

CORPORATE TRANSPARENCY ACT (CTA)

ANTI-MONEY LAUNDERING LAW TO PRESENT ONGOING COMPLIANCE CHALLENGES TO SMALL ENTITIES

Over 25 million existing business entities and 3-4 million new entities every year will be affected by the new Corporate Transparency Act (CTA). The first wave of regulations implementing the CTA could become final as soon as late 2022. The CTA requires “reporting companies” to submit personally identifying information about the individuals who own or control them, and about the individuals who made the decision to register them with a secretary of state’s office. Civil and criminal penalties for non-compliance include per diem civil penalties of \$500/day while violation continues, plus six-figure criminal fine and prison time for willful failure to report or willfully filing erroneous reports.

The CTA, and the regulations promulgated thereunder, represent a major overhaul in federal anti-money laundering (AML) requirements.¹ The stated purpose of the CTA is to prevent bad actors from hiding behind shell companies as they participate in the American financial system.² The CTA requires many domestic and foreign for-profit enterprises, including corporations, partnerships and trusts, to report data about themselves, their “beneficial owners” and their “applicants” to the Financial Crimes Enforcement Network (“FinCEN”), a bureau within the U.S. Department of the Treasury that is charged with, among other things, enacting and enforcing federal AML regulations.³ There is no small business exemption to the CTA; in fact, small, unregulated businesses are arguably the CTA’s key target.

The CTA became law on January 1, 2021.⁴ FinCEN issued its first Notice of Proposed Rulemaking (the “Reporting NPRM”) including its proposed regulations interpreting the CTA on December 8, 2021. The public comment period closed on February 7, 2022, and once FinCEN digests the comments, it will propound its final regulations, possibly within as little as 30 days. The publication date of the final regulations will be different from their effective date. FinCEN has much preparation to do and to coordinate with other authorities before it can begin enforcing the reporting regulations, as we will explain. Once effective, the regulations will give existing entities one year to make their first report to FinCEN, while entities that are created on or after the effective date of the regulations will have only 14 days to report. **Vigilance will be key to staying in compliance with the CTA.** Reporting companies will have only 30 days to report every time they have a change in the personnel who have substantial ownership or control of the organization, or a beneficial owner changes their name or home address.

CTA’s impact will be swift. The CTA is already generating headlines in industry press.⁵ Business entities should be putting processes and controls in place for the gathering of information.

¹ Reporting NPRM, 86 Fed. Reg. 69948 (Dec. 8, 2021).

² Reporting NPRM, 86 Fed. Reg. 69925.

³ FinCEN’s mission and purpose are discussed on [its website](#) and in brief on p. 2-3 of this [March 2021 Consent Order](#).

⁴ 31 USC 5336.

⁵ See e.g. American Bankers Association, “[Letter to FinCEN on Beneficial Ownership Information Reporting Requirements](#)” (May 5, 2021) (approving of the CTA’s goal of modernizing AML laws, and of its effect of making it easier for financial institutions to comply with their customer due diligence obligations); American Bar Association, “[Beneficial Ownership Disclosure and the Corporate Transparency Act - Overdue or Overwrought?](#)” (July 7, 2021) (approving of the CTA’s goals, but critical of its potential affect on lawyers’ ethical obligations; section membership required to view); BCLP, “[FinCEN’s Broad Proposed Beneficial Ownership Reporting Requirements](#),” (Dec. 9, 2021); American Bar Association, “[Shell Game:](#)

More specifically, companies, partnerships and trusts should start assessing whether they are “reporting companies” and if so, who their beneficial owners and applicants are. Long-term impacts on corporate structure and strategy should also be considered.

