



## Real Estate Investment in the Age of Beneficial Ownership Information Reporting

**By: Kris Ferranti and Yuval Rosenthal<sup>1</sup>**

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This article discusses the issuance of Department of FinCEN's highly anticipated final Beneficial Ownership Information reporting provisions and the importance of real estate-holding companies staying apprised of the same.

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On September 29, 2022, the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued its highly anticipated final Beneficial Ownership Information (BOI) reporting provisions (Final Rule), thereby implementing part of the Corporate Transparency Act (CTA).

The prevalent use of legal entities in owning real estate assets makes the U.S. real estate market particularly vulnerable to non-compliance. Indeed, FinCEN has frequently noted concerns about the sector throughout its rulemaking process. Therefore, the industry should pay special attention to the Final Rule's broad reporting requirements.

Effective January 1, 2024, FinCEN's Final Rule will mark the most significant updates to the U.S. anti-money laundering and countering the financing of terrorism (AML/CFT) compliance framework in a generation. It aims to combat illicit financial activity and enhance national security interests by requiring that reporting companies provide detailed information regarding their beneficial ownership. The following summarizes the Final Rule's key elements:

### **Who must file?**

Both foreign and domestic reporting companies must file BOI reports with FinCEN under the CTA, unless specifically exempt. A domestic reporting company is any entity created by filing with the secretary of state or a similar office, including limited liability partnerships, business trusts, corporations, and LLCs. Foreign reporting companies include any entity formed under the laws of a foreign country that is registered to do business in the U.S. The act of filing with a state office to create or register the entity is the decisive factor in defining reporting companies.

One key exemption to the reporting requirements is for “large operating companies,” or entities that employ more than 20 full-time U.S. staff, report more than \$5 million in annual revenue, and operate out of a physical location in the U.S. However, this exemption will not apply to most real estate-owning entities because they generally do not hire their own employees, but instead outsource to property managers employed by other entities.

Other notable exemptions include SEC-registered issuers, tax-exempt entities, certain financial institutions, and pooled investment vehicles such as REITs and JVs that are not considered foreign reporting companies (domestic pooled investment vehicles are exempt while their foreign counterparts are not) and are advised by other exempted entities. Similarly, most trusts will be exempt from reporting requirements to the extent they are not created by a filing with an applicable state office.

### **What information must be disclosed?**

Reporting companies must disclose each of their beneficial owners or company applicants’ full legal name, date of birth, complete and current address, unique identifying number from an acceptable identification document, and an image of the identification document. An owner may streamline future reporting by requesting a FinCEN ID number that can be reported in lieu of the identifying information listed above.

Each reporting company must also disclose its full legal name, any trade name or “doing business as” name (whether registered or not), the address of its principal place of business in the U.S., its jurisdiction of formation, and an IRS Tax Identification Number.

When beneficial owners exercise substantial control or hold ownership interests through exempt entities, a reporting company may only disclose the name of an exempt entity rather than additional information about the exempt entity and its beneficial owners.

### **Who is a beneficial owner?**

A beneficial owner is each individual who (1) exercises substantial control over a reporting company, or (2) owns and controls at least 25 percent of the ownership interests of a reporting company.

Substantial control is broadly defined and is exercised by a reporting company’s senior officers, those with authority over the appointment or removal of any senior officer or a majority of the board of directors of a reporting company, and others who make significant decisions on behalf of the entity. Substantial control may also be exercised directly or indirectly, including in less conventional ways (i.e., through economic pressures, bribery, or threats) and despite use of emerging governance structures such as series LLCs and decentralized

autonomous organizations. However, how control in such entities is assessed – and who exactly must be included in the reports – remain largely unexplained. Thus, FinCEN will likely issue additional guidance and clarifications in the future as it gains experience with the variety of structures.

Ownership interest is also broadly defined to include equity in the reporting company, capital or profit interests (including partnership interests), convertible instruments, warrants or rights, and options and privileges to acquire equity, capital, or other interests in a reporting company. In addition, a catch-all provision includes “[a]ny other instrument, contract, arrangement, understanding, relationship, or other mechanism used to establish ownership.” Reports must also disclose 25% or more ownership interests in reporting companies held in trust by trustees or other individuals with authority to control or dispose of trust assets.

The regulations provide five exceptions to the definition of “beneficial owner,” including for minor children, individuals acting as nominees or agents, employees (provided they are not senior officers), individuals whose only interest in a reporting company is a future interest through a right of inheritance, and those whose sole interest in a reporting company is as creditors. The key element of the creditor exception is whether the right in question is intended to secure the right to receive payment or enhance the likelihood of repayment.

### **Who is a company applicant?**

A company applicant is the individual who directly filed the document that creates or registers the entity, or if more than one individual is involved in the filing of the document, the individual who is primarily responsible for directing or controlling such filing by another. In many instances, company applicants would be the lawyers or paralegals who prepared formation papers. This measure is meant to discourage legal professionals from assisting criminals in the formation of sham entities.

Moreover, the identities of company applicants (unlike beneficial owners’) never changes after the entity’s creation. To alleviate information gathering challenges, existing or registered companies as of the effective date (January 1, 2024) need not identify and report on their company applicants.

### **When must a reporting company file its disclosures?**

Reporting companies created or registered prior to the effective date must file their initial BOI report within one year of the effective date, while those created or registered after the effective date must file their initial BOI report within 30 days of creation or registration. Once the initial report has been filed, reporting companies must file updates within 30 days of a change in their BOI.

## What are the penalties for a failure to file?

The Final Rule imposes civil and criminal liability on any person that willfully fails to report true, correct, and complete BOI, including any reporting company, individuals, or other entities. A person is considered to have failed to report complete or updated BOI if the person causes the failure directly or indirectly (by providing information to another person for purposes of a report) or is a senior officer of the entity at the time of the failure. This means that potentially all senior officers of a reporting company may be held liable for willful failures to report. FinCEN will consider all facts relevant to a determination of willfulness when deciding whether to pursue enforcement actions. A safe harbor provision protects from liability if inaccurately reported information is corrected within 90 days after submission.

## What are the next steps?

FinCEN must engage in further rulemaking to implement the Corporate Transparency Act. Specifically, who may access BOI, for what purposes, and what safeguards will be required to ensure that the information is secured remain to be established. FinCEN's Customer Due Diligence rule must also be revised to align with the Final Rule.

Real estate-holding reporting companies must stay apprised of the Final Rule's requirements and put in place processes and procedures to ensure sufficient time to recognize whether reporting is necessary, identify beneficial owners, and address any complexities associated with their organizational structures.

## Endnote

1. Kris Ferranti is the Real Estate Team Leader and a partner at Shearman & Sterling LLP. He represents clients in complex commercial real estate transactions, including in the areas of acquisitions, dispositions, joint ventures, development projects, foreign investment, financings, and ground and space leasing. He is recognized by Bloomberg Law, Law360, Crain's New York Business, and Super Lawyers as a "Rising Star" in Real Estate, and has authored several publications and has been involved in a number of speaking engagements at seminars and conferences and on podcasts and webcasts on various real estate subjects.

Yuval Rosenthal is a Law Clerk on the Real Estate Team at Shearman & Sterling LLP. He concentrates on cross-border and domestic real estate investment transactions, REITs, bank financing, workouts, leasing and acquisitions and dispositions.