

FinCEN Releases Final Rule on Beneficial Ownership Disclosure Requirements

Seven Things To Know

On September 29, 2022, the Financial Crimes Enforcement Network (“FinCEN”) issued the first of three final rules (the “[Final Rule](#)”) implementing the Corporate Transparency Act (“CTA”). This Final Rule, which largely adopts the provisions of FinCEN’s December 2021 [Proposed Rule](#), addresses beneficial ownership reporting requirements. Subsequent rulemakings will address (i) access to and safeguards around information in the contemplated beneficial ownership information database and (ii) revisions to FinCEN’s existing customer due diligence (“CDD”) rule for financial institutions (which currently remains in place).

As discussed in our [prior client alert](#), under the CTA, which was passed as part of the 2020 Anti-Money Laundering Act (“AMLA”), Congress created a new federal framework for the reporting, disclosure, and use of beneficial ownership information. The CTA aims to combat the illicit use of shell companies to hide the proceeds of crime, and to transfer some of the burden of identifying the owners of such companies from financial institutions to the government itself.

The timing of the next two rulemakings under the CTA remains unclear. FinCEN has announced no schedule, and FinCEN’s AMLA-related rulemaking processes are running behind the deadlines set out in the statute. In addition to promulgating these additional rules, FinCEN must also develop the technological infrastructure to receive, store, and provide regulated access to the beneficial ownership information that will be reported pursuant to this Final Rule.

This alert summarizes seven key takeaways from the Final Rule.

1

The Final Rule Largely Retains the Proposed Rule’s Broad Definition of “Reporting Company,” But Clarifies an Exemption for U.S. Sole Proprietorships, Trusts, and General Partnerships

The Proposed Rule and Final Rule both require domestic entities to file beneficial ownership information reports if they are corporations, LLCs, or other similar entities — a category that includes any entity that is created by the filing of a document with a Secretary of State or similar office. Foreign entities must file reports if they are registered to do business in the U.S.

FinCEN declined to define “other similar entity” with greater specificity, such as by listing the types of domestic entities that are subject to the rule in order to remove the possibility of state-by-state variations. At the same time, FinCEN explained its view that when a domestic entity such as a sole proprietorship, trust, or general partnership registers for a business license or similar permit, such registration would generally not qualify as “creating” the entity, and it would remain outside the scope of the rule.

2

FinCEN Again Declined to Introduce Any New Exemptions to the Definition of “Reporting Company”

Under the CTA, Congress required FinCEN to exempt 23 statutorily-specified entities from reporting, and also enabled FinCEN to exempt additional entities, with the concurrence of the Attorney General and Secretary of Homeland Security. The statutory exemptions include certain regulated entities (such as financial institutions), U.S. public companies and companies with substantial physical operations in the United States.

In the Proposed Rule, FinCEN did not specify any exempt entities beyond the 23 included in the CTA, and

FinCEN has not added any new exemptions in the Final Rule. This means, among other things, that foreign public companies may need to file beneficial ownership information reports unless they qualify for other exemptions, such as the large operating company exemption. Foreign pooled investment vehicles are also subject to a reporting requirement, although the requirement is more limited.

In its commentary on the Final Rule, FinCEN explained its view that the statutory purposes of the CTA favor “a high bar for creating additional exemptions.” Nonetheless, FinCEN has the statutory authority to provide additional exemptions in the future, should a compelling case be made that such exemptions are warranted.

3

FinCEN Did Not Adopt a Process for Obtaining Exemption Certificates

In the Proposed Rule, FinCEN invited comment on the appropriateness of permitting exempt entities to voluntarily file exemption certifications. In the Final Rule, however, FinCEN did not include any process by which exempt entities could obtain verification of their exempt status.

In its commentary on the Final Rule, FinCEN explained its view that there is not “a basis in the CTA” for imposing an obligation to obtain exemption certificates, and that FinCEN does not “believe that a voluntary process is needed for such filings at this time.” FinCEN also signaled that it will interpret ambiguities in the statutory exemptions narrowly, suggesting that it may prefer that entities that are unsure of their status to assume that they are required to report. Accordingly, entities should document the basis for an applicable exemption in the event the position is subsequently challenged.