A. PURPOSE OF THE CTA AND ITS IMPACT ON FINANCIAL INSTITUTIONS’ CUSTOMER DUE DILIGENCE

U.S. law enforcement, intelligence agencies, financial regulators, and international organizations fighting financial crime have been pushing for a major overhaul to American AML laws for more than 20 years.⁶ The result was Congress’ passage of the CTA, amending the Bank Secrecy Act.⁷ According to FinCEN, the “[t]he current lack of a centralized U.S. BOI [beneficial ownership information] reporting requirement and database makes the United States a jurisdiction of choice to establish shell companies that hide the ultimate beneficiaries.”⁸ Likewise, the U.S.’s legal system for the purchase of real property, which does not require purchasing entities to disclose their beneficial ownership, and the U.S.’s prosperous and stable economy “attract[] unlawful actors, domestic and abroad, to abuse our state-based registration system and the U.S. financial industry.”⁹ The CTA requires FinCEN to create a secure central repository for beneficial ownership data, which law enforcement and intelligence agencies will be able to access with a court order. FinCEN’s database is expected to dramatically speed up investigations that used to rely on discovery and grand jury subpoenas, sometimes taking years.¹⁰

The expectation is that FinCEN’s database will also be made available, without a court order, to banks, broker dealers and other financial institutions as they comply with their customer due diligence obligations under what is currently FinCEN’s CDD Rule. The CDD Rule (31 CFR 1010.230), in effect since 2018, requires covered financial institutions¹¹ to verify the identities of a legal entity’s beneficial owners before the entity may open a new account at the institution. Having access to the national beneficial ownership database will allow, and require, financial institutions to perform a more thorough beneficial ownership verification before account opening. FinCEN plans to amend the CDD Rule to bring it into line with the CTA; FinCEN will handle these changes in a separate, future rulemaking.¹²

[How the Corporate Transparency Act Aims to End the Illicit Use of Shell Companies, Where It Fails, and What to Do About It](#),” (Dec. 21, 2021) (critical of the CTA, from a defense contracting perspective).

⁶ Reporting NPRM, 86 Fed. Reg. 69923-69927.

⁷ Congress passed the CTA as part of the National Defense Authorization Act (NDAA) of 2021. Division F of the NDAA was the Anti-Money Laundering Act of 2020. Section 6403 of the CTA amended the Bank Secrecy Act to add 53 USC 5336, titled Beneficial Ownership Information Reporting Requirements.

⁸ Reporting NPRM, 86 Fed. Reg. 69928; see also 69922, fn. 10, in which the NPRM reviews a June 2019 survey by the National Association of Secretaries of State which analyzes how much (or more properly, how little) information states collect about entities’ beneficial owners and applicants at the time of formation or registration.

⁹ Reporting NPRM, 86 Fed. Reg. 69926-27.

¹⁰ Reporting NPRM, 86 Fed. Reg. 69926.

¹¹ According to FinCEN, “covered financial institutions” are “U.S. banks, mutual funds, brokers or dealers in securities, futures commission merchants, and introducing brokers in commodities.” See

<https://www.fincen.gov/resources/statutes-and-regulations/cdd-final-rule>.

¹² Reporting NPRM, 86 Fed. Reg. 69921, 69929.

In total, FinCEN plans to perform three waves of rulemaking regarding the CTA: 1) regulations for the reporting of beneficial ownership data (the “Reporting Regulations”; this is the only rulemaking which is currently underway), 2) regulations for securing and accessing beneficial ownership data (the “Access Regulations,” expected in draft form in 2022), and 3) revision of FinCEN’s existing CDD Rule.¹³

B. WHAT KIND OF ENTITIES MUST REPORT – “REPORTING COMPANIES”

The CTA requires “reporting companies” to report information about themselves, their “beneficial owners” and the “applicants” who registered them with the secretary of state.

The CTA applies to domestic and foreign companies. It defines a domestic reporting company¹⁴ as a “corporation, limited liability company *or other similar entity*” (emphasis added) which is “created by the filing of a document with a secretary of state or a similar office”.¹⁵ In defining “other similar entit[ies],” FinCEN’s draft Reporting Regulation requires **all** entities which are formed by a filing in their state secretary of state’s office to comply. “[L]imited liability partnerships, limited liability limited partnerships, business trusts (a/k/a statutory trusts or Massachusetts trusts), and most limited partnerships, in addition to corporations and limited liability companies (LLCs)” would likely need to report, depending on their state’s formation requirements, according to the Reporting NPRM.¹⁶ FinCEN recognizes that states vary on whether they require general partnerships, other trusts and sole proprietorships to register at the time of formation. FinCEN does not propose to make a bright line distinction based on the type of corporate organization. Instead, “**FinCEN will focus on the act of filing to create the entity** as the determinative factor” in identifying reporting companies, both domestic and foreign.¹⁷

