



Business Law Section Newsletter

Vol. 43, No. 1 — Summer 2022

Anti-Money Laundering Act of 2020 Requires Beneficial Ownership Filings by Businesses

By Barry J. Bendes

Once final regulations are adopted by the Financial Crimes Enforcement Network (FinCEN) and become effective, most newly formed business and most existing businesses will be required to file reports with FinCEN under the Corporate Transparency Act (CTA). Versions of the Anti-Money Laundering Act of 2020 (AMLA) and the CTA, which was included in the AMLA, were introduced numerous times in Congress over the years. There are House and Senate reports available that will provide additional color to the CTA as proposed and enacted.

While the CTA went into effect January 2, 2020, and required that regulations under the CTA be promulgated by the end of 2021, final regulations have not been promulgated as of the date of this article in 2022. On December 7, 2021, FinCEN issued a Notice of Proposed Rulemaking (NPRM)¹ under the CTA. The NPRM anticipates that there will be three sets of regulations: The first dealing with the duty to report beneficial ownership to FinCEN, the second dealing with the central registry of beneficial ownership to be administered by FinCEN, and the third dealing with how the CTA and the regulations will affect the Bank Secrecy Act (BSA) and the duty of financial institutions to report under the BSA.

The intent of the CTA is to strengthen the United States' financial crimes monitoring systems. Among the significant provisions in the CTA is the creation of a non-public, secure central registry to be administered by FinCEN to track the beneficial ownership of business entities formed in or registered in the United States, whistleblower protective provisions and certain provisions dealing with records relating to the sale of and dealings with antiquities by dealers, galleries and others involved in the art and antiquities trade.

The CTA creates and the NPRM provides details concerning new reporting obligations for entities relating to their "company applicants," beneficial ownership, control persons and entity structures. Civil and criminal fines and penalties are prescribed for a failure to comply or for willfully providing false information to FinCEN.

As published in the Federal Register,² the NPRM includes an introduction providing an overview of the regulatory initiative and a long and detailed recitation of the proposed regulations. It also foreshadows additional regulations that will be issued by FinCEN or the Department of the Treasury covering substantive and procedural safeguards concerning the FinCEN beneficial ownership registry database and who will have access to

the FinCEN beneficial ownership database. The NPRM further advises that FinCEN will be issuing regulations necessary to adapt the duties and obligations applicable to financial institutions under the BSA with regulations issued by FinCEN under the CTA.

To assist covered entities, their owners and advisers to understand the scope and some of the details of the proposed regulations, FinCEN issued a brief fact sheet highlighting what FinCEN calls its “Key Elements of the Proposed Beneficial Ownership Information Reporting Regulation.”³ Neither the FinCEN fact sheet, which is very brief, nor this article can address the many details contained in the proposed regulations. A careful analysis of the NPRM and the final regulations, when issued, will be important for a fuller understanding of the CTA filing requirements and the safeguards to be included in the FinCEN CTA database of beneficial ownership.

Information filed under the CTA will not be available to the general public but will be available to state law enforcement authorities and to “a Federal agency engaged in national security, intelligence, or law enforcement activity.” In addition, a reporting company may authorize FinCEN to provide information to a bank or other financial institution to satisfy the bank’s or institution’s “know your customer” or other “diligence” requirements under the BSA. Generally, until the adoption of the CTA regulations by FinCEN, most companies are not obligated to report beneficial ownership information to federal or state governmental authorities, except under FinCEN’s existing Customer Due Diligence Rule (CDD Rule) adopted under the BSA. Under the CDD Rule, covered U.S. financial institutions are already required to collect beneficial ownership information from certain customers in connection with the opening of new accounts for those customers.

The NPRM uses a very broad brush to define who is required to report and what must be reported. To ensure compliance with the reporting requirements it is important that all “company applicants” for and officers and directors or companies formed by a filing with the New Jersey Department of the Treasury or a Secretary of State’s office in other states (or a tribal authority) begin to identify the persons about whom the filing must be made and to collect the necessary information to make a timely filing under the CTA once the regulations go into effect.

Under the CTA a “reporting company” must disclose and update the names and identifying information of its “beneficial owners” (newly defined terms for such

purposes) or be subject to substantial penalties. Thus, the key is to determine which entities are “reporting companies” and which are exempt. On June 6, 2022, FinCEN issued an advance notice of proposed rulemaking (ANPRM) to solicit public comment on questions relating to the implementation of a no-action letter process at FinCEN under Section 6305(a) of the AMLA.⁴

The reporting obligation will apply to existing entities as well as newly formed entities once FinCEN adopts final regulations implementing the CTA. It will also apply to “foreign reporting companies,” which are entities formed under the laws of any foreign jurisdiction that are registered to do business in the United States.

After the effective date of the regulations, entities formed or registered in the United States must file beneficial ownership reports promptly following formation or registration. The NPRM provides for a 14 day period from formation for the filings to be made with FinCEN. While the CTA provides existing entities with up to two years to file beneficial ownership reports after regulations are effective, the proposed regulations shorten this period to one year after adoption of the final regulations. If the final regulations follow the NPRM proposed regulations, reporting companies will be required to provide to FinCEN updated information within 30 days following a change in beneficial ownership, and will have 14 days to correct inaccuracies in filed reports after they discover or should have discovered the errors, omissions or mistakes.

