updated BOI if the person causes the failure or is a senior officer of the entity at the time of the failure. The term "senior officer" means any 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. 31 C.F.R. § 1010.380(f)(10).

Who will have access to Beneficial Ownership Information?

FinCEN has published the reporting forms for reporting under the Rule in the Federal Register, and the public has provided feedback on the forms. On December 16, 2022, FinCEN proposed regulations to implement provisions in the CTA that authorize certain recipients to receive disclosures of identifying information associated with reporting companies, their beneficial owners and their company applicants. It allows only certain authorized recipients access to BOI for limited purposes as allowed under the CTA.

FinCEN will disclose BOI to five categories of recipients:

1. Federal, State, local and Tribal government agencies
2. Foreign law enforcement agencies, judges, prosecutors, central authorities, and competent authorities, provided their requests come through an intermediary Federal agency and meet additional criteria
3. Financial Institutions using BOI to facilitate compliance with customer due diligence requirements
4. Federal functional regulators and other appropriate regulatory agencies acting in a supervisory capacity assessing Financial Institutions
5. U.S. Department of the Treasury

Even within the five categories, the CTA expressly restricts access to BOI to only those authorized users (1) who are directly engaged in an authorized investigation or activity; (2) whose duties or responsibilities require access to BOI; (3) who have undergone appropriate training or use staff to access the system who have undergone appropriate training; (4) who use appropriate identity verification to obtain access to the information; and (5) who are authorized by agreement with the Secretary of the Treasury to access BOI. See 87 Fed. Reg. 77409.

Recognizing the highly sensitive nature of BOI, the CTA requires that BOI be maintained "in a secure, nonpublic database, using information security methods and techniques that are appropriate to protect non-classified information security systems at the highest security level ..." To that end, FinCEN has consulted with future stakeholders who would access BOI, as well as other government entities that have developed beneficial ownership databases in its development of the BOI database. See 87 Fed. Reg. 77407.

Limits to Disclosure

FinCEN is proposing limitations on re-disclosure of information by authorized recipients. Although the CTA expressly limits the circumstances under which FinCEN itself may initially disclose BOI to other agencies or Financial Institutions, it does not specify the circumstances under which an authorized BOI recipient may re-disclose the BOI to another person or organization. See 87 Fed. Reg. 77417, 77418. To minimize the changes of re-disclosure or unauthorized disclosure of BOI, The CTA makes it unlawful for any person to knowingly disclose or knowingly using BOI unless such disclosure is authorized under the CTA. These



violations are subject to the same civil and criminal penalties for failure to satisfy a company's reporting obligation.

Next Steps

The proposed rules for re-disclosure will become subject to protocols designed to protect the security and confidentiality of BOI. FinCEN continues to solicit comments on the mechanism or other techniques that would be appropriate for the security of BOI should re-distribution be permitted.

Lathrop GPM will continue to monitor and keep our clients apprised of developments related to the beneficial ownership information reporting requirements. If you have any questions on the impact of the Rule to your company, please contact Dale Werts, Alex Reed or Dara Alvarado.