



Corporate Transparency Act: Summary of Key Aspects of the Final Rule

By: Laurence V. Parker, Jr. & Patrick R. Tomlinson

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As previously reported, on September 30, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued the final rule to implement the beneficial ownership reporting requirements of the Corporate Transparency Act.

This alert will summarize the following:

- Definition of Reporting Companies
- Exemptions
- Reporting Requirements
- Definition of a Beneficial Owner, Substantial Control and Ownership Interests
- The Company Applicant
- Timeframe for Reporting
- Potential Violations
- Next Steps

Entities Required to File Reports

Definition of Reporting Companies

The BOI reporting requirements under the CTA apply to "Reporting Companies," which include foreign and domestic corporations, limited liability companies and other similar entities. The Final Rule divides "Reporting Companies" into two categories: (a) "Domestic Reporting Companies," which are entities created by the filing of a document with the secretary of state (or similar office) of a jurisdiction in the U.S. and (b) "Foreign Reporting Companies," which are entities formed under the laws of a foreign jurisdiction that are registered to do business in the U.S.

?Domestic Reporting Company? means any entity that is (a) a corporation, (b) limited liability company or (c) other entity that is created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe.

?Foreign Reporting Company? means any entity that is: (a) a corporation, limited liability company, or other entity; (b) formed under the law of a foreign country; and (c) registered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe.

The Final Rule interprets the language ?other similar entities? in the CTA to mean any entity that is created (in the case of a Domestic Reporting Company) or registered to do business in the U.S. (in the case of a Foreign Reporting Company) through a filing with a secretary of state (or any similar office) in a U.S. jurisdiction.

Exemptions from Reporting Companies

Exemptions

While FinCEN has the authority to expand the list of entities that are exempt from the definition of ?Reporting Company? in the CTA, the Final Rule adopts nearly verbatim the 23 types of Exempt Entities under the CTA and does not include any additional categories of Exempt Entities. Importantly, the specific exemptions to the definition of ?Reporting Companies? mainly apply to larger U.S. entities or U.S. regulated-entities. Therefore, small businesses and other entities that are not otherwise subject to federal or state regulations that impose BOI reporting obligations will remain subject to the CTA.

Summary Title of Proposed Exempt Entities[1]

- Securities Issuers
- Domestic Governmental Authorities
- Banks
- Domestic Credit Unions
- Bank Holding Companies and Savings and Loan Holding Companies
- Registered Money Transmitting Businesses
- Broker-Dealers
- Securities Exchange or Clearing Agents
- Other Exchange Act Registered Entities
- Registered Investment Companies and Advisers
- Venture Capital Fund Adviser
- State-Regulated Insurance Companies
- State-Licensed Insurance Producers

One notable category of Exempt Entities is for "large operating companies." Under the Final Rule, an entity qualifies as a "large operating company" if it (a) employs more than 20 full-time employees in the U.S.,^[2] (b) has filed a federal tax return or, if applicable, consolidated federal tax return^[3] recording more than \$5 million in gross receipts or sales in the previous year and (c) has an operating presence at a physical office in the U.S.^[4] Also, under the Final Rule, the direct and indirect wholly-owned subsidiaries of most Exempt Entities are themselves exempt.

Related Filings

The Final Rule does not require purportedly Exempt Entities to file a report in order to claim an exemption from the definition of Reporting Companies. However, in the event that any entity that is not a "Reporting Company" by virtue of any exemption to that definition no longer meets the criteria for any exemption, the entity must file a BOI report with FinCEN within 30 days after the date it ceases to be exempt.

Information Required to be Reported

Under the Final Rule, a Reporting Company is required to submit the following information to FinCEN:

- With respect to the Reporting Company itself, (a) its full name, (b) any alternative names through which the company engages in business, (c) its business street address, (d) its jurisdiction of formation or registration and (e) its TIN; and
- With respect to each Beneficial Owner and Company Applicant (each of which is described below) of the Reporting Company, the individual's (a) full legal name, (b) date of birth, (c) current residential or business street address and (d) unique identifying number from an acceptable identification document^[5] (as well as a scanned copy of this underlying document).

