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FinCEN Proposed Beneficial Ownership Rule

On December 7, 2021, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a highly anticipated proposed rule that would implement key provisions of the Corporate Transparency Act (CTA), a law enacted earlier this year as part of the Anti-Money Laundering Act of 2020 (AMLA). When fully implemented, the CTA and AMLA will bring the most significant revisions to the U.S. anti-money laundering/countering the financing of terrorism (AML/CFT) compliance framework in more than 20 years. FinCEN's December 7 proposal (the Proposed Rule), which followed an April 2021 Advanced Notice of Proposed Rulemaking (ANPRM), marked a significant milestone in this process.

The Proposed Rule would implement sweeping beneficial ownership disclosure requirements included within the CTA—in response to longstanding international criticism that the United States lacked appropriate measures to ensure corporate transparency. Specifically, the Proposed Rule would require a diverse array of "reporting companies" to disclose their beneficial owners to FinCEN either within 14 days of formation for new entities, or within one year of the final rule's effective date for existing entities.

Although notable in various ways, as described below, the Proposed Rule leaves many important questions unanswered; FinCEN explains that it is only the first of three rulemakings that together will implement the CTA. In particular, FinCEN reserved for the second rulemaking a set of issues that generated significant focus in responses to the ANPRM—the agency's plans for creating and maintaining a database to store beneficial ownership information and provisions regarding use and access of that database.

The third and final CTA-related rulemaking will revise FinCEN's existing customer due diligence (CDD) to meet the statutory directive to "reduce any burdens" on financial institutions that, in light of the corporate registry, become "unnecessary." This important rulemaking is due within one year of the CTA's other requirements becoming effective.

Key Takeaways

An Expansive Definition Proposed for "Beneficial Owners." The CTA defines a beneficial owner as "any 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% of the ownership interests of the entity." This definition could create disclosure obligations capturing a broad group of individuals beyond those holding traditional ownership interests, including those involved in the administration of entities subject to reporting and even some who may have nontraditional control rights, such as through lending arrangements.

Although the statute did not define "substantial control" for these purposes, the Proposed Rule suggests various factors that may be indicative, including: service as a senior officer of a reporting company; authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar body) of a reporting company; and the ability to direct or determine, or exercise a substantial influence over, important matters of a reporting company. Unlike the CDD Rule, which requires identification of a single control person, FinCEN makes clear that more than one person can qualify under this standard as having "substantial control" over a reporting company. Disclosure of all such individuals would be required.

Further, the Proposed Rule explains that substantial control can arise directly or indirectly, including through rights associated with financing arrangements and "financial or business relationships." On its face, this expansive definition appears broad enough to include business counterparties of or lenders to a reporting company, who, in some cases, may exercise "substantial control" even without a formal relationship as an employee, officer, director, or equity holder.

Notably, changes in beneficial ownership are required to be reported within 30 days under the new rule, and corrections based on new information within 14 days, creating an ongoing monitoring and reporting obligation that will increase administrative burdens on reporting companies.

Broad Definition of "Reporting Company." The CTA places disclosure obligations on "reporting companies," broadly defined to include "a corporation, limited liability company, or other similar entity" created by a filing to a secretary of state. The requirement also will apply to entities formed under the laws of a foreign country that are registered to do business in the United States. The Proposed Rule would further expand the definition to include "domestic reporting compan[ies]" and "foreign reporting compan[ies]." Although in each case, FinCEN largely adopts the statutory definition, the agency proposes also to include limited liability partnerships, limited liability limited partnerships, business trusts, and limited partnerships. These additions provide helpful clarity for what the statute describes only as "other similar entities."

No New Exemptions, but Helpful Clarification. Twenty-three entity types are excluded from the definition of "reporting company" under the CTA. Although the statute permits FinCEN to add others, and many commenters to the ANPRM encouraged the agency to do so, the Proposed Rule does not include additional exclusions.

FinCEN's proposal would, however, clarify the scope of certain exemptions that were ambiguous in the statutory text, including that for "dormant entities." This exemption is especially important to investment funds, real estate ventures, and other entities that typically include shelf companies within their organization. Under the CTA, the term includes any entity that, among other things, has been "in existence for over 1 year." But the Proposed Rule would narrow its application significantly. FinCEN makes clear that it is meant as a "grandfathering provision" covering only "entities in existence for over one year at the time the CTA was enacted;" it does not apply to "entities in existence for over one year at any time the statute is applied." In making this clarification, FinCEN explains that its aim is to limit "opportunities for bad actors to exploit the exemption."

Importantly, FinCEN also declined to act on comments advocating a de minimus exception, such that inactive entities holding relatively small value assets would not be required to report. Thus, under the proposed rule, any entity holding assets will be required to report, irrespective of the value of assets held. FinCEN's proposed rule also clarifies that exemption from reporting will extend to all subsidiaries wholly owned by a parent company that qualifies for exemption, but will not extend to entities whose ownership includes even a minority interest held by a company required to report under this rule.

The proposed rule would not require exempt entities to make a filing with FinCEN to claim exemption; however, reporting companies that later become exempt will be required to report their exemption determination.

Outstanding Issues

In adopting a phased approach to CTA implementation, FinCEN's Proposed Rule left open various key questions that had been concerning to market participants and observers across industries and sectors. It will fall to the coming installments of FinCEN's CTA rulemaking process to address them.

Of particular note, FinCEN leaves for future rulemakings:

- A timeline for implementing the FinCEN database;
- Rules regarding access to and permissible use of information submitted to the FinCEN database, in particular whether financial institutions may rely on such information as presumptively accurate;
- Technical information about the database, including measures to ensure security and data integrity;
- A description of the information reporting companies will be required to provide to FinCEN about the company itself;
- Clarity regarding how entities should demonstrate eligibility for an exemption from the definition of "reporting company;" and
- Whether reporting companies will be obligated to confirm the accuracy of information in the database on a periodic basis or after certain events.

Recommendations

Although important issues remain open, it is not too early for companies to begin preparing for full implementation of the CTA. For example, those involved in the formation and administration of entities that may be subject to reporting should consider developing a process to identify potential "reporting companies" and consider how they may establish eligibility for any available reporting exemptions and confirm ongoing eligibility at periodic intervals. Moreover, where reporting may be required, now is the time to consider a how to identify and track who may qualify as a "beneficial owner" under the expansive definition FinCEN proposes.

We will continue monitoring additional developments in the CTA implementation process. Perkins Coie attorneys are available to discuss these and related issues.

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