

Locke Lord QuickStudy: Some Key Takeaways From the FinCEN December 7, 2021 Notice of Proposed Rule Making Under the Corporate Transparency Act

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The material set forth below was developed before the 2024 and 2025 district court injunctions regarding the CTA (which were subsequently stayed and continue to be litigated). As a result, the material set forth below, including filing deadlines, may not be current. Please consult FinCEN's [website](#) for the latest filing due dates and other information regarding the CTA and its requirements.

As a follow-up to our earlier QuickStudies on the [Corporate Transparency Act](#) (“CTA”), [Anti-Money Laundering Act of 2020](#) (“AMLA”) and [art and antiquities under the AMLA](#), we are providing this QuickStudy to highlight a few of the important takeaways from the December 7, 2021, Financial Crimes Enforcement Network (“FinCEN”) Notice of Proposed Rulemaking (“NPRM”) relating to the implementation of the CTA. Although the final regulations are not yet in effect, companies, their beneficial owners and “company applicants” should begin to collect the necessary information to make their initial FinCEN CTA filings as they become required under the proposed shortened time periods provided in the NPRM.

The NPRM clarifies a number of definitions and exemptions contained in the CTA, including, who is a “company applicant” and who must file as a “beneficial owner”. FinCEN’s NPRM makes clear that FinCEN intends to exercise its rule making authority to clarify a number of ambiguities in the CTA and to shape the exemptions to filing beneficial ownership reports with FinCEN that were specifically included in the CTA. However, FinCEN has not used its authority to tailor many of the CTA’s statutory exemptions, nor does the NPRM provide any new exemptions.

As discussed in our earlier QuickStudies, Congress enacted the CTA as part of the AMLA to increase transparency by requiring “reporting companies” to file basic information concerning business, “beneficial ownership,” and “company applicant” information with FinCEN. Failure to comply with the CTA’s reporting requirements can lead to civil and criminal penalties, including a maximum civil penalty of \$500 each day the violation continues (up to \$10,000), and imprisonment for up to two years.

The CTA and the NPRM demonstrate that FinCEN is targeting information from smaller enterprises, startups and foreign entities registering in the United States to do business. Among the exemptions available under the CTA, are exemptions for entities who are regulated by other government authorities (be they federal or state), such as companies whose shares are publicly traded, banks, insurance companies and producers, brokers or dealers in securities, registered investment companies and advisers, venture capital fund advisers, as well as accounting

firms, tax exempt entities (or those assisting tax exempt entities), and special pooled investment funds. ?

Large operating companies may be exempt from CTA filings with FinCEN. To qualify for the large operating company exemption the enterprise must have each of the following attributes:?

?(1) “Employ more than 20 employees on a full-time basis in the United States;”?

?(2) have filed Federal income tax returns in the prior year “demonstrating more than ??\$5,000,000 in gross receipts or sales in the aggregate,” including receipts or sales from entities ?owned by the entity and through which the entity operates; and

?(3) have “an operating presence at a physical office within the United States.”?

The NPRM also clarifies when a subsidiary of an exempt entity is also exempt from CTA filings ?limiting the exemption to subsidiaries that are owned entirely by one or more exempt entities. ?

For enterprises formed after the effective date of the CTA final regulations, the reports will be due to ?FinCEN 14 days after the date of initial filing with the Secretary of State (or similar authority) or tribal ?authority.?

Although the CTA itself would have permitted non-exempt enterprises up to two years to file initial ?reports, the NPRM provides that the time to file initial reports with FinCEN will be shortened to only ?one year. Accordingly, if the final regulations adopt the language from the NPRM, initial reports for ?existing non-exempt entities together with their beneficial owners and company applicants will be ?required to be filed with FinCEN within one year from the effective date of the regulations.?

Reports by existing or newly formed non-exempt enterprises are required to contain: (1) the ?company's full name; (2) any trade names, fictitious names or D/B/As; (3) business street address; (4) ?jurisdiction of formation; and (5) IRS taxpayer ID number (TIN) as well as information relating to each ?beneficial owner and company applicant.?