The Final Rule also includes certain special reporting rules that modify the above default reporting requirements, including:

- If a Reporting Company or any Beneficial Owner or Company Applicant has received a FinCEN identifier (i.e., a unique number assigned to a person by FinCEN), this number can be submitted to FinCEN in lieu of the requested information regarding the Reporting Company or the individual, as applicable; and
- If an individual would otherwise be a Beneficial Owner by virtue of an ownership interest held exclusively through one or more Exempt Entities, the name of the Exempt Entity (rather than the individual) should be reported.

Beneficial Owner

The CTA defines a Beneficial Owner as any individual who, directly or indirectly, (a) exercises substantial control over a Reporting Company or (b) owns or controls at least 25% of the ownership interests of a Reporting Company. The Final Rule defines substantial control and ownership interests broadly, and FinCEN has not capped the number of Beneficial Owners a Reporting Company must report. Therefore, a Reporting Company would be required to list and provide BOI for *each and every* individual that satisfies either of the two prongs of the definition of beneficial ownership, subject to specific exceptions.^[6] FinCEN expects that each Reporting Company will identify at least one Beneficial Owner with substantial control. Importantly, in contrast to the CDD Rule, which requires legal entity customers to identify only a single individual under the substantial control prong of the definition of Beneficial Owner, the Final Rule requires reporting of BOI for every individual deemed to exercise substantial control over a Reporting Company. Indeed, FinCEN specifically rejected proposals to incorporate the CDD Rule's numerical limitation for identifying Beneficial Owners via the substantial control prong as inconsistent with the CTA's objective of establishing a comprehensive BOI database for all Beneficial Owners of Reporting Companies.

Substantial Control

Under the Final Rule, substantial control means (a) service as a senior officer of a Reporting Company, (b) authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar governing body) of a Reporting Company, (c) direction, determination or decision of, or substantial influence over, important matters of a Reporting Company or (d) any other form of substantial control over the Reporting Company. FinCEN describes the first category as capturing those individuals with authority by law, the second and third categories as capturing those individuals with *de facto* authority and the fourth category as intended to be a catch-all that captures novel and unorthodox ways to assert control.

The Final Rule provides that an individual can assert substantial control over a Reporting Company through a variety of means, including through the following, among others:

- Board representation;
- Ownership or control of a majority of the voting shares of the Reporting Company;
- Rights associated with any financing arrangement or interest in a company;
- Control over one or more intermediary entities that, separately or collectively, exercise substantial control over a Reporting Company;
- Arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- Any other contract, arrangement, understanding, relationship or otherwise.

The still broad definition of "substantial control" in the Final Rule may create considerable challenges for Reporting Companies that are obligated to report and update the BOI with respect to every individual with "substantial control" over the company. In comparison, the current CDD Rule only requires that the BOI of a *single* individual with "significant responsibility" to control, manage or direct the entity be reported.^[7] These reporting requirements may be especially burdensome for those Reporting Companies with complex governance structures, especially in light of the fourth catch-all category of "substantial control," which would require Reporting Companies to assess whether there are any idiosyncratic factors that result in other individuals being deemed to have substantial control over the company.

Ownership Interests

The Final Rule also includes an expansive definition of "ownership interests." While the CDD Rule only considers equity interests in an entity,^[8] under the Final Rule, "ownership interests" would include equity interests in the Reporting Company, as well as capital or profit interests, convertible instruments, warrants or rights or other options or privileges to acquire equity, capital or other interests in a Reporting Company. Under the Final Rule, any debt instrument is also deemed to be an "ownership interest" to the extent it enables the holder to exercise the same rights as one of the specified equity or other interests in the definition of "ownership interests," including the ability to convert the instrument into one of the specified equity or other interests.

"Ownership Interests" means:

(A) Any equity, stock, or similar instrument; preorganization certificate or subscription; or transferable share of, or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust; in each such case, without regard to whether any such instrument is transferable, is classified as stock or anything similar, or confers voting power or voting rights;

(B) Any capital or profit interest in an entity;

(C) Any instrument convertible, with or without consideration, into any share or instrument described in paragraph (d)(2)(i)(A), or (B) of this section, any future on any such instrument, or any warrant or right to purchase, sell, or subscribe to a share or interest described in paragraph (d)(2)(i)(A), or (B) of this

section, regardless of whether characterized as debt;

(D) Any put, call, straddle, or other option or privilege of buying or selling any of the items described in paragraph (d)(2)(i)(A), (B), or (C) of this section without being bound to do so, except to the extent that such option or privilege is created and held by a third party or third parties without the knowledge or involvement of the Reporting Company; or

(E) Any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership.