The CTA contains a list of 23 industries and business types that are exempt from being reporting companies.¹⁸ The rationale is that these entities are generally larger and more heavily regulated, making it likely that their beneficial ownership data would already be available to law enforcement through their regulators or through existing public disclosure requirements.¹⁹ Exempt are “securities issuers, domestic governmental authorities, banks, domestic credit unions, depository institution holding companies, money transmitting businesses, brokers or dealers in securities, securities exchange or clearing agencies, other Securities Exchange Act of 1934 entities, registered investment companies and advisers, venture capital fund advisers, insurance companies, state licensed insurance producers, Commodity Exchange Act registered entities, accounting firms, public utilities, financial market utilities, pooled investment vehicles, tax exempt entities, entities assisting tax exempt entities,

¹³ Reporting NPRM, 86 Fed. Reg. 69921.

¹⁴ Foreign reporting companies must also report. Foreign reporting companies are entities that had to make a filing in a secretary of state’s office (or equivalent office) in any state in order to do business in the U.S. Reporting NPRM, 86 Fed. Reg. 69939.

¹⁵ 31 USC 5336(a)(11)(A)(ii)-(ii).

¹⁶ Reporting NPRM, 86 Fed. Reg. 69938-39; proposed 31 CFR 1080.380(c)(i)(C).

¹⁷ Reporting NPRM, 86 Fed. Reg. 69938.

¹⁸ 31 USC 5336(a)(11)(B)(i)-(xxii).

¹⁹ Reporting NPRM, 86 Fed. Reg. 69939.

large operating companies, subsidiaries of certain exempt entities, and inactive businesses.”²⁰ The CTA gave FinCEN the authority to add additional exempt entities to the list, with the written agreement of the Attorney General and the Secretary of Homeland Security, but FinCEN does not intend to add any additional exemptions, according to the Reporting NPRM.²¹

Two of the most widely sought-after exemptions will be for “large operating companies” and “inactive businesses.” A “large operating company” is one that has 20 or more full-time employees in their U.S. office and reported more than \$5 million in gross receipts or sales on the prior year’s U.S. tax return.²² This exemption for large entities exists because the purpose of the CTA is to flush out illicit shell companies, which frequently have no employees or operations at all.²³ It will be more difficult to qualify for an exemption as an “inactive business,” which FinCEN sometimes calls a “dormant entity” or “inactive entity.” An inactive entity is one that had already been in existence for over one year at the time the CTA was enacted, is not engaged in active business, is not foreign-owned, has not had a change in ownership or received more than \$1,000 within the preceding 12-month period, and does not hold assets of any type.²⁴ The Reporting NPRM and the CTA’s legislative history make clear that this exception can only benefit entities that were in existence for 12 months prior to the CTA’s enactment.²⁵

In summary, “reporting companies” are active for-profit enterprises, generally not subject to heavy federal regulation, which have 20 or fewer full-time employees in the U.S., less than \$5 million in gross receipts on the prior year’s U.S. tax return, and which required a filing in the secretary of state’s office for their creation (if domestic) or to do business in the U.S. (if foreign).

C. WHOSE DATA MUST BE REPORTED -- “BENEFICIAL OWNERS” AND “APPLICANTS”

“Reporting companies” must disclose information about: (1) themselves, (2) their current “beneficial owners,” and (3) the “applicants” who made the formation filing.

An **applicant** is the actual filer – “any individual who files the document that creates” a domestic reporting company or “any individual who files the document that first registers” a foreign reporting company to do business in any state.²⁶ “Applicants” are defined broadly, so that the person who actually files the paperwork, *and* the individual who directs the filing, are both considered “applicants.”²⁷ FinCEN explicitly notes that law firms frequently “are responsible for the decision to form a reporting company,” making law firm employees “applicants.”²⁸ Applicants are covered by the CTA, even if they assisted with corporate

²⁰ Reporting NPRM, 86 Fed. Reg. 69939.

²¹ 31 USC 5336(a)(11)(B)(xxiv); Reporting NPRM, 86 Fed. Reg. 69940-41.

