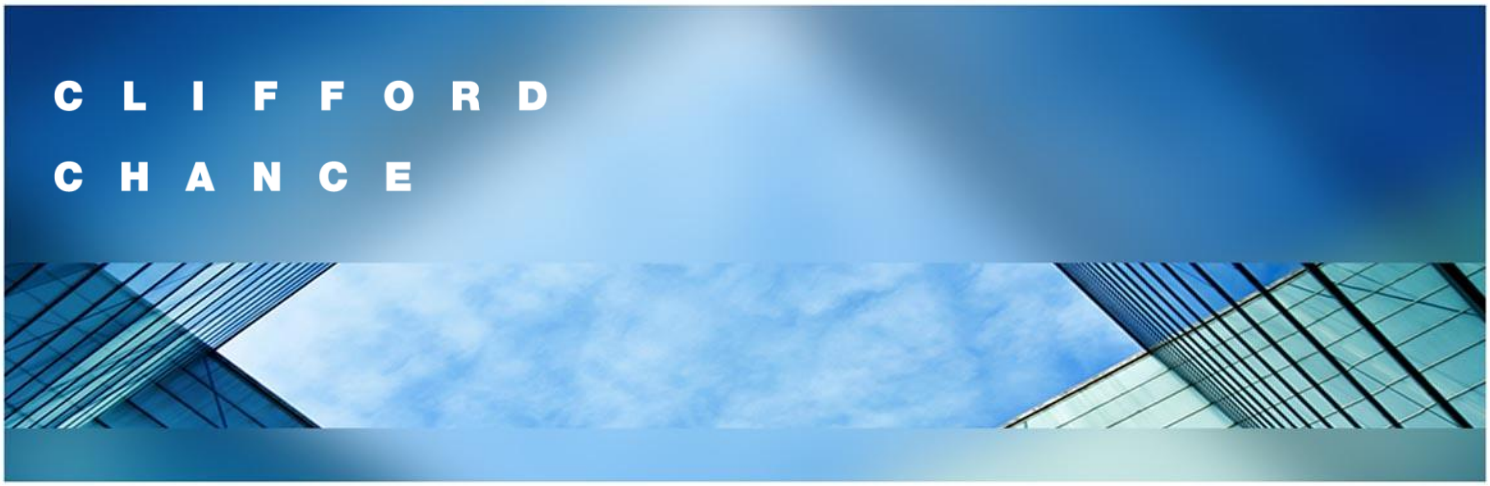
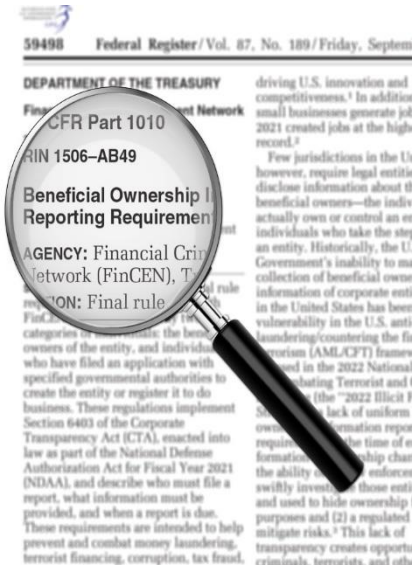


CORPORATE TRANSPARENCY ACT IMPOSES NEW REQUIREMENTS ON U.S. BUSINESSES

REAL ESTATE INVESTMENT TRUSTS AND OTHER PROPERTY HOLDING ARRANGEMENTS WITHIN SCOPE


59498 Federal Register / Vol. 87, No. 189 / Friday, Septem

DEPARTMENT OF THE TREASURY

CFR Part 1010

RIN 1506–AB49

Beneficial Ownership I
Reporting Requiremen

AGENCY: Financial Cri
letwork (FinCEN), T

ION: Final rule

Starting January 1, 2024, more than 32 million legal entities will be required to file certain information with the U.S. Government about their beneficial owners.[1] The requirement is part of a broader effort to make it easier for law enforcement to investigate illicit activities and associated money laundering through the use of companies and other legal structures.

