January 13, 2021

New Beneficial Ownership Reporting Obligation Approved

Tucked into the end of the National Defense Authorization Act for Fiscal Year 2021, passed by Congress on January 1, is a new law that creates a broad beneficial ownership reporting requirement for certain privately held companies. The accurately, if unimaginatively, titled Corporate Transparency Act generally requires that certain companies ("reporting companies") disclose to the Financial Crimes Enforcement Network (FinCEN) the name, address, date of birth and unique identification number from an "acceptable identification document" of all significant equity holders ("beneficial owners" under the act). Still a work in process, the act requires that further clarifying rules be promulgated by the Treasury Department on or before December 31, 2021, and the act will not become effective until implemented by those rules.

The act provides that "beneficial ownership information collected under the [act] is sensitive information and will be directly available only to authorized government authorities, subject to effective safeguards and controls" and is intended to facilitate national security and law enforcement activities and to confirm beneficial ownership information provided to financial institutions in connection with various other reporting regimes. Consequently, the act does *not* create a publicly accessible database of beneficial owner information. FinCEN will hold all information collected until the date that is five years after the termination of the reporting company. The act permits FinCEN to disclose beneficial ownership information in specified circumstances, including upon receipt of (i) a request from federal or state agencies engaged in national security, intelligence, or law enforcement activity for use in furtherance of such activity or from a state or local law enforcement agency if ordered by a court of competent jurisdiction; (ii) certain requests from a federal agency on behalf of foreign authorities; (iii) a request made by a financial institution subject to customer due diligence requirements with the consent of the reporting company; and (iv) a request made by a federal functional regulator or other appropriate regulatory agency to ascertain compliance of financial institutions.

What Is a Reporting Company?

A reporting company is a corporation, limited liability company or other similar entity (i) created by the filing of a document with the secretary of state of a given state or (ii) formed under the laws of a foreign country and registered to do business in the United States. Partnerships and trusts are not specifically included in the definition of reporting company. However, the act directs that a study be conducted to determine whether such entities should be included.

The following entities are not reporting companies:

- An issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934.
- An entity established under the laws of the United States, an Indian tribe, a state or a political subdivision of a state that exercises governmental authority on behalf of the United States or any such Indian tribe, state or political subdivision.
- Certain entities subject to supervision or which have existing reporting requirements to financial regulatory authorities, including banks, credit unions, bank holding companies, money transmitting businesses registered with the secretary of the Treasury, brokers or dealers, and exchanges or clearing agencies.
- An entity that is an investment company or investment adviser registered with the Securities and Exchange Commission under the Investment Company Act or the Investment Advisers Act of 1940.
- An insurance company.
- A public utility that provides telecommunications services, electrical power, natural gas, or water and sewer services within the United States.

- Any entity that (i) employs more than 20 employees on a full-time basis in the United States, (ii) filed a federal return that reported more than $5 million in gross receipts or sales (including by subsidiaries and operating affiliates) and (iii) has an operating presence at a physical office within the United States.
- 501(c) organizations, political organizations, and certain trusts described in paragraph (1) or (2) of Section 4947 of the Internal Revenue Code.
- A money transmitting business registered with FinCEN.
- Certain registered investment companies and investment advisers.
- Entities owned or controlled directly or indirectly by one or more of the other enumerated exempt entities.

What Are the Reporting Requirements?

Reporting companies are required to file information identifying certain beneficial owners at the time of the company's formation. Further, any existing entity that qualifies as a reporting company will have two years following the effective date of the regulations to file the requisite information. After a reporting company has filed its initial report, it is required to file an updated report within a year of any change in the information contained in such report, including any change in beneficial ownership. The reporting company must submit a report to FinCEN that identifies each beneficial owner and each applicant with respect to the reporting company by (i) full legal name, (ii) date of birth, (iii) current residential or business street address, and (iv) unique identifying number from an "acceptable identification document" (e.g., a driver's license or passport) or FinCEN identifier. A FinCEN identifier is a unique identifying number assigned by FinCEN to a person or entity in connection with the filing of an application. An "applicant" is an individual who files an application to form a U.S. entity or an individual who applied or files to register a non-U.S. entity to do business in the United States.

Who Is a Beneficial Owner?

A "beneficial owner" is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise (i) exercises substantial control over the entity, or (ii) owns or controls not less than 25 percent of the ownership interest of the entity. The act does not define "substantial control"; however, the final rules may provide guidance on what constitutes substantial control. A beneficial owner does not include (i) a minor child; (ii) a nominee, intermediary, custodian, or agent on behalf of another individual; (iii) an employee of the reporting company; (iv) an individual whose only interest in the reporting company is through a right of inheritance; and (v) a creditor of the reporting company.

Penalties for Non-Compliance

Any party that willfully fails to file an application or files an application for the formation of a reporting company that intentionally fails to comply with the act will be liable for fines of no more than $500 for each day that there is a willful failure to report complete beneficial ownership information, and such parties may be subject to aggregate fines of up to $10,000 or a prison term of up to two years or both. Negligent violations, however, will not be subject to any civil or criminal penalties.

Given the broad application of the act—which creates reporting requirements for many privately held entities and small businesses—as well as the significant civil and criminal penalties that may accrue, care will need to be taken in order to ensure compliance once the act is effective. Even before the provisions of the act are effective, however, there are some opportunities to begin planning for it. The act will likely place a not insignificant additional annual filing requirement on both domestic and foreign entities. Potential filers can consider now what internal systems and personnel changes may be needed to meet these future reporting obligations. Privately held entities and small businesses can begin to evaluate whether the entity needs to collect additional information from its equity holders, and review and revise its compliance programs to ensure compliance with this act. Day Pitney will continue to monitor developments concerning the act and provide updates.

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