²² 31 USC 5336(a)(11)(B)(xxi); proposed 31 CFR 1010.380(c)(2)(xxi)(A)-(C); Reporting NPRM, 86 Fed. Reg. 69939-40.

²³ Reporting NPRM, 86 Fed. Reg. 69949.

²⁴ 31 USC 5336(a)(11)(B)(xxiii); proposed 31 CFR 1010.380(c)(2)(xxii).

²⁵ Reporting NPRM, 86 Fed. Reg. 69940.

²⁶ Proposed 31 CFR 1010.380(e); 31 USC 5336(a)(2).

²⁷ Reporting NPRM, 86 Fed. Reg. 69938.

²⁸ Reporting NPRM, 86 Fed. Reg. 69938.

registration long before the CTA, and even if they are deceased when the reporting company's first report is due. "[A] company applicant will remain the same for all time after the entity is created", according to FinCEN.²⁹ Understanding that long-deceased applicants' information may not be available, FinCEN plans to direct reporting companies to report as much information as they actually know.³⁰ FinCEN says these broad interpretations serve Congress's intent, which is to make corporate organizations transparent to law enforcement and the intelligence community.³¹

The CTA provides two channels by which someone may become a "**beneficial owner.**" A beneficial owner is "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 percent of the ownership interests** of the entity".³² All reporting companies must have at least one beneficial owner.³³

Regarding "substantial control": The CTA is silent on the definition of this term, but FinCEN's draft Reporting Regulations provide three ways that someone may exert "substantial control" over an entity: (i) by exercising authority as a senior officer, regardless of title³⁴, (ii) having authority to appoint or remove a senior officer, or a majority of the board of directors, or (iii) through a catch-all list of creative ways of exerting control.³⁵ FinCEN acknowledges that the number of individuals who are in "substantial control" is greater under the CTA's definition than under FinCEN's current CDD Rule. FinCEN plans to amend the CDD Rule to bring it into accordance with the CTA.³⁶ (See Part A of this Alert for a further discussion of FinCEN's current CDD Rule and its application to financial institutions, such as banks.)

Regarding 25% ownership/control interests: The CTA is likewise silent on exactly how ownership and control interests should be determined, but the regulations provide that reporting companies must aggregate all of an individual's interests when considering who meets the 25% threshold.³⁷ That includes an individual's interests in equity, profit, proprietorship, convertible interests, options, indirect ownership through joint ownership, ownership through a trust, and "through any other contract, arrangement, understanding, or relationship."³⁸ Debt interests that give a creditor "a right or ability to convert the right to payment of a predetermined sum to any form of ownership interest" are control interests.³⁹ This definition of ownership and control is broader than the analogue under FinCEN's current CDD Rule. Reporting companies will not need to specify the percentage of ownership and control that each beneficial owner holds.

²⁹ Reporting NPRM, 86 Fed. Reg. 69933.

³⁰ Proposed 31 CFR 1010.380(b)(3)(iv).

³¹ Reporting NPRM, 86 Fed. Reg. 69938.

³² 31 USC 5336(a)(3)(A)(i)-(ii).

³³ Reporting NPRM, 86 Fed. Reg. 69933.

³⁴ A proposed list of titles at 31 CFR 1010.380(f)(8) includes various C-suite executives, secretary, general counsel, and others.

³⁵ Reporting NPRM, 86 Fed. Reg. 69933-34; proposed 31 CFR 1010.380(d)(1)(i)-(iii).

³⁶ Reporting NPRM, 86 Fed. Reg. 69934.

³⁷ Reporting NPRM, 86 Fed. Reg. 69935; proposed 31 CFR 1010.380(d)(3)(iii).

³⁸ Reporting NPRM, 86 Fed. Reg. 69935; proposed 31 CFR 1010.380(d)(3)(i)-(ii).

³⁹ Reporting NPRM, 86 Fed. Reg. 69937; proposed 31 CFR 1010.380(d)(4)(v).

Limited exclusions: The CTA excludes from the definition of beneficial owner: minor children, employees, creditors, inheritors of an interest, and “an individual acting as a nominee, intermediary, custodian or agent on behalf of another individual”.⁴⁰ However, FinCEN plans to limit all of these exclusions, except the one in favour of minor children, as described above (e.g., senior officers cannot avoid reporting because they are employees, and creditors cannot avoid reporting if their debt interest gives them substantial control, as described earlier in Part C of this Alert).