Implementation of the rule may be relatively straightforward in some circumstances, but not in others, including situations involving legal structures frequently used to hold real property.

ENTITIES SUBJECT TO REPORTING

The reporting requirements of the Corporate Transparency Act and its corresponding rules (the "**Act**") apply to any entity that, through filing a document with the secretary of state or similar office, is either formed in the United States, or registered to do business in the United States and which does not qualify for an exemption from such requirements (such non-exempt entity, a "**Reporting Company**"). Both domestic and foreign companies may need to file. The Act delineates 23 types of entities that are exempt from the Act's reporting obligations, including public companies, large operating companies, banks, securities brokers or dealers, insurance companies, registered investment companies and advisers and pooled investment vehicles, among others. Based on current estimates, only 11% of entities registered or operating in the U.S. will qualify for an exemption.[2]

For most Reporting Companies, the information will be relatively simple to provide, but determining how the rule applies to particular entities and who must be reported as a beneficial owner may be complicated in many situations. In addition, the requirement to update changes in beneficial ownership may create ongoing compliance difficulties. Businesses with abundant entities or complex

1 Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59498, 59549 (Sept. 30, 2022).
2 *Id*. at 59568. FinCEN estimates that approximately 4,024,577 entities will be exempt out of a total 36,581,506 entities registered or operating in the U.S. *Id*.

structures may face greater compliance challenges under the Act. While the "subsidiary exemption" may apply for some subsidiaries, subsidiaries of exempted entities may nonetheless have filing obligations by virtue of not being wholly owned by one or more exempt entities.

REPORTING OBLIGATIONS

Reporting Companies are required to submit reports to the Financial Crimes Enforcement Network ("**FinCEN**") which is the bureau of the U.S. Department of Treasury responsible for collecting, analyzing and disseminating financial intelligence to support law enforcement.

Each Reporting Company will be required to report its full legal name (including names under which it does business), its business street address, jurisdiction of formation and taxpayer identification number.

Each Reporting Company also needs to identify and report information concerning its "Beneficial Owners", such as their full legal name, date of birth, residential address, and their identification number from an acceptable identification document (e.g., a driver's license or passport) together with a scanned copy of such document.

Entities formed or registered after January 1, 2024 will be required to file similar information about the individual(s) responsible for forming or registering the entity with a state authority; FinCEN defines these persons as the "company applicant(s)".[3]

IDENTIFYING BENEFICIAL OWNERS

Beneficial Owners are those *individuals* that, *directly or indirectly*, exercise substantial control over the Reporting Company *or* own or control 25% or more of the ownership interests in the Reporting Company.

Substantial control generally includes any type of control over important decisions of the Reporting Company.[4] Note, however, property managers and those that exercise day-to-day managerial decisions, without additional control rights, would generally not be considered to exercise substantial control.[5] Although most trusts generally will not fit within the definition of a Reporting Company, trustees of trusts that hold assets in legal entities that are Reporting Companies may need to be reported as beneficial owners of such Reporting Companies by virtue of the control that they can exert over the trust's property.

The aspect of owning or controlling at least 25% of the ownership interests in a Reporting Company is meant to capture a variety of ownership interests, regardless of how they are labelled or constructed.[6] For Reporting Companies that issue capital or profit interests, the ownership interests are the capital and profit interests in the entity, calculated as a percentage of the total outstanding capital and profit interests in such entity.[7] For Reporting Companies that issue

[3] The company applicant is both (i) the individual who directly files the document that creates the reporting company or registers the company to do business in the U.S. and (ii) the individual who is primarily responsible for directing or controlling such filing. It can be more than one person. 31 CFR 1010.380(e).

[4] Some examples of substantial control include service as a senior officer, the authority over appointment or removal of any senior officer or board member and the ability to direct or determine important decisions of the Reporting Company.