Thus, the key terms that must be understood are “beneficial owner,” “substantial control” and “company applicant.” Generally, for this purpose, the term “beneficial owner” means “with respect to an entity, an 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 percent of the ownership interests of the entity.” This is a very broad definition and could encompass persons not generally considered to be in control. It also would allow for multiple persons to be deemed to be in “substantial control” of the same reporting entity at the same time for reporting purposes. There is a long list of exceptions and exclusions to what is a beneficial owner. Some of the exceptions include minor children, guardians for minor children, nominees, intermediaries, mere employees without control over the economic benefits of the entity, a creditor of the entity who does not exercise control or an heir.

Not all entities formed or registered in the U.S. will be treated as “reporting companies” for this purpose. The term reporting company “means a corporation, limited liability company, “or other similar entity” that is “(i) created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe; or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or a similar office under the laws of a State or Indian Tribe.” In New Jersey, the term “similar office” would mean the Department of the Treasury.

The reporting obligations also relate to “company applicants” who are described as “any individual who (A) files an application to form a corporation, limited liability company, or other similar entity under the laws of a State [which term includes the District of Columbia, Puerto Rico and US possessions and protectorates] or Indian Tribe; or (B) registers or files an application to register a corporation, limited liability company, or other similar entity formed under the laws of a foreign country to do business in the United States by filing a document with the secretary of state or similar office under the laws of a State or Indian Tribe.” Under the NPRM this will also cover persons who file or cause the application to be filed. FinCEN specifically mentions that this is intended to include attorneys and service companies that submit the applications for filing as “company applicants.” The term “cause” is a very broad term and might be deemed to include not just the person submitting the application, but those who authorize or direct the filing which may, in turn, require up the ladder reporting by supervising attorneys as well as the supervised attorneys, paralegals and secretaries who actually submit the document for filing or to the service company. Many comments on the NPRM have asked for clarification on this point.

Among the 23 statutory exceptions to the definition of “reporting company” are certain not-for-profit entities, money transmitting businesses, dormant entities meeting certain criteria, banks, insurance companies, registered accounting firms, publicly traded entities and other entities filing reports with the Securities and Exchange Commission, certain entities already filing reports with other governmental agencies, and entities employing more than 20 full-time employees in the U.S. who are operating from a U.S. physical location and who have filed income tax returns in the U.S. demonstrating

more than \$5 million in gross receipts or sales in the previous year. For this purpose, under the NPRM direct and indirect wholly-owned subsidiaries would generally qualify as exempt if the parent and ultimate parent entity are also exempt.

While there is no requirement for an exempt entity to file with FinCEN to claim the exemption under the NPRM, once an exempt entity is no longer exempt, it must make a prompt beneficial ownership filing with FinCEN.

The definition of “beneficial ownership” is broadly written,⁵ and includes “an individual, who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise—exercises substantial control” or who “owns or controls not less than 25 percent of the ownership interests of the entity.” The proposed regulations take an expansive interpretation of “substantial control” to include both executive officers and others exercising similar control over important matters concerning a reporting company and thus not only those individuals with authority under law, but also persons with the power to elect and remove directors and those individuals with de facto authority or persons having “unorthodox” ways to assert control over a reporting company. Accordingly, an individual can be found to assert “substantial control” over a reporting company through a variety of means, including through rights associated with a financing arrangement or interest in a company, control over one or more parent or 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 some other contract, arrangement, understanding or relationship.

The broad definition of “substantial control” in the proposed rule may create considerable challenges for reporting companies that, as a result of the proposed rule, would be obligated to report and update their beneficial ownership information with respect to every individual with “substantial control” over the company. In comparison, the current CDD Rule only requires that the beneficial ownership information of a single individual with “significant responsibility” to control, manage or direct the entity be reported. These reporting requirements may be especially burdensome for those reporting companies with multiple investors or layered ownership structures.

Under the CTA and the proposed regulations, each “reporting company” will be required to report to FinCEN its beneficial owners’ names; dates of birth; current residence or business addresses; and some form of government issued unique identification number, such as a driver’s license number, passport number or FinCEN identifier. An individual or entity that provides beneficial ownership information to FinCEN may request the issuance of a “FinCEN identifier,” which may then be supplied to a reporting company for its use in reports to FinCEN or to a financial institution for its “know your customer” (KYC) or diligence review. FinCEN may, with the consent of a reporting company, disclose beneficial ownership information to a financial institution to facilitate such institution’s compliance with its KYC customer due diligence requirements.

Although the NPRM comment period ended on February 7, 2022, and the ANPRM comment period ended August 5, 2022, it is unclear when FinCEN will publish the final rules under the CTA or concerning a No-Action Letter process. A number of Senators have written to FinCEN requesting prompt action by FinCEN to issue final regulations under the CTA. ■

Barry J. Bendes is a partner at Locke Lord LLP. He concentrates his practice on U.S.-based and cross-border corporate, commercial and real estate transactions, including sales and, marketing and distribute of goods, financings, sale, manufacturing and distribution of consumer products, licensing, privacy/data protection, internet, software and computer-related law matters.

Endnotes

1. fincen.gov/news/news-releases/fincen-issues-proposed-rule-beneficial-ownership-reporting-counter-illicit
2. govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-26548.pdf
3. fincen.gov/news/news-releases/fact-sheet-beneficial-ownership-information-reporting-notice-proposed-rulemaking
4. 87 FR 34224-01, 2022; WL 1909537(F.R.)
5. 31 USC § 5336 as added by AMLA § 6403