D. WHAT DATA MUST BE REPORTED

About itself: A reporting company must report four pieces of information: 1) its name, including any d/b/a names, 2) its business street address, 3) its “jurisdiction of formation or registration,” and 4) its Taxpayer Identification Number (“TIN”).⁴¹

About each beneficial owner: A reporting company must provide their 1) full legal name, 2) date of birth, 3) current residential address used for tax residency purposes, and 4) the unique identifying number from an “acceptable identification document,” **including a scanned image of the ID.**⁴² Note that the unique ID number must be provided, and a scanned image of the identifying document must also be provided. Acceptable forms of ID are a current U.S. passport, a current state ID or driver’s license, or, if none of those are available, then a current foreign passport.⁴³ If an exempt entity has a controlling interest in a reporting company, then the reporting company must only report the exempt entity’s name, but no other information.⁴⁴ FinCEN also plans to seek voluntary reporting of each beneficial owner’s TIN (which, for most people, would be their Social Security Number), with the individual’s consent.⁴⁵

About its applicants: A reporting company must provide the same information as for their beneficial owners, except that applicants who “provide a business service as a corporate or formation agent” must report their business address.⁴⁶ FinCEN does not clearly explain who these “corporate formation agents” are, other than to say that they are individuals who “make a business of filing documents on behalf of many companies”.⁴⁷ The Reporting NPRM says that that law enforcement may find it useful to identify such individuals by looking for patterns in their business addresses.⁴⁸ All other applicants must provide the residential address they use for tax purposes.⁴⁹

Using a FinCEN Identifier: Any reporting company, beneficial owner or applicant may apply directly to FinCEN for a unique identifier, which they may then provide to FinCEN in future

⁴⁰ 31 USC 5336(a)(3)(B); proposed 31 CFR 1010.380(b)(3).

⁴¹ Proposed 31 CFR 1010.380(b)(1)(i). If the reporting company is newly formed and does not yet have a TIN, it may instead submit a Dun & Bradstreet Universal Numbering System (DUNS) number or a Legal Entity Identifier (LEI).

⁴² 31 USC 5336(b)(2)(A); proposed 31 CFR 1010.380(b)(1)(ii); Reporting NPRM, 86 Fed. Reg. 69930-69931.

⁴³ 31 USC 5336(b)(2)(A); 31 USC 5336(a)(1).

⁴⁴ 31 USC 5336(b)(2)(B); proposed 31 CFR 1010.380(b)(3)(i).

⁴⁵ Proposed 31 CFR 1010.380(b)(2); Reporting NPRM, 86 Fed. Reg. 69931.

⁴⁶ 31 USC 5336(b)(2)(A); Reporting NPRM, 86 Fed. Reg. 69930.

⁴⁷ Reporting NPRM, 86 Fed. Reg. 69930.

⁴⁸ Reporting NPRM, 86 Fed. Reg. 69930.

⁴⁹ Reporting NPRM, 86 Fed. Reg. 69930.

reports, in lieu of their other biographical details.⁵⁰ Having a FinCEN identifier would allow individuals to avoid providing their personal details to each reporting company in which they are a beneficial owner and/or applicant. This may be a consideration, for efficiency and privacy purposes, for those individuals who are associated with a significant number of reporting companies.⁵¹ The filing requirements necessary to obtain a FinCEN identifier would be the same as those otherwise applicable to such persons in connection with the CTA.

E. WHEN THE REGULATION WILL BECOME EFFECTIVE; WHEN TO REPORT

Effective date of the regulation: FinCEN sent somewhat mixed messages in the Reporting NPRM regarding how quickly it wishes to move to implement the Reporting Regulations. On one hand, FinCEN said in the Reporting NPRM that it was contemplating a “delayed effective date” for its final Reporting Regulation, but simultaneously sought input on “the soonest possible effective date after the publication of the final rule.”⁵² In addition, in a press release issued on February 8, 2022, the day after the public comment period closed on the Reporting NPRM, FinCEN said that it was “considering” re-opening the public comment period on the Reporting NPRM simultaneously with issuing its Access NPRM, expected later in 2022.⁵³ However, FinCEN made no promises about whether it would reopen comments on the Reporting NPRM.