[5] Beneficial Ownership Information Reporting Requirements, 86 Fed. Reg. 69920, 69934 (Dec. 8, 2021).

[6] Debt instruments could be deemed to be ownership interests if such instruments enable the holder to exercise rights akin to those accompanied with equity (e.g., voting). As such, convertible debt could be considered ownership interests. Options or similar interests are to be treated as exercised.

[7] 31 CFR 1010.380(d)(2)(iii)(B).

shares of stock, both voting and non-voting shares will factor into potentially complicated determinations of who is reported as a beneficial owner.[8]

DEADLINES

Each Reporting Company existing prior to January 1, 2024 will have until January 1, 2025 to file its report with FinCEN.

Each Reporting Company formed or registered on or after January 1, 2024 will have 30 days after the date such company receives notice (actual or constructive) that such company has been formed or registered to file its report with FinCEN.

Furthermore, Reporting Companies are required to maintain the accuracy of their reports filed with FinCEN. Should changes occur relating to the information a company has reported, such Reporting Company is required to file an updated report within 30 days of the change. Similarly, if a mistake exists on a submitted report, a Reporting Company has 30 days following the date it knew or should have known of the mistake to file a corrected report.

NOTABLE EXEMPTIONS

Entities with more than 20 full-time U.S. employees, that have an operating presence at a physical office in the United States and that have filed a U.S. federal income tax return (or informational return) in the previous year showing in excess of $5 million gross receipts or sales (each, a "**Large Operating Company**") can qualify for an exemption from the Act.[9] Note that for purposes of meeting the $5 million gross receipts threshold, entities owned by such entity and those entities through which such entity operates are included in such calculation.

There are several securities-related exemptions, including (a) issuers of securities that either (i) issue a class of securities registered under section 12 of the Secuirties Exchange Act of 1934 (the "**1934 Act**") or (ii) are required to file under section 15(d) of the 1934 Act (such issuer of securities, the "**Securities Reporting Issuer**")(e.g., public companies),[10] (b) investment companies and advisers that are registered with the Securities and Exchange Commission,[11] (c) venture capital fund advisers[12] and (d) pooled investment vehicles.[13] To be exempt, pooled investment vehicles must be (i) operated by either a bank, domestic credit union, broker or dealer, registered investment company or adviser, or venture capital fund adviser, and (ii) either (x) an investment company as defined under the Investment Company Act of 1940 or (y) would qualify as an investment company pursuant to such section but for an exclusion under 3(c)(1) or (3)(c)(7) of the Investment Company Act of 1940 and is identified by the applicable investment adviser in Form ADV.[14]

8 31 CFR 1010.380(d)(2)(iii)(C).
9 31 CFR 1010.380(c)(2)(xxi).
10 31 CFR 1010.380(c)(2)(i).
11 31 CFR 1010.380(c)(2)(x).
12 31 CFR 1010.380(c)(2)(xi).
13 31 CFR 1010.380(c)(2)(xviii).
14 15 U.S.C. 80a-3(c)(1) provides that the pooled investment vehicle has no more than 100 beneficial owners. 15 U.S.C. 80a-3(c)(7) is limited to investors that are qualified purchasers (an individual is a qualified purchaser if they own $5 million or more in investments; $25 million for entities).

There is an exemption for subsidiaries of most exempt entities (the "**Subsidiary Exemption**").[15] However, the subsidiary must be wholly owned by one or more exempt entities to qualify.

UPDATED REPORTS

Updated reports need to be filed for "any change with respect to any information previously submitted to FinCEN concerning the reporting company or the beneficial owners of the reporting company."[16] If an entity begins to or ceases to meet the criteria for an exemption, it must file a report indicating as such. In contrast, a Reporting Company does not need to file an updated report in connection with its termination or dissolution.

PENALTIES FOR NONCOMPLIANCE

Willful breach of the Act's reporting requirements can result in civil or criminal actions. A civil penalty of $500 *per day* can be assessed for each day that such violation continues. Criminal fines and imprisonment are possible in extreme circumstances.

SECURITY AND PRIVACY

The information collected under the Act will be stored in a non-public database, encrypted with data security at the highest information security protection level under the Federal Information Security Management Act. Disclosure of information collected under the Act will be limited to various functions of state and federal governments via processes and under restrictions to be determined in future rulemaking prior to the implementation of the Act.[17]

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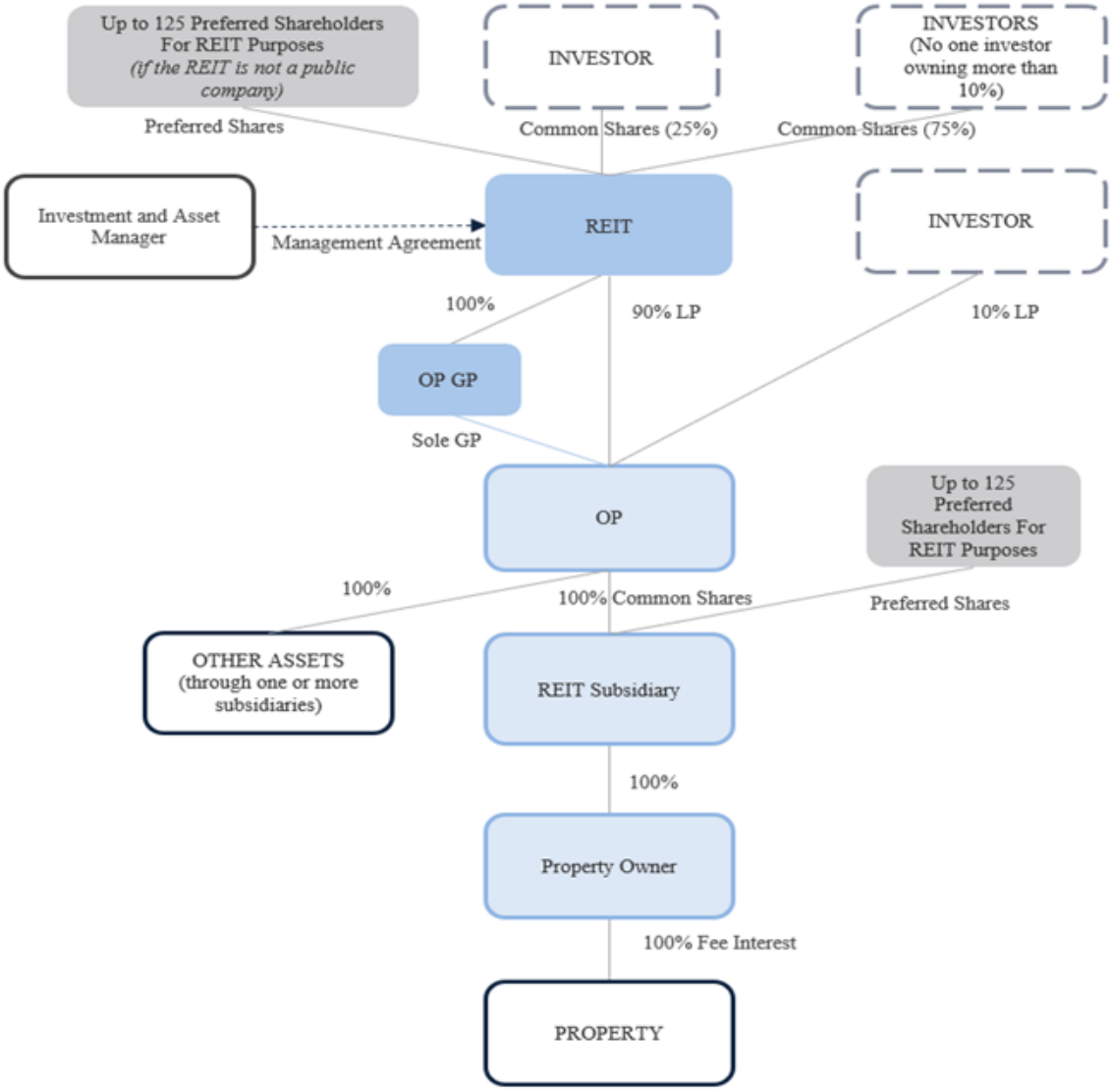
15 31 CFR 1010.380(c)(2)(xxii). Note that subsidiaries of the following types of exempt entities will not qualify for this exemption: money services businesses, pooled investment vehicles, entities assisting a tax exempt entity, subsidiaries of certain exempt entities, and inactive entities. *Id*.

