Final Transparency Regs Offer Businesses a Few Breaks

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Long-awaited Treasury final rules on beneficial ownership reporting largely track with earlier proposed regs but include several changes to provisions, including those regarding company applicants and the timing of reports, that could be welcomed by businesses.

The 330-page final regs from Treasury's Financial Crimes Enforcement Network related to the Corporate Transparency Act (CTA) were released on September 29.

"The final rule . . . represent[s] a sea change in how corporate transparency works in this country," a senior Treasury official said on a September 28 press call. "FinCEN has made every effort to get it right. We've worked hard to make sure that this rule is consistent with the goals that Congress set in the CTA — that is, to develop a beneficial ownership database that will be useful to law enforcement and national security agencies while at the same time minimizing the burden on reporting companies."

The CTA, which became law in January 2021, targets tax fraud, terrorism financing, and money laundering by requiring corporations, limited liability companies, and similar entities to disclose information about beneficial owners to FinCEN. The regs predict that there will be 32.6 million reporting companies the first year the rules are effective and 5 million additional reporting companies each subsequent year over a decade.

Treasury Secretary Janet Yellen praised the final rule's effect on tax evasion in a September 29 statement.

"It will help level the playing field for honest businesses that play by the rules but are at a disadvantage when competing against bad actors who use shell companies to evade taxes, hide their illicit wealth, and defraud customers and employees," Yellen said.

According to the preamble of the final regs, the lack of federal beneficial ownership reporting requirements had made the United States the "jurisdiction of choice" for those looking to create shell companies to hide their assets. It states that Treasury, when examining a sample of IRS cases from 2016 through 2019, found that entities were used in a substantial portion of those cases to commit tax evasion and fraud.

The Financial Accountability and Corporate Transparency (FACT) Coalition, which previously voiced its support for the proposed regs, also praised the final rule, labeling its release a "historic moment" while urging further guidance.

"While being behind other jurisdictions with public disclosure of beneficial owners, the U.S. also has a chance to learn from experience. Information on the true owners of entities supplied to FinCEN under this law must be reliably verified to avoid the problems we've seen in other jurisdictions," Ian Gary, executive director of the FACT Coalition, said in a September 29 statement. "Our beneficial ownership directory should deploy real-time and automated verification mechanisms to ensure an accurate and useful database."

Treasury released proposed beneficial ownership rules (RIN 1506-AB49) in December 2021 that provide details on reporting requirements, definitions, and exemptions. Reporting is necessary for both domestic and foreign companies and requires information such as names, addresses, and identifying numbers from the reporting entity, the beneficial owner, and the company applicant.

Under the proposed regs, the company applicant is the individual who files, or directs and controls the filing of, the formation or registration documents. A beneficial owner is defined as any individual who, directly or indirectly, either exercises substantial control over a reporting company or owns or controls at least 25 percent of the ownership interests of the company. Substantial control includes acting as a senior officer, having authority over the appointment or removal of senior officers or a majority of the board of directors, and having substantial influence over important matters of the company. Exempt from the reporting requirement are large operating companies with 20 or more full-time U.S. employees, more than $5 million in sales, and a physical operating presence in the United States.

Despite having the authority to do so, the proposed regs offered no additional exemptions beyond what was outlined under the CTA. The final rules likewise decline to expand on the enumerated exemptions, although the preamble states that FinCEN will continue to consider the matter.

"The CTA reflects Congress's concern that exemptions could create loopholes that illicit actors could exploit to evade reporting requirements. The CTA therefore sets a high bar for creating additional exemptions: the Secretary, the Attorney General, and the Secretary of Homeland Security must all agree that requiring [beneficial ownership information] from such entities would neither serve the public interest nor help further key government objectives," the preamble states.

Ending the 'Wild Goose Chase'

Public interest in the proposed regs was great, as demonstrated by the hundreds of comments FinCEN received. Commentators were divided. Some voiced general support for the definitions on beneficial ownership and substantial control, while others expressed worry over the proposed regs' breadth and the burdens and liabilities they could impose.

One common criticism that FinCEN was receptive to was the difficulty in obtaining company applicant information for existing reporting companies — described by small businesses as a "nightmare" and a "wild goose chase."

Under the final regs, reporting companies existing or registered by the regs' effective date are no longer required to identify and report their company applicants. The preamble states that the value of that information for law enforcement purposes is limited and "becomes increasingly attenuated over time." Citing similar rationale, while newly created entities will need to report company applicants, they will no longer have to update the company applicant information. Corrections of inaccuracies will still require company applicant information.

The final rules also define a company applicant as, at most, only two persons: (1) an individual who directly files the creation document of the entity or, for a foreign company, registers the entity to do U.S. business; and (2) the individual who is primarily responsible for directing or controlling the filing of the document.

Pointing to the changes to the definition, Bruce Zagaris of Berliner Corcoran & Rowe LLP said that the final regs' modification could be viewed as a concession to both the business community and formation agents. He noted that under the proposed regs, anyone in the "chain" working on formation was considered a company applicant.

Severiano Ortiz of Kozusko Harