

[TAXES - The Tax Magazine \(2006 to Present\), KNIGHT WATCH—The Proposed Beneficial Ownership Information Reporting Requirements Under The Corporate Transparency Act: A Challenge for Reporting Companies, \(Mar. 8, 2022\)](#)

TAXES - The Tax Magazine (2006 to Present)

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This is the inaugural column of Knight Watch, a column by Holland & Knight's tax attorneys. We look forward to covering tax policy (Organization for Economic Co-operation and Development (OECD), U.S. tax legislation, U.S. treaty developments, and U.S. regulatory developments), transfer pricing, tax controversy, and domestic and international tax planning issues.

The first article in the series addresses a cutting-edge issue in information reporting. The legislation to require reporting of beneficial ownership information (BOI) in the United States has become a reality, and reporting will commence when the U.S. Department of the Treasury specifies the effective date of reporting in final regulations to be issued under the Corporate Transparency Act (CTA). In this article, we summarize the rules relating to the reporting of BOI as set forth in the recently issued *proposed* regulations; explain why, if these proposed rules were to become final without modification, reporting companies may find it challenging to comply with the requirements contained in the proposed regulations; and suggest that individuals and organizations potentially impacted proactively consider compliance challenges. Forewarned is forearmed.

I. Background

The CTA is federal legislation (applicable not only to states but also to territories and possessions) that, for the first time, implements a national beneficial ownership register. The legislation requires (1) certain entities designated "reporting companies" to provide selected information to the Financial Crimes Enforcement Network (FinCEN), a bureau of the Department of the Treasury, about (a) beneficial owners (broadly defined) of reporting companies, which are existing and newly formed, domestic and foreign entities, as well as (b) the individuals who directed, controlled, and filed applications to form, or register, the reporting company (collectively, BOI); (2) for FinCEN to maintain that information in a centralized, secure, and non-public database; and (3) to limit disclosure of that information to certain government agencies (domestic and foreign) for purposes specified in the CTA, and to financial institutions to assist them in meeting their customer due diligence (CDD) requirements. All disclosures of information will be subject to appropriate controls to protect the security and confidentiality of the BOI. Civil and criminal penalties will be imposed for non-compliance. The overall purpose of the CTA is to protect U.S. national security, provide critical information to law enforcement, and promote financial transparency and compliance.

The CTA is part of a long-term effort to obtain beneficial ownership of accounts and entities. The effort arose from investigations into Swiss banking practices by the U.S. Senate Permanent Subcommittee on Investigations. These investigations led to the Foreign Account Tax Compliance Act (FATCA) and proposed legislation to require states to provide BOI to the Department of the Treasury. ^[1]

II. The FinCEN Proposed Regulations

Under the legislation, the Secretary of the Treasury had one year from the date of enactment of the CTA (January 1, 2021) to promulgate regulations for the CTA. ^[2]

Fast forward to December 8, 2021. FinCEN published proposed BOI reporting regulations (the Proposed Regulations) requiring reporting companies to file reports with FinCEN. The Proposed Regulations contain guidance as to (A) who must file a report, (B) who is a beneficial owner or company applicant, (C) what information must be provided, (D) when a report is due, and (E) the penalties for reporting violations.

Upon implementation, the final regulations will impact millions of entities (U.S. and foreign) doing business in the United States.

The ultimate goal of the Proposed Regulations, which is one aspect of the CTA, is to prevent the proliferation of anonymous shell companies that facilitate the flow and sheltering of illicit money in the United States, and thereby combat money laundering, terrorist financing, tax fraud, and illicit activity.

A. Who Must File?

The Proposed Regulations identify two types of reporting companies: domestic and foreign. A “domestic reporting company” includes a corporation, limited liability company (LLC), or any other entity created by the filing of a document with a secretary of state or similar office under the law of a state or Indian tribe. A “foreign reporting company” includes a corporation, LLC, or other entity formed under the law of a foreign country and that is registered to do business in any state or tribal jurisdiction.

Entities within the definition of a reporting company include corporations, LLCs, limited liability partnerships, business trusts, and most limited partnerships for the reason that these types of entities typically are created by a filing with a secretary of state or similar office. A foreign company is within scope if it is required to register to do business in a state. Whether a foreign company need to register depends on state law and not all activities within a state require registration. ^[3] General partnerships, sole proprietorships, and common law trusts used in personal/wealth planning are generally excluded since these types of entities, particularly trusts, are not created by the filing of a document with a secretary of state or similar office.

The Proposed Regulations exempt 23 types of entities from the definition of reporting company, to include publicly traded companies, companies within heavily regulated industries (such as banks, insurance companies), large operating companies, ^[4] tax-exempt entities, and certain inactive entities. The reason active entities within the list of exempt entities do not have to report is that they already are subject to Federal or state beneficial ownership reporting.

B. Who Is a Beneficial Owner and Company Applicant?

1. Beneficial Owner

The term means any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (1) exercises *substantial control* over a reporting company, or (2) owns or controls at least 25 percent of the *ownership* interests of a reporting company. Since the statute does not further define these terms, FinCEN, pursuant to its regulatory authority, has provided guidance in this regard.

Substantial control over a reporting company includes (1) services as a senior officer; ^[5] (2) authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of directors (or similar body); (3) direction, determination, or decision of, or substantial influence over, important matters affecting the reporting company; and (4) any other form of substantial control over the reporting company.

FinCEN views the first criteria as identifying individuals with nominal or *de jure* authority, the second and third as identifying individuals with *de facto* authority and the fourth as a “catch-all” to reflect that control exercised in other ways can still be substantial.

Substantial control can be exercised directly or indirectly, *and*, an individual who has the right or ability to exercise substantial control, directly or indirectly, is deemed to exercise substantial control.

FinCEN believes that its approach “supports the basic goal of requiring a reporting company to identify who stands behind the reporting company and direct its actions” and “is designed to close loopholes that would allow corporate structuring that obscures owners or decision-makers... crucial to unmasking shell companies.” ^[6]

Under the foregoing formulation, *all* persons in substantial control of a reporting company are reportable. Further, FinCEN believes that its proposed approach should not be particularly burdensome for most businesses.

Ownership interests in a reporting company is intended to encompass “the underlying reality of ownership, [and] not the form it takes. An individual may own or control an ownership interest directly or indirectly and through a variety of means, ^[7] including through a trust or similar arrangement.

For purposes of determining whether an individual owns or controls 25 percent of the ownership interests in a reporting company, *all* ownership interests of any class or type are considered, and the percentage of ownership interests that an individual owns or controls is determined by aggregating all of the individual’s ownership interests in comparison to the undiluted ownership interests of the entity.

FinCEN believes that its approach should frustrate “the use of complex ownership structures and ownership vehicles other than direct equity ownership to obscure a reporting company’s real owners.”

In sum, in all but the simplest of structures, reporting companies likely will have to undertake careful fact finding and rigorous analysis to seek to identify *all* individuals who are beneficial owners, either through the substantial control or the ownership interest tests. In response to requests by FinCEN, stakeholders and commentators have commented that FinCEN’s proposed approach may not be easy to apply, particularly in the context of multi-tiered structures and trusts. ^[8] The concepts of substantial control and ownership interests are central to the effectiveness of the BOI reporting requirements. Time will tell how FinCEN responds to the comments it receives with respect to the formulation and application of these two tests.

2. Exceptions to Definition of Beneficial Owner

There are five exceptions: (1) minor children (provided the reporting company reports the required information for a parent/legal guardian of the child); (2) nominees or other intermediaries (here, a reporting company must report identifying information of beneficial owners); (3) employees (acting solely as an employee); (4) inheritors (whose sole interest is through a future right of inheritance—once an individual inherited an ownership interest, the individual is a beneficial owner); and (5) creditors (unless the creditor exercises substantial control over the entity, owns or controls 25 percent of the entity’s ownership interests, or has the ability to convert its creditor interest to any form of ownership interest).

3. Company Applicant

This term includes any individual who files a document that creates a domestic reporting company or who first registers a foreign reporting company with a secretary of state or similar office in the United States. The term also includes any individual who *directs or controls* the filing of a formation or registration document by another person. According to the Preamble, an individual who directs or controls the formation of a legal entity “should not be able to remain anonymous simply by directing another individual to file the requisite paperwork” and should be disclosed and that this information will be useful to law enforcement.

The expansive definition of company applicant likely will result in numerous individuals associated with the formation/registration of an in-scope entity to be company applicants and subject to reporting. Reporting

companies and organizations engaged in entity formations and registrations will be subject to challenges to identify and update changes unless the proposed rules are modified, as further discussed below.

C. What Information Must Be Provided?

A reporting company will be required to identify itself ^[9] and provide four items of information for beneficial owners and company applicants. These include the (1) full legal name, (2) date of birth, (3) complete address, ^[10] and (4) a unique identifying number from an acceptable identification document ^[11] (including an image of the ID document). If an individual or reporting company provides its BOI to FinCEN, the individual or reporting company can obtain a “FinCEN Identifier.” Then, that identifier can be provided to FinCEN in lieu of other required information.

In connection with the above, FinCEN will prescribe the form and manner of the report, which will contain a certification by the filer as to the accuracy and completeness of the report. Commentators have suggested that any certification requirement should be qualified by a reasonable knowledge standard. ^[12]

D. When Is a Report Due?

The timing of report depends on (1) when a reporting company was created or registered, and (2) whether the report at issue is an *initial* report, an *updated* report providing new information, or a *corrected* report (*i.e.*, correcting erroneous information in a previous report).

Initial Report:

- Domestic reporting companies created **before the effective date of the final regulations** would have to file their report not later than one year after the effective date of the final rule.
- Foreign reporting companies registered **before the effective date of the final regulations** would have to file their report not later than one year after the effective date of the final rule.
- Reporting companies created (domestic companies) or registered (foreign companies) **after the effective date of the final regulations** would have to file their report within **14 days** of the date of their formation or registration.

Updated Report: Reporting companies would have **30 days** after the date on which there is **any** change to file updates to their previously filed reports, to include changes with respect to a beneficial owners, beneficial owner or applicant information.

Corrected Report: Reporting companies have **14 days** to correct an inaccurate report after they discover, or **have reason to know**, that the report information was inaccurate.

FinCEN’s general rationale for the filing deadlines is “to both minimize burdens on filers and to advance the objectives of providing a timely and accurate database of highly useful information for authorized users.”

With respect to newly formed reporting companies, FinCEN believes that “requiring initial reports to be filed relatively quickly will help make the BOI reporting a natural part of the formation or registration process, furthering the CTA’s objective to ‘set a clear, Federal standard for incorporation practices.’”

With respect to preexisting companies, FinCEN has sought to balance “the need for effective outreach and notice to preexisting companies with the need to collect beneficial information in a timely manner and ensure a level playing field between all legal entities that constitute reporting companies.” “Further, FinCEN intends to work with secretaries of state or similar offices and to leverage other communication channels to ensure that reporting companies in existence prior to the effective date of the regulations receive timely notice of and guidance on their BOI reporting obligations.”

With respect to updated and corrected reports, the brief time period is consistent with FinCEN’s belief that quickly correcting updating/errors is essential for fulfilling instruction by Congress that BOI reported to the agency be “accurate, complete, and highly useful.” Further, FinCEN believes a 30-day calendar –day deadline

in necessary to limit the possible abuse of shell companies; *i.e.*, entities formed as generic corporations without assets and then effectively assigned to new owners.

E. What Are the Reporting Violations?

1. Reporting Violations

The Proposed Regulations provide: *It shall be unlawful for any person to willfully provide, or attempt to provide, false or fraudulent beneficial information, including a false or fraudulent identifying photograph or document, to FinCEN in accordance with this section, or to willfully fail to report complete or updated BOI to FinCEN in accordance with this section.*

For purposes of the above reporting violations:

- *The term “person” includes any individual, reporting company, or other entity.*
- *The term “BOI” includes any information provided to FinCEN under this section.*
- *A person “provides or attempts to provide BOI to FinCEN if such person does so directly or indirectly, including by providing such information to another person” for purpose of a report. (Per FinCEN: individual beneficial owners and company applicants who provide inaccurate information about themselves to reporting companies may be liable if they willfully provide false or fraudulent information to be filed with FinCEN by a reporting company.)*
- *A person “fails to report” complete or updated BOI to FinCEN 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. (Per FinCEN: an individual who willfully directs a company not to report or willfully fails to report while such an individual is in substantial control of a reporting company also is liable for a penalty.)*