16 Beneficial Ownership Information Reporting Requirements, 87 Fed. Reg. 59498, 59573 (Sept. 30, 2022).

17 Pursuant to the Act, further rulemaking is also expected to address whether, and how, certain information collected under the Act can, with the consent of the Reporting Company, be disclosed to financial institutions in connection with those institutions' Bank Secrecy Act customer due diligence requirements.

EXAMPLE: APPLICATION OF THE ACT IN THE REAL ESTATE CONTEXT



Above is an illustrative example of how the Act might apply with respect to a particular multi-tiered structure involving a real estate investment trust ("**REIT**"). This analysis focuses on application of the Act to the REIT and its subsidiaries and does not include an analysis with respect to the investors.

Structure of Company:

The structure in this example is a simple Umbrella Partnership REIT structure which consists of the REIT, as the holder of 90% of the limited partnership interest of, and indirectly the general partner (the "**GP**") of, its operating partnership (the "**OP**"), which holds all the assets of the REIT.

In our example, the REIT has multiple investors, including one that holds 25% of the common shares of the REIT and other investors, that collectively hold the balance of the common shares of the REIT, with no such investor in that group owning more than 10% of the common shares of the REIT. To meet the

requirement for the REIT to have at least 100 shareholders, the REIT issued preferred shares to 125 shareholders.

The REIT is advised by an external investment and asset manager (the "**Manager**") pursuant to a management agreement.

The OP owns certain properties indirectly through a subsidiary REIT (the "**Subsidiary REIT**") and the REIT owns all the common shares of the Subsidiary REIT. Similar to the REIT, the Subsidiary REIT issued preferred shares to 125 shareholders. The Subsidiary REIT in turn wholly owns a limited liability company (the "**Property Owner**") which owns the Property as its sole asset.

For the purposes of this example, we have assumed that all of the above entities were formed prior to January 1, 2024.

Analysis:

Which Entities in this Structure are Reporting Companies?

The first question to analyze is whether the REIT and its subsidiaries are Reporting Companies. In other words, are they potentially subject to the Act and, if so, is there an exemption that would apply.[18]

We have assumed that the REIT, the OP and their respective subsidiaries shown on the chart are U.S. entities and thus they are all potentially subject to the Act unless they qualify for one of the exemptions from constituting a Reporting Company.

The REIT:

Considering the REIT first, if the REIT is a public company with shares listed on a national securities exchange, it would qualify as a Securities Reporting Issuer and would be exempt from the Act.[19]

If the REIT cannot qualify as a Securities Reporting Issuer, it may still qualify for several exemptions. For example, if the Manager is a registered investment adviser, and the REIT either (i) qualifies as an investment company under the Investment Company Act of 1940 or (ii) would qualify as an investment company but for an exclusion pursuant to Section 3(c)(1) or 3(c)(7) thereof (and it is identified by the Manager in Form ADV), then it would be exempt from the Act as a pooled investment vehicle.[20]

Also, if the REIT qualifies as a Large Operating Company by, among other requirements,[21] having filed a U.S. federal income tax return (or informational return) in the previous year showing in excess of $5 million in gross receipts or sales, then the REIT will be exempt from the Act.

For the purposes of our example, we will assume that the REIT satisfied one of the above exemptions other than a pooled investment vehicle[22] (and, as such, does not constitute a Reporting Company). Note that even though in our example the REIT has an investor which owns 25% of the common shares of the REIT, because the REIT is exempt, the REIT need not disclose the identity of such investor pursuant to the Act.

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18 As we noted previously, this example focuses on the REIT and its subsidiaries. It may very well be the case that one or more of the REIT's investors are Reporting Companies subject to the Act.

19 *See* 31 CFR 1010.380(c)(2)(i).

20 *See* Notable Exemptions, *supra*. *See also* 31 CFR 1010.380(c)(2)(xviii).

21 *See* Notable Exemptions, *supra*. *See also* 31 CFR 1010.380(c)(2)(xxi).

22 We make this assumption because subsidiaries of pooled investment vehicles do not qualify for the Subsidiary Exemption.

The GP:

The GP would not be considered a Reporting Company under the Act because it is a wholly owned subsidiary of the REIT which is an exempt entity of the permitted exemption types listed under the Subsidiary Exemption.[23]

The OP:

In contrast with the GP, the OP is not wholly owned by the REIT and, as such, would not qualify for the Subsidiary Exemption, unless each of its other investors are also exempt from the Act and of the permitted exemption types listed under the Subsidiary Exemption. For purposes of this example, we will assume that one or more of the investors in the OP (the "**OP Investor**") is not exempt from the Act. Thus, the OP must separately qualify for an exemption under the Act.

In our example, it does not appear that the OP would qualify for many of the exemptions that may apply to the REIT. The OP is not a Securities Reporting Issuer. Nor is the OP directly operated or advised by the Manager as was the case for the REIT, so it would not qualify for the exemption applicable to pooled investment vehicles.

Nonetheless, based upon the specific facts, there may be another exemption that would apply to the OP. For example, if the OP could qualify as a Large Operating Company, it would be exempt. Note that if it is the OP's first year of operation, the OP will not have filed a federal U.S. federal income tax return (or informational return) in the previous year, meaning this exemption would likely not be available.

For our discussion of the Subsidiary REIT and the Property Owner below, it is important to note that the analysis of the applicability of the Act to the subsidiaries of the OP remains the same regardless of whether the OP is exempt from the Act, though that would not be the case in every structure.

The Subsidiary REIT:

As we noted in the example, due to the 100-shareholder requirement for REITs, the Subsidiary REIT is not wholly owned by the OP. In order to satisfy this requirement, the Subsidiary REIT issued preferred shares to 125 shareholders. These shareholders are typically individuals and would therefore not be exempt entities. This means that, regardless of whether or not the OP constitutes a Reporting Company under the Act, the Subsidiary REIT will not be able to rely on the Subsidiary Exemption. Instead, a separate analysis would need to be performed as to whether or not the Subsdiariy REIT is subject to the Act.

In this case, for the same reasons the OP likely would not qualify for the exemptions applicable to the REIT, the Subsidiary REIT similarly would likely not be eligible for the same.

Additionally, since in this example the Subsidiary REIT owns a single asset, there are likely many situations in which it would not have the requisite operating personnel (more than 20 full-time employees) nor the gross receipts or sales (i.e., $5 million as reflected on its U.S. tax return (or informational return) necessary to qualify as a Large Operating Company.

[23] *See* 31 CFR 1010.380(c)(2)(xxii).

As such, it is likely that the Subsdiairy REIT would constitute a Reporting Company and be subject to the Act. This analysis is not impacted by whether or not the OP or the REIT is exempt from the Act.

The Property Owner:

If the Subsidiary REIT is exempt from the Act, the Property Owner could also be exempt as a wholly-owned subsidiary thereof under the Subsidiary Exemption.

If the Subsidiary REIT is not exempt from the Act, the Property Owner would also not qualify for an exemption for the same reasons that precluded the Subsidiary REIT from qualifying for an exemption.

As such it is likely that the Property Owner, like the Subsdiairy REIT, would constitute a Reporting Company and be subject to the Act. This analysis is not impacted by whether or not the OP or the REIT is exempt from the Act.