The Final Rule provides that an individual may directly or indirectly own or control an ownership interest of a Reporting Company through a variety of means, including through the following, among others:

- Joint ownership with one or more other persons of an undivided interest in an ownership interest;
- Control of such ownership interest owned by another individual; and
- With regard to a trust or similar arrangement that holds an ownership interest:
 - Acting as a trustee of the trust or other individual (if any) with the authority to dispose of trust assets;
 - Being a beneficiary of the trust who (a) is the sole permissible recipient of income and principal from the trust or (b) has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or
 - Being a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust: (a) through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the Reporting Company; or (b) through any other contract, arrangement, understanding or relationship.

Under the Final Rule, when determining whether an individual owns or controls 25% or more of the ownership interests of a Reporting Company, the individual's aggregated ownership interests across all categories of ownership interests should be compared to the undiluted ownership interests of the Reporting Company. The Final Rule attempted to provide some guidance on how to determine if this 25% ownership interest threshold has been met where there may be more than one class of equity interests, or where options or partnership profits interests are outstanding. Under the Final Rule, if options or profits interests are outstanding, they are deemed to be exercised and in the money for purposes of determining whether the 25% ownership interest threshold has been met. If there is more than one class of equity interests outstanding, the 25% threshold is determined as a percentage of all outstanding interests if possible, but, failing that, more than 25% of any class of equity interests triggers the reporting requirement.[9]

Company Applicants

Under the Final Rule, Reporting Companies must also identify the Company Applicant, which includes (a) the individual who files the entity formation documents (in the case of a domestic Reporting Company) or (b) the individual who files the first registration document allowing the foreign entity to do

business in the U.S. (in the case of a foreign Reporting Company). Furthermore, in order to ensure that the Reporting Company provides information on individuals that are responsible for the decision to form or register a Reporting Company, any individual who directs or controls the filing of any such document by another person also constitutes a "Company Applicant" under the Final Rule. The Final Rule specifies that the term "Company Applicant" is limited to two people at most: the first being the individual who directly files the document to create or register the Reporting Company, and the second being the individual who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing.[10]

Timeframe for Filing Reports

Under the Final Rule, the timeframe for filing an initial BOI report with FinCEN depends on when a Reporting Company is created (in the case of a domestic Reporting Company) or first registers to do business in the U.S. (in the case of a foreign Reporting Company). All Reporting Companies created or first registered to do business in the U.S., as applicable, before January 1, 2024 will have until January 1, 2025 to file their respective initial reports with FinCEN. All Reporting Companies created or first registered to do business in the U.S., as applicable, on or after January 1, 2024 will have 30 calendar days from the date they were created or first registered to do business in the U.S. to file their respective initial reports with FinCEN.

In the event of any change to any of the BOI that a Reporting Company previously reported to FinCEN, the Reporting Company will have 30 calendar days to file an updated report. However, if a Reporting Company files a report with BOI that was inaccurate at the time of filing, the Reporting Company must file a report correcting such BOI within 30 calendar days of the date it knew or should have known that the BOI was inaccurate.

Penalties for Reporting Violations

The CTA provides for significant civil and criminal penalties in the event of certain violations of the BOI reporting obligations. Any person that willfully provides or attempts to provide, false or fraudulent beneficial ownership information to FinCEN or willfully fails to report complete or updated beneficial ownership information to FinCEN, may be liable for a civil penalty of up to \$500 for each day a violation continues or has not been cured, and may be fined up to \$10,000 and imprisoned for up to two years (or both) for a criminal violation.