4

The Final Rule Largely Adopts the Proposed Rule’s Broad Definition of “Beneficial Owner”

As defined in the CTA, a “beneficial owner” is “any individual who, directly or indirectly, either exercises substantial control over such reporting company or owns or controls at least 25 percent of the ownership interests of such reporting company.” The Final Rule largely maintains the same broad definition of “substantial control” as the Proposed Rule (discussed [here](#)) with some minor alterations.

The Proposed Rule defined “substantial control” to include authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of directors; the Final Rule removes “dominant minority” from this definition. The Final Rule also removes corporate secretaries and treasurers from the definition of “senior officer,” such that individuals holding those positions will not fall into the definition of beneficial owner. Notably, many states require corporations to identify a secretary and a treasurer when a corporation is formed, whereas a number of the officer titles identified in the Final Rule may not be used at all, especially by smaller entities. Finally, the Final Rule specifies that “direct or indirect exercise of substantial control” includes the exercise of such control through a trust or other similar arrangement.

FinCEN maintained the catch-all prong of the “substantial control” definition in the Final Rule, which requires reporting as a beneficial owner any individual that “has any other form of substantial control over the reporting company” — a challenging standard to apply, particularly given that reporting entities are required to identify *all* such individuals. FinCEN also reiterated its view that reporting companies are expected to always identify at least one beneficial owner who meets the “substantial control” component of the definition, even if no individual meets the ownership interest component.

As to ownership interests, the Final Rule clarifies that holders of options on instruments that could qualify them as having an ownership interest in a reporting company *will not* be considered to have an ownership interest if they are a third party and the option is created without the knowledge or involvement of the reporting company. This alteration reduces the burden on reporting companies to determine if any unrelated persons or entities may have acquired such options. The Final Rule also fleshes out the methodology for calculating whether an interest amounts to a 25% “ownership interest.”

5

The Final Rule Partially Clarifies the Extent of Individual Liability for Reporting Violations

The CTA includes civil and criminal penalties for the willful failure to provide accurate beneficial owner information or to report such information to FinCEN. Such failures are subject to a civil penalty of up to \$500 for each day a violation continues or has not been remedied, and a criminal penalty of up to \$10,000 in fines and/or up to two years imprisonment.

The Proposed Rule provided for the possibility of individual liability for reporting violations if an individual directed or controlled another person with respect to a failure to report, or was in “substantial control” of a reporting company that failed to report. The Final Rule revises the individual liability provision to instead state that an individual can be liable where “such person either causes the failure, or is a senior officer of the entity at the time of the failure.” While the removal of “substantial control” aids clarity, it remains to be seen how FinCEN will interpret the new phrase “causes the failure.”

6

The Final Rule Maintains the Onus on Reporting Companies to Amend Inaccurate Reports

The Final Rule obliges reporting companies to file a corrected report in the event that a report is inaccurate when filed and remains inaccurate. The corrected report must be filed within “30 calendar days after the date on which such reporting company becomes aware or has reason to know of the inaccuracy.”

7

Existing Companies that Fall Within the Final Rule Must File Their First Report by January 1, 2025

The Final Rule is effective on January 1, 2024. Reporting companies created or registered before that date will have until January 1, 2025 to file their first required report, while reporting companies created or registered on or after January 1, 2024 must file their first report within 30 days of receiving notice that their creation has become effective. For entities that are exempt as of the effective date but that cease to be exempt during 2024, the first report will be due on the later of (i) January 1, 2025, or (ii) 30 days from the time when they cease to be exempt. Entities that cease to be exempt after January 1, 2025 are required to report within 30 days of their change in status.

For further information on the Proposed Rule or the CTA more generally, please contact the members of Covington’s Financial Institutions and Tax practices.

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