



PERSPECTIVES

Beneficial Ownership: An Overview of the FinCEN Final Rule

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INTRODUCTION

On September 30, 2022, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued a final rule implementing the beneficial ownership information (BOI) reporting requirement of the Corporate Transparency Act (CTA)¹. The final rule establishes BOI reporting requirements for certain entities (reporting companies) organized or registered to conduct business in the United States.

The purpose of the rule is to address perceived deficiencies in the U.S. anti-money laundering (AML) regime and aid the efforts of U.S. government departments and agencies, law enforcement, tax authorities, and financial institutions in protecting the U.S. financial system from illicit use by expanding the scope of information certain legal entities are required to disclose under U.S. law. The final rule requires the disclosure of information to FinCEN related to the reporting company, its beneficial owners, and company applicants.

This article explains the key aspects of the final rule and makes note of the additional new rules expected to implement the BOI requirements.

When is the Beneficial Ownership - FinCEN Final Rule Effective?

The final rule is effective January 1, 2024. Covered entities created or registered prior to the effective date will have until January 1, 2025 to file the initial BOI report; and companies formed after January 1, 2024 will need to file their initial BOI report within 30 days of their creation or registration.

What is the Definition of a Reporting Company?

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 (Domestic Reporting Company); 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 (Foreign Reporting Company)².

While the definition of reporting company is broad, the final rule exempts 23 types of entities.

Notable exemptions from the FinCEN Final Rule

- *Entities already required to disclose beneficial ownership information* such as U.S. banks and credit unions, U.S. branches of foreign banks, securities broker-dealers, investment advisors registered with the Securities and Exchange Commission (SEC) and money service businesses registered with FinCEN, among others,
- *Large operating companies* that (i) employ more than 20 employees on a full-time basis in the United States; (ii) filed in the previous year federal income tax returns in the United States demonstrating more than \$5,000,000 in gross receipts or sales in the aggregate, including the receipts or sales of other entities owned by the entity and through which the entity operates; and (iii) have an operating presence at a physical office within the United States,
- *Tax-exempt entities*,
- *U.S. governmental authorities*,
- *Subsidiaries* whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more exempt entities (subject to exceptions); and
- *Inactive entities* that (i) existed on or before January 1, 2020, (ii) are not engaged in active business, (iii) are not owned by a foreign person, whether directly or indirectly, wholly or partially, (iv) have not experienced any changes in ownership in the preceding 12-month period, (v) have not sent or received funds in an amount greater than \$1,000 either directly or through any financial account in which the entity or any affiliate of the entity had an interest, in the preceding 12-month

¹ See Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59,498 (Sept. 30, 2022): <https://www.federalregister.gov/documents/2022/09/30/2022-21020/beneficial-ownership-information-reporting-requirements>.

² 31 U.S.C. 5336(a)(11)

period, and (vi) does not otherwise hold any kind or type of assets, whether in the United States or abroad, including any ownership interest in any corporation, limited liability company, or other similar entity.

The final rule also authorizes the Secretary of the Treasury to exempt additional entities from the definition of reporting companies. However, FinCEN expressed reluctance to do so. Furthermore, FinCEN made clear that any ambiguities in the exemptions should be interpreted reasonably narrowly.

As a result of the various exemptions, it is likely that many publicly traded companies and large operating companies will trigger an exemption. However, it is essential, particularly for domestic and foreign entities with U.S. subsidiaries, that they evaluate qualification criteria for such exemptions.

What is the Definition of Beneficial Owner?

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) exercised substantial control over the entity; or (ii) owns or controls not less than 25% of the ownership interests of the entity³.

There are some specific exclusions to the term beneficial owner, including:

- a minor child, as defined in the state in which the entity is formed,
- an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual,
- an individual acting solely as an employee of a corporation, limited liability company, or other similar entity and whose control over or economic benefits from such entity is derived solely from the employment status of the person,
- an individual whose only interest in a corporation, limited liability company, or other similar entity is through a right of inheritance, or

- a creditor of a corporation, limited liability company, or other similar entity⁴.

The definition of beneficial owner under the CTA and FinCEN final rule is broader than the existing definition which requires the identification of a single individual with control. This final rule requires the identification of *any* individual with control, meaning there could be more than one individual. Furthermore, the final rule provides broader definitions of what constitutes an ownership interest and substantial control.

Substantial Control

The final rule adopts a broad definition of substantial control which includes an individual who:

- (i) Serves as a senior officer of the reporting company,
- (ii) Has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body) of the reporting company,
- (iii) Directs, determines, or has substantial influence over important decisions of the reporting company, such as nature and scope of business, the organization and dissolution of the company, financial aspects, among others,
- (iv) Has any other form of substantial control over the reporting company.