The Final Rule provides that the term "person" includes any individual, Reporting Company or other entity. Therefore, individual Beneficial Owners, Company Applicants and others involved with any erroneous filing are also potentially liable for such violations of the BOI reporting obligations. Notably, if a Reporting Company fails to make a filing in connection with a change in BOI, only a person who "either causes the failure, or is a senior officer of the entity at the time of the failure," is liable[11]

Next Steps

The Final Rule becomes effective January 1, 2024. As noted above, Reporting Companies created or registered prior to this effective date will have a one-year grace period (i.e., through January 1, 2025) to

file their initial reports, and Reporting Companies created or registered on or after this effective date will have 30 days following their creation or registration to file their initial reports. A second set of regulations is intended to establish protocols for access to and disclosure of BOI. FinCEN noted that the rulemaking process with respect to these regulations will occur in parallel to the finalization of the Final Rule. The third set of regulations is designed to conform the current CDD Rule with the final version of the Final Rule. FinCEN is required to make these conforming updates within one year of the publication of the final version of the Final Rule (or September 30, 2023).

We would expect many law firms and service companies that assist in business formation will develop protocols over the next year to poll customers they assisted in forming companies on or before January 1, 2024 with questionnaires designed (1) to determine whether each such customer is an Exempt Company or a Reporting Company, and (2) for any such customer who is a Reporting Company, to advise them of the need to report BOI to FinCEN once the Final Rule becomes effective. Similarly, we would expect many law firms and service companies that assist in business formation will develop protocols over the next year to poll customers engaging in such activity on or after January 1, 2024 with questionnaires designed to (1) to determine whether each such customer is an Exempt Company or a Reporting Company, and (2) for any such customer who is a Reporting Company, to assist them with identifying the universe of Company Applicants and BOI reportable to FinCEN.

Finally, we expect that FinCEN may, over the next year, publish one or more Q&As, similar to what it has done under the CDD rule, to guide Company Applicants and Reporting Companies through the Beneficial Ownership reporting requirements.

Williams Mullen will continue to monitor FinCEN's implementation of the Corporate Transparency Act, and we will provide updates and alerts when warranted.

This article contains general, condensed summaries of actual legal matters, regulations, and opinions for informational purposes. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel. For more information, please visit our website at www.williamsmullen.com, or contact Larry Parker at 804.420.6467 or via email at lparker@williamsmullen.com or Pat Tomlinson at 757.473.5305 or via email at ptomlinson@williamsmullen.com.

[1] Short titles included for information purposes only and are qualified by reference to the full text of the Proposed Rule.

[2] For purposes of this exemption, full-time employee generally means an individual employed an average of at least 30 service hours per week or 130 service hours per month, with adaptations for non-hourly employees.

[3] For an entity that is part of an affiliate group of corporations (within the meaning of Section 1504(a) of the Internal Revenue Code of 1986, as amended), the applicable amount is the gross receipts or

sales listed on the group's consolidated tax return.

[4] FinCEN notes that a U.S. operating presence would be one for which the physical office is owned or leased by the entity and does not include a residence or shared space (beyond spaces shared with affiliated entities).

[5] An acceptable identification document means, with respect to an individual, one of the following documents: (i) a non-expired U.S. passport issued to the individual, (ii) a non-expired identification document issued to the individual by a State, local government or Indian tribe for the purpose of identifying the individual, (iii) a non-expired driver's license issued to the individual by a State or (iv) if the individual does not possess any of the foregoing documents, a non-expired passport issued by a foreign government to the individual.

[6] The following types of individuals are excepted from the definition of "Beneficial Owners" and, therefore, would not need to be listed on the BOI report submitted to FinCEN by a Reporting Company: (a) a minor child, (b) an individual acting as a nominee, intermediary, custodian or agent on behalf of another individual, (c) an employee of a Reporting Company, acting solely as an employee and not as a senior officer, whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee, (e) an individual whose only interest in the Reporting Company is a future interest through a right of inheritance and (d) a creditor of a Reporting Company.

[7] 31 CFR § 1010.230(d)(2) (includes an executive officer, senior manager or "other individual who regularly performs similar functions?").

[8] 31 CFR § 1010.230(d).

[9] 31 C.F.R., § 1010.380(d)(2)(iii).

[10] Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. at 59,536.

[11] 31 C.F.R., § 1010.380(g)(4)(iii).

Related People

- Laurence V. Parker, Jr. ? 804.420.6467 ? lparker@williamsmullen.com
- Patrick R. Tomlinson ? 757.473.5305 ? ptomlinson@williamsmullen.com

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