The foregoing regulatory clarifications are targeted primarily towards individuals who have a relationship with a reporting company, even though reporting obligations are imposed on reporting companies. As explicated by FinCEN, the reason for these clarifications as to individual liability is to forestall bad actors from seeking “to create new entities to replace old ones whenever an entity is subject to liability, or to attempt to use the corporate form to insulate themselves from the consequences of their willful conduct.”

2. Penalties

Civil and criminal penalties are provided for any person violating the reporting obligations. The civil penalty is up to \$500 for each day that a violation continues or has not been remedied, and the penalty for criminal violation is up to \$10,000 or imprisonment for up to two years, or both.

III. Reporting Challenges

It is anticipated that reporting companies may face challenges if the BOI reporting requirements are finalized in their current form. In raising these issues, we commend FinCEN for affirmatively soliciting specific and general comments from stakeholders on how best to implement the CTA BOI reporting requirements. FinCEN is forthright in raising its own challenges as to how to craft regulations to implement rules that, on one hand, balance the collection of accurate, complete, and useful information with, on the other hand, the minimization of burdens on reporting companies to implement the objectives of the CTA; *i.e.*, to protect U.S. national security interests, the provision of critical information to law enforcement, and the promotion of financial transparency and compliance.

We identify a number of challenges below.

First, how will entities be informed that they may have reporting obligations? FinCEN estimates that millions preexisting entities (about 25 million) will be subject to reporting. FinCEN states that it intends to work with secretaries of state or similar offices and to leverage other communication channels to ensure that in-scope entities receive timely notice of, and guidance on, their BOI reporting obligations to collect BOI in a timely

manner. With respect to newly formed entities (some 3 million per year), FinCEN's aspiration is that the BOI reporting process becomes a natural part of the formation or registration process.

Second, if an entity is ostensibly in-scope, query the time and effort to confirm its status, ^[13] identify its beneficial owners/company applicants, gather the requisite information needed to report and timely file initial//update/correct report?

For reporting organizations that have more complex structures, these organizations will have to determine whether they will undertake the reporting obligations in-house, outsource it, or use a combination of internal and external resources. If reporting will be done in-house, it is likely that new systems will have to be put in place, particularly to monitor/update/correct changes, such as of names, addresses, substantial control or 25 percent ownership interests.

Apart from beneficial ownership changes, the monitoring of company applicant change would appear to be particularly onerous, particularly since once an individual is a company applicant, his or her status does not change, which is different from the status of whether an individual is a beneficial owner or not. Further, numerous individuals may be company applicants. How does a reporting company identify and track changes of company applicants that formed the reporting companies many years ago? What happens if the company applicant has long since died? ^[14]

For in-scope entities that will be formed after the effective date of the final regulations, query whether the relationship between the organization that forms the company and the client will change after the Proposed Regulations are finalized? We discuss this in the next section.

In the Regulatory Analysis Section of the Proposed Regulations, FinCEN has identified the costs for small entities to comply with the BOI reporting requirements to include (1) gathering relevant BOI for both initial and updated BOI reports, (2) hiring or utilizing legal or other resources for advice on filing requirements, and (3) training of personnel to file the report. ^[15] Its estimate of costs seem unrealistic and under inclusive; *i.e.*, such as legal fees.