The beneficial ownership reports must be filed and updated promptly with respect to each beneficial ?owner (as defined) following changes in “beneficial ownership” and must include (1) the name of the ?beneficial owner required to make the report, (2) the person’s birthdate; (3) the person’s address; and ??(4) a unique identifying number from an acceptable identification document, such as a passport or ?the unique ID number issued by FinCEN to the beneficial owner or company applicant, or both with ?an image of the applicable document). In contrast to the FinCEN Bank Secrecy Act CDD ?Rule, which requires legal entity customers to identify only a single individual under the “control ?prong” of the definition of beneficial owner, the proposed CTA regulations, if adopted in the form in ?the NPRM, would require beneficial ownership reporting for each individual deemed to exercise ?substantial control over a reporting company.?

The term “beneficial owner” is defined by the CTA as “any individual who, directly or indirectly” either: ??(1) “exercises substantial control” over the reporting company; or (2) “owns or controls” at least 25% of ?the ownership interests of the reporting company. The terms “substantial control” and “ownership ?interest” are not defined in the CTA. If the final regulations adopted by FinCEN mirror the proposed ?regulations in the NPRM, then

for purposes of the CTA, individuals who own or control 25% or more of the ownership interests of an enterprise, and all senior officers, persons with authority over appointment or removal of senior officers, persons who have the ability to appoint or remove members of the governing authority (i.e., directors, managers or LLCs, general partners, etc.) and persons who can exert substantial influence on material decisions by the enterprise all will be deemed have substantial control of the enterprise and thus will be required to file reports with FinCEN as having “substantial control” of the enterprise. Unfortunately, “substantial influence” is also not a defined term. However, the NPRM is clear that the above criteria are not exclusive. Accordingly, FinCEN can exercise broad discretion on a case-by-case basis to decide who is and who is not in “substantial control” of or who exercises “substantial influence” over the enterprise and is thus required to file beneficial ownership reports with FinCEN.

The 25% ownership interests’ trigger for filings is similarly broadly defined. If the final regulations follow the NPRM proposed regulations, the 25% beneficial ownership filing requirement will require the enterprise and all potentially reporting persons to consider

(i) all forms of equity in the enterprise as well as capital and profit interests,

(ii) convertible securities (shares, bonds and notes), and

(iii) warrants and other forms of or rights, options or privileges to acquire equity, capital, membership interests, limited liability company interests, partnership interests, economic or other ownership interests.

The proposed regulations also give the term “company applicant” a very broad definition for purposes of requiring filings with FinCEN. The definition would cover the individual who filed the application to form the enterprise (be it a certificate or articles of incorporation, certificate of formation, limited partnership certificate or other initiating document) for a non-exempt corporation, limited liability company, or other similar entity under the laws of a State or Tribe. For foreign entities, a company applicant would be the individual who files the application or document that first registers the entity to do business in the United States. It not only includes the actual person that made the filing but also any person who directs or controls the filing of the relevant document by another person or entity. This would include lawyers, persons acting for corporate service companies, accountants, financial planners, etc. to the extent that such persons filed the document or caused it to be filed. In the NPRM, FinCEN specifically identifies and treats lawyers and corporate service companies, as gatekeepers who have knowledge necessary for FinCEN to exercise its regulatory authority and duty to maintain the registry required by the CTA. Thus, where an enterprise uses an attorney, service provider or other person to file the relevant formation document, both the filer and the person who directed or controlled the filing must each file beneficial ownership reports with FinCEN.

It can be anticipated that state and tribal authorities such as Secretaries of State and similar authorities that accept filings for new non-exempt enterprises may adopt their own rules and forms, and make their own disclosures directly to FinCEN to enable FinCEN to enforce its regulations. This may result in delays in forming new business that are not exempt from the CTA’s filing requirements once the final FinCEN regulations are effective.

Failure to comply with the CTA’s reporting/filing requirements once the final regulations are in effect can lead to civil and criminal penalties, which may include a maximum civil penalty of \$500 each day the violation continues

(up to \$10,000), and imprisonment for up to two years. Accordingly, it would be prudent to begin to collect the necessary information from the “company applicants”, “beneficial owners” and control persons of existing non-exempt enterprises and from such persons involved in the formation of new enterprises in order to enable timely filing of the necessary reports.

The NPRM does not identify a proposed effective date for the final regulations but anticipates that the effective date will be soon after the date the final regulations are published in the Federal Register.

The NPRM also advises that further rulemaking will occur with respect to who and how access to the registry will be regulated and limited and conforming regulations under the Banks Secrecy Act applicable to financial institutions.

The comment period for the Notice of Proposed Rulemaking ends February 7, 2022.

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