An individual may directly or indirectly, including as a trustee of a trust or similar arrangement, exercise substantial control over a reporting company through various means. Those include board representation, ownership of majority voting power, control over intermediary entities that exercise control over the reporting entity, financial or business relationships and any other contract, arrangement, understanding, relationship, or otherwise.

³ 31 U.S.C. § 5336 (3)(A)(i)-(ii)

⁴ 31 U.S.C. § 5336 (3)(B)

Ownership or Control of Ownership Interests

The final rule includes a catch-all provision for the definition of ownership interest to include “any other instrument, contract, arrangement, understanding, relationship, or other mechanism used to establish ownership.” The final rule is designed to ensure that any individual or entity that establishes an ownership interest in a reporting company through a contractual or other relationship is subject to the beneficial owner reporting requirements. Therefore, an individual may directly or indirectly own or control an ownership interest.

What is the Definition of Company Applicant?

The final rule specifies that the term company applicant means the individual who directly files the document to create or register the reporting company and the individual who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing. This definition is designed to identify the individual who is responsible for the creation of a reporting company through the filing of formation documents, and the individual that directly submits the formation documents, if that function is performed by a different person. Consequently, it reduces potential burdens by limiting the definition of company applicant to only one or two individuals.

What Information Should be Reported?

For the Reporting Company

- (i) The full legal name of the reporting company,
- (ii) Any trade name or “doing business as” name of the reporting company,
- (iii) A complete current address consisting of:
 - a. In the case of a reporting company with a principal place of business in the United States, the street address of such principal place of business; and

- b. In all other cases, the street address of the primary location in the United States where the reporting company conducts business,

(iv) The state, Tribal, or foreign jurisdiction of formation of the reporting company,

(v) For a foreign reporting company, the state or Tribal jurisdiction where such company first registers, and

(vi) The Internal Revenue Service (IRS) Taxpayer Identification Number (TIN) (including an Employer Identification Number (EIN)) of the reporting company, or where a foreign reporting company has not been issued a TIN, a tax identification number issued by a foreign jurisdiction and the name of such jurisdiction.

For Individuals who are Beneficial Owners or Company Applicants

- (i) The full legal name of the individual,
- (ii) The date of birth of the individual,
- (iii) A complete current address,
- (iv) A unique identifying number, the issuing jurisdiction and image of one of the following documents:
 - a. A non-expired passport issued to the individual by the United States government,
 - b. A non-expired identification document issued to the individual by a state, local government, or Indian tribe for the purpose of identifying the individual,
 - c. A non-expired driver’s license issued to the individual by a state, or
 - d. A non-expired passport issued by a foreign government to the individual, if the individual does not possess any of the documents described above.

What are the Penalties for Non-Compliance of the FinCEN Final Rule?

The final BOI rule utilizes the penalty framework outlined in the CTA. Liability can be established for indirect and direct violations and for omissions. Willful violation of BOI requirements can result in a civil penalty of up to \$500 per day until a violation is remedied. There can also be criminal penalties of up to \$10,000 and / or imprisonment for up to two years.

Future Rulemakings

The BOI Final rule is the first of three rule makings anticipated to fully implement the BOI requirements of the CTA. Following the issuance of this final rule – on December 15, 2022 – FinCEN issued a Notice of Proposed Rule Making on BOI Access and Safeguards for the CTA. The Proposed Rule implements provisions of the CTA that govern the access to, and protection of the BOI reported to FinCEN pursuant to the Final Rule. Specifically, it discusses the authorized recipients of BOI which includes:

- Federal agencies
- State, local, and Tribal Law Enforcement Agencies
- Federal agencies on behalf of Certain Foreign Authorities
- Financial institutions and federal regulators
- Officers or employees of the U.S. Department of Treasury

The comment period for this proposed rulemaking ended on February 14, 2023. Several comments were critical of the restricted access the proposed rule provides, and it remains to be seen how the final rule regarding access to the BOI system will be affected by these comments. The third rulemaking in the trio will revise FinCEN's Customer Due Diligence (CDD) rule no later than one year after the effective date of the BOI Reporting Rule (January 1, 2024).

CONCLUSION

The BOI rule represents a significant change and / or adds additional responsibility for legal entities to disclose beneficial ownership information. Legal entities and their officers should ensure they are prepared for the upcoming reporting requirements and whether the reporting requirements are applicable to them and any of their beneficial owners (direct or indirect), especially given the large number of exemptions to the rule. Furthermore, as the two further rulemakings are issued, legal entities are advised to stay abreast of these requirements.

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