There are several factors arguing in favor of a slower implementation for the CTA, but none of them guarantee that FinCEN will choose to move slowly. One primary barrier to immediate implementation is that FinCEN will need time to design and build a secure IT system to collect and store the beneficial ownership data. Further, secretaries of state have asked FinCEN for time to update their internal processes, documents and websites to reflect the CTA before it comes into effect, because of the enormous potential resource challenges – states anticipate that they will field the bulk of the questions regarding compliance with the CTA, since they administer the corporate formation process. (States will have no role in actually collecting beneficial ownership data.) Finally, FinCEN also needs time to work on its draft Access Regulations, defining who may request access to the beneficial ownership data and how to do so.⁵⁴

No matter how many months away the effective date for the Reporting Regulations may be, the CTA and the draft Reporting Regulations have already set the timeline for reporting companies to make their initial, subsequent, and corrected reports.

First reports: The effective date of the final regulations controls the timeline for reporting companies to make their first reports. The proposed Reporting Regulations provide that:

⁵⁰ 31 USC 5336(b)(3)(A); proposed 31 CFR 1010.380(b)(5)

⁵¹ Reporting NPRM, 86 Fed. Reg. 69933.

⁵² Reporting NPRM, 86 Fed. Reg. 69945.

⁵³ FinCEN Press Release, “[FinCEN Statement Regarding Beneficial Ownership Information Reporting and Next Steps](#)” (Feb. 8, 2022).

⁵⁴ For details about the three waves of rulemaking that FinCEN will perform to implement the CTA, see part A of this Alert.

- All reporting companies formed or registered with the secretary of state **before** the effective date of the regulations must make their first report within 1 year after the effective date of the regulations.⁵⁵
- All reporting companies formed or registered **on or after** the effective date of the regulations must make their first report within 14 calendar days of their registration with the secretary of state. By providing such a short window between formation and reporting, FinCEN hopes that reporting will become a natural part of the corporate formation process.^{56 57}

Subsequent reports: Once an entity first reports, there is no annual (or other periodic) requirement to update its beneficial ownership data. **Any changes in the reports regarding who is a beneficial owner, or to their reportable data, must be made within 30 days after the change occurred.**⁵⁸ This requirement means that reporting companies will likely be reporting to FinCEN throughout the year, as the identity of the beneficial owners may change (in particular, which individuals satisfy the “substantial control” prong), along with reportable data for the beneficial owners (i.e., a change of home address).

Corrected reports: If a reporting company discovers that it made a mistake in its reported data, the reporting company has 14 calendar days after the reporting company knows or has reason to know of the inaccuracy to correct it without penalty.⁵⁹

In setting these proposed timelines, FinCEN considerably shortened the maximum possible timelines that Congress allowed in the CTA.⁶⁰ FinCEN believes that these shorter timelines fulfil Congress’ mandate that the beneficial ownership data be “accurate, complete and highly useful” to law enforcement and intelligence agencies.⁶¹

F. ACCESS TO AND RETENTION OF THE REPORTED INFORMATION

There is nothing in the CTA, the Reporting NPRM, or the proposed regulation that would stop FinCEN from retaining beneficial ownership data forever. FinCEN acknowledges it has “record retention obligations” in the Reporting NPRM, but says nothing about how long it would hold data regarding a beneficial owner who dies, or who ceases to be a beneficial owner due to management changes.⁶² Likewise, there is nothing in the CTA or the draft Reporting Regulations preventing FinCEN from retaining indefinitely the data from a reporting company that goes out of business. The CTA sets a minimum time (at least 5 years) for FinCEN to retain data after a reporting company terminates, but there is no direction on when the data must be

⁵⁵ Proposed 31 CFR 1010.380(a)(1)(iii).

⁵⁶ Proposed 31 CFR 1010.380(a)(1)(i)-(ii); Reporting NPRM, 86 Fed. Reg. 69941.

⁵⁷ We anticipate a significant uptick in corporate formation activity at Secretary of States’ offices in advance of the regulations’ effective date, to take advantage of the 1-year initial filing period for existing entities.