What Needs to be Reported?

Initial Report:

As we have discussed, the Property Owner and the Subsidiary REIT constitute Reporting Companies and are required to file reports with FinCEN on or prior to January 1, 2025, containing the information set forth in the section entitled "Reporting Obligations" above. If the OP is a Reporting Company it would also have to file such a report before such date.[24]

Each such report will need to list all controlling beneficial owners or direct and indirect beneficial owners of 25% or more of the applicable Reporting Company (other than direct or indirect owners of any beneficial owners that are exempt from the Act). For any beneficial owners that are exempt entities, the Reporting Company is merely required to report the legal name of such exempt entity.

For the Property Owner, this means that it will need to list the Subsidiary REIT (as the holder of all of its membership interests) and the OP (as the indirect holder of more than 25% of the Property Owner). Additionally, if the OP is a Reporting Company and not exempt from the Act, the Property Owner will need to list the GP (due to its control over the OP) and the REIT (as an indirect holder of more than 25% of the Property Owner). Note that the OP Investor who holds 10% of the limited partnership interests of the OP would not be required to be listed. With the REIT being exempt, its investors do not need to be listed.

For the Subsidiary REIT, the analysis is similar. In identifying beneficial owners, it would need to list the OP (as the holder of more than 25% of the Subsidiary REIT). Additionally, if the OP is a Reporting Company and not exempt from the Act, the GP (due to its control over the OP) and the REIT (as a controlling party and as a indirect holder of more than 25% of the Property Owner) would also need to be listed. As was the case with the Property Owner, the OP Investor does not need to be disclosed and since the REIT is exempt, the investors in the REIT would not need to be listed.

Updated Report

All of the entities that constitute Reporting Companies, will need to file an updated report with FinCEN within 30 days after certain changes in beneficial

[24] Reminder: In this example all of the entities are formed prior to January 1, 2024, which results in a January 1, 2025 filing deadline. If an entity were formed on or after that date, the filing by that entity with FinCEN would be due within 30 days of the entity's registration.

ownership or certain other changes or within 30 days after receipt of actual or constructive notice of a mistake.

As we previously mentioned, if at any time any exempt entities cease to be exempt, this would trigger filing obligations for such entity within 30 days thereafter, and if any subsidiaries thereof were exempt because of such specified entity's exemption, they too would need to file.

Conclusion:

Even in cases where the primary parent company is exempt under the Act (for example, because it is a public company or a fund managed by a registered investment adviser), subsidiaries of such parent company need to be separately analyzed under the Act and may, perhaps unexpectedly, be subject to the requirements thereof.

While such obligations on such subsidiaries will not require reporting of information about the ultimate investors of such exempt companies, they do need to be reviewed and monitored to avoid any inadvertent non-compliance which may happen if a thorough review of all entities in a structure is not performed.

POTENTIAL FURTHER DEVELOPMENTS

The Act and FinCEN's rulemaking have had multiple supporters and detractors and it remains to be seen whether and how implementation of the Act's requirements will be supported budgetarily by Congress. As the effective date in January 2024 approaches and throughout the first few years of implementation, FinCEN is expected to engage in significant educational outreach efforts and provide additional guidance (particularly with respect to the small business community) addressing the many questions that will likely arise in connection with the application of the Act. At the time that it finalized its rule on beneficial ownership, FinCEN chose not to expand the previously proposed exemptions, but did note that it would continue to take into consideration feedback for the purpose of considering future exemptions.

In addition, FinCEN has a separate rulemaking initiative underway to establish new anti-money laundering requirements specifically applicable to the real estate sector. Issues that arise in the real estate sector with respect to the implementation of the Act are likely to have an impact on how FinCEN approaches broader requirements for the industry.

ADDITIONAL GUIDANCE

Determining reporting obligations and exemption eligibility is fact specific and depends upon a wholistic review of the entity's circumstances. For further guidance, please contact a member of the Clifford Chance team listed below.

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