Third, the deadlines for filing of reports also will be challenging. There are tight timelines for filing most reports, other than perhaps the initial reports for preexisting companies, and some have even complained about that ^[16] Preexisting entities are required to file initial reports within one year after the effective date of the final regulations. Entities formed or registered after the effective date of the final regulations have 14 days from the date of their formation/registration to file. In that regard, commentators have criticized tying the reporting date to the date of formation as specified by the secretary of state or other filing office because that date may not be known to the reporting company in sufficient time to ensure compliance with the reporting deadline, suggesting the filing date be tied to the date on which the filing agency transmits evidence of the accepted filing to the reporting company or applicant. ^[17]

The 30-day period to update (correct) reports would seem to be particularly challenging. FinCEN assessed that the most likely causes for updates to report in companies' initial reports are: (1) change in address of a beneficial owner or applicant, (2) death of a beneficial owner, ^[18] or (3) a management decision resulting in a change in the beneficial owner. Think of all the conceivable changes that could occur not only to individuals who are beneficial owners but also company applicants. Further, tying the 14 day date to *has reason to know* that information is inaccurate is an extremely short time frame. ^[19]

To add additional stress in this area is the clarification in the Proposed Regulations that not only the reporting company but also any individual may be liable and subject to reporting violations.

IV. What Should Be Done Now?

A. In-Scope Entities

In view of the pending reporting obligations, in-scope entities might want to consider how they would comply with these upcoming reporting obligations, even though the rules are not finalized. In performing this exercise, a determination could be made as to whether all the necessary information is readily accessible, whether there are gaps, uncertainties or restrictions ^[20] in that information/documentation that could impede full compliance, how to remedy those deficiencies and, overall, how to be in a position to comply with these new rules once they are finalized.

B. Company Applicants

Company applicants will have their own concerns. Law firms, professional services firms, and other firms that assist clients in the formation/registration and on-going activities of in-scope entities will need to consider their rights, responsibilities and obligations under these new rules and particularly whether any of these would conflict with their ethical obligations or restrictions.

This arises because, under current law, these organizations currently do not have to track information with respect to individuals within their organization that may be company applicants. Once FinCEN finalizes the company applicant rules, query whether it be advisable for the client, newly-formed reporting company and the company applicant organization to enter into an agreement as to the obligations and responsibilities of the company applicant organization after it organizes the reporting company? ^[21] Also, for preexisting companies, do current engagement letters have to be revised or entered into to deal with these new rules? Overall organizations will have to think through how to deal with new, current and former clients in view of these BOI reporting obligations. Query, will FinCEN provide additional guidance with regard to company applicants and the rights, obligations and duties of company applicants and their counterparties?

V. Conclusion

The degree of challenge for reporting companies, beneficial owners, and company applicants to comply with BOI reporting requirements of the CTA will depend on whether—and, if so, how—FinCEN modifies the content of the Proposed Regulations as a result of comments submitted by stakeholders. FinCEN will have its own challenge to minimize burdens on reporting companies when balanced against the objective of combating the proliferation of anonymous shell companies that facilitate the flow and sheltering of illicit money in the United States. These contradictory objectives cannot easily be reconciled.

Footnotes

- 1 See, e.g., S.1465, Incorporation Transparency and Law Enforcement Assistance Act, 113th Cong. 2013.
- 2 Apart from the BOI reporting proposed regulation, FinCEN will engage in additional rulemakings to establish rules for who may access BOI, for what purposes, and to prescribe safeguards to ensure that information is secured and protected; and to revise FinCEN's CDD rules following the promulgation of the BOI reporting final rules. FinCEN is also developing the infrastructure to administer these requirements, such as the BOI technology system.
- 3 That is, whether the activity of the reporting company is below a particular state's law doing business registration threshold. For example, in the foreign private client area, whether the use of a "blocker" foreign corporation to own or lease real estate requires registration varies among states. Note, if a U.S. "blocker" corporation was used, that entity, in most circumstances, would be a domestic reporting company. See Alan S. Lederman, "Corporate Transparency Act May Obscure Inbound Planning," BLOOMBERG TAX (February 3, 2021).
- 4 A large operating company is defined as any entity that employs more than 20 full-time employees in the continental United States, has an operating presence at a physical office within the United States, and filed a federal income tax return for the previous year reflecting more than \$5 million in gross receipts (excluding sales from sources outside United States).