⁵⁸ Proposed 31 CFR 1010.380(a)(2).

⁵⁹ Proposed 31 CFR 1010.380(a)(3).

⁶⁰ Compare to 31 USC 5336(b)(1).

⁶¹ 31 USC 5336(b)(4)(b)(ii); Reporting NPRM, 86 Fed. Reg. 69942.

⁶² Reporting NPRM, 86 Fed. Reg. 69947, 69933 (noting that once a beneficial owner is deceased, they cease to be a beneficial owner under the CTA because they would no longer have a current address); 31 USC 5336(b)(2)(A), proposed 31 CFR 1010.380(d).

purged.⁶³ It is possible that FinCEN's forthcoming Access Regulations will address when FinCEN will purge out-of-date information.

The CTA specifies who will need a court order to access beneficial ownership data and who will not. Federal requestors will not. FinCEN will make the information available to federal law enforcement, intelligence agencies and functional regulators, including the IRS (which, like FinCEN, is part of the Department of the Treasury), upon their request.⁶⁴ Foreign law enforcement will make an "official request" to U.S. federal law enforcement but will not need a court order. However, U.S. state law enforcement will need a court order.⁶⁵ Financial institutions may request access to the information, with the consent of the reporting company, to facilitate the financial institution's CDD review.⁶⁶ (See Part A of this Alert for more information about the CDD Rule.) FinCEN does not address the exact form for each type of request in its Reporting NPRM, but should address these issues in the Access NPRM later in 2022.⁶⁷

The CTA and FinCEN's proposed regulations do not explicitly say whether FinCEN would disclose the data in response to a Freedom of Information Act (FOIA) request.

G. WHAT HAPPENS IF YOU DON'T REPORT, OR IF YOU MISHANDLE REPORTING INFORMATION

The CTA sets both civil and criminal penalties for reporting violations, and for unauthorized use or disclosure of beneficial ownership data. The timelines for first reporting and updated reporting are outlined in Part E of this Alert, and what data must be reported is discussed in Part D.

Reporting violations: CTA provides that it is unlawful to "willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN" or to "willfully fail to report complete or updated beneficial ownership information to FinCEN".⁶⁸ A reporting violation "shall" be punished with a civil penalty of up to \$500/day while the violation continues, plus a possible a criminal fine of \$10,000 and up to 2 years in prison.⁶⁹ Notably, providing a "false or fraudulently identifying photograph" is a violation.⁷⁰ This would appear to make it important for beneficial owners to keep their driver's license photos up to date in FinCEN's files.

The CTA provides a definition of "willfully," on which the regulations do not expand. According to the CTA, "In this subsection, the term 'willfully' means the voluntary, intentional violation of a known legal duty."⁷¹ This definition would seem to require deliberate evasion of the reporting requirements to constitute a violation. However, where a reporting company willfully

⁶³ 31 USC 5336(c)(1).

⁶⁴ 31 USC 5336(c)(2)(B), (c)(5)(B).

⁶⁵ 31 USC 5336(c)(2)(B).

⁶⁶ 31 USC 5336(c)(2)(B)(iii).

⁶⁷ Reporting NPRM, 86 Fed. Reg. 69921, 69929.

⁶⁸ 31 USC 5336(h)(1)(A)-(B).

⁶⁹ 31 USC 5336(h)(3)(A)(i)-(ii).

⁷⁰ 31 USC 5336(h)(1)(A).

⁷¹ 31 USC 5336(h)(6).

fails to report or willfully reports inaccurate information, the Reporting NPRM provides that **both the reporting company and its beneficial owners may be liable**. According to FinCEN, “the proposed regulations clarify that a person ‘fails to report’ complete or updated beneficial ownership information to FinCEN within the meaning of section 5336(h)(1), if such person directs or controls another person with respect to any such failure to report, or is in substantial control of a reporting company when it fails to report.”⁷² (See Part C of this Alert for a discussion of “substantial control.”)