- 5 A senior officer includes a president, secretary, treasurer, CFO, general counsel, CEO, COO, or any other officer, regardless of official title, who performs a similar function.
- 6 Fact Sheet to Proposed Regulations.
- 7 An individual may reach the 25 percent threshold by jointly owning or controlling with one or more other persons an undivided ownership interest in a reporting company.
- 8 See STEP New York, Comments on Proposed Regulations Implementing Section 6403 of the Corporate Transparency Act (Feb. 7, 2022). The comment letter states: “The reporting requirements are not sufficiently clear for reporting companies to be able to understand and use them in the trust context.” With respect to the substantial control, direct or indirect concept, the STEP New York Branch writes: “This concept of indirect control is overly broad in general and is particularly problematic in the trust context.”
- 9 The reporting company must provide (1) its full name, (2) its trade name or “doing business as” name, (3) the business street address, (4) the state/tribal jurisdiction of formation (or for a foreign reporting company, the state/tribal jurisdiction where such a company first registers), and (5) the IRS Taxpayer Identification Number (TIN) (including an Employer Identification Number), or where a reporting company has not yet been issued a TIN one of the following: (a) the Dun & Bradstreet Data Universal Number System (DUNS) number or (b) the Legal Entity Identifier (LEI).
- 10 For a company applicant that is a business, the business street address is used; in other cases, the residential street address of the individual for tax residency purposes is used.
- 11 These include (1) a non-expired U.S. passport, (2) a non-expired ID issued to individual by state/local government/tribe, (3) non-expired state driver’s license, or (4) non-expired foreign passport if individual does not have any of the foregoing documents.
- 12 See American Bar Association Business Law Section Comments on the Proposed Regulations, dated February 7, 2022 (“Business Section Comments”).
- 13 This determination could impact a large operating company that initially qualifies or subsequently becomes disqualified because of a decrease in employees or revenues in different years, and, as a consequence, would have to timely file updated reports. See Business Section Comments.
- 14 In the case of a preexisting reporting company where a company applicant has died, the Proposed Regulations would allow the reporting company to report whatever identifying information it has about the company applicant. FinCEN specifically has requested comments on ways to alleviate the burden of company applicant reporting.
- 15 FinCEN estimates that it would cost these existing reporting companies approximately \$45 apiece to prepare and submit an initial report in the first year that the BOI reporting requirements are in effect and that the burden of the reporting BOI for preparing an initial report would be 70 minutes per response (20 minutes to read the form and understand the requirement, 30 minutes to identify and collect information about beneficial owners and applicants, 20 minutes to fill out and file the report, including attaching a scanned copy of an acceptable identification document for each beneficial owner and applicant). FinCEN estimates the average burden of updating such reports as 30 minutes per update (20 minutes to identify and collect information about beneficial owners or applicants, and 10 minutes to fill out and file the update).
- 16 See STEP New York Branch Comments.
- 17 Business Section Comments.
- 18 As the Preamble indicates, a reporting company is not required to file an updated report to notify FinCEN of the death of a beneficial owner; however, when the estate of a deceased beneficial owner is settled, the reporting company is required to file an updated report removing the deceased former beneficial owner and identifying any new beneficial owners. Further, the reporting company would be required to report any beneficial owner who meets the substantial control or ownership components as a result of another beneficial owner’s death.
- 19 There is also a statutory safe-harbor for incorrect filings.

- 20 In terms of restrictions, determine whether there are any restrictive agreements preventing disclosure and/or any jurisdiction specific privacy laws (such as the European Union's General Data Protection Regulation) that might apply and, if so, how such agreements or laws might restrict a reporting company from complying with its BOI reporting obligations. See Dorsey & Whitney LLP Alert (Jan. 14, 2022) (D&W Comment) and Business Section Comments.
- 21 D&W Comment ("Both corporations and individuals engaged in incorporation activities have raised liability concerns if such persons and entities employing those persons are charged or delegated with accurately providing BOI data to FinCEN.... In that regard, as a general rule, company applicants organizing legal entities frequently do not engage in any significant degree of diligence regarding ownership and control of the entity being formed. If a company applicant is viewed as providing an initial filing to FinCEN, persons and entities that constitute or employ company applicants may be required to consider contractual representations regarding ownership interests in reporting companies, including record retention of BOI obtained. Similarly, in the instance in which a company applicant files in initial report with FinCEN for a reporting company, care may have to be exercised to clearly terminate future reporting responsibilities by the company applicant.")