Disclosure violations: CTA provides that it is unlawful to “knowingly disclose or knowingly use the beneficial ownership information obtained by the person” for an unauthorized purpose.⁷³ It does not matter whether the data is part of a reporting company’s own submission to FinCEN, is obtained from FinCEN through an inter-agency request or court order, or as part of a financial institution’s request under the CDD Rule. (See Part F of this Alert for details about who may access FinCEN’s beneficial ownership database.) Neither the statute nor the regulations define “known” or “knowing”. Unauthorized disclosure or use of reported information carries a **mandatory civil penalty of \$500/day while the violation continues, plus either a criminal fine of up to \$250,000 or imprisonment for up to 5 years, or both**.⁷⁴ These steep, mandatory punishments for disclosure violations are meant to give confidence to beneficial owners and applicants that the reporting companies and financial institutions that receive their personal information will handle it with care.⁷⁵

H. UNRESOLVED QUESTIONS – NAME CHANGES

In assessing the reasons why reporting companies may need to update their reported data, FinCEN said that the most likely causes were (i) a change in a beneficial owner or applicant’s address, (ii) the death of a beneficial owner, or (iii) a change in beneficial owners resulting from a management decision.⁷⁶ However, FinCEN appears not to have considered the impact of name changes due to marriage or divorce, or the disproportionate impact this rule will have on women beneficial owners. FinCEN may be compelled to address these concerns in response to public comments on the Reporting NPRM. It will be important to examine the final regulation for guidance in this regard.

I. CONCLUSION

Through the CTA, which has already become law, Congress has enacted major reform to the U.S.’s AML laws. The CTA will require ongoing compliance from tens of millions of legitimate businesses, domestic and foreign, many of them with relatively small numbers of employees and annual incomes. The CTA focuses on legal entities that limit the liability of their creators and beneficiaries. Its stated goal is to make it impossible for the natural persons who own or control such legal entities to hide behind anonymous ownership structures.

⁷² Reporting NPRM, 86 Fed. Reg. 69944.

⁷³ 31 USC 5336(h)(2)(A)-(B).

⁷⁴ 31 USC 5336(h)(3)(B)(i)-(ii).

⁷⁵ Reporting NPRM, 86 Fed. Reg. 69934, 69951.

⁷⁶ Reporting NPRM, 86 Fed. Reg. 69962.

FinCEN, part of the Department of the Treasury, is the regulator responsible for implementing the CTA. FinCEN is still in the process of finalizing its regulations and the data infrastructure necessary to implement them. However, the draft regulations give us significant insight into what will be required to comply. The burden of reporting will fall onto “reporting companies,” which are entities, generally outside of heavily regulated industries, that were created through a filing in a secretary of state’s office. Reporting companies will report four basic, readily-available pieces of information about themselves to FinCEN. They will also report four slightly different pieces of readily-available information about each of the individuals who made the decision to register them with the local secretary of state (their “applicants”) and about the individuals who own or control at least 25% of them (their “beneficial owners”). FinCEN will make the data available to federal law enforcement, federal regulators, the IRS, and federal intelligence agencies upon their request, without a court order. State law enforcement will be able to access the data with a court order. Financial institutions will also have access to the data, with a reporting company’s consent, to support the customer due diligence reviews that financial institutions are already required to perform.

Timelines for CTA compliance are not yet fully determined, but once the regulation becomes effective, existing entities will likely have one year to report to FinCEN about themselves, their applicants and their beneficial owners. Entities which are formed on or after the regulation’s effective date will have 30 days to make their first reports. Any changed data will have to be reported within 30 days of the change. Errors must be corrected within 14 days to avoid penalty. There will be no annual reporting requirement. There will be significant civil and criminal penalties for willful failure to report, and even steeper civil and criminal penalties for mishandling reported data.

The CTA will add a permanent layer of federal reporting that smaller legal entities will have to undertake on an ongoing basis. Affected entities will likely report to FinCEN several times a year, as their ownership/control changes, and as beneficial owners change their names or personal addresses.

BCLP is actively studying the CTA. We will issue further Alerts as FinCEN’s Reporting Regulations are finalized and take effect, possibly as soon as late 2022, and as FinCEN issues the Access Regulations and revises the CDD Rule. If you have specific questions about how CTA will affect your business, or whether you will need to report under the CTA, please contact Jeff Ziesman (Kansas City), Barry Hester (Atlanta), Stan Koppel (San Francisco) or Shannon Wheaton (St. Louis) for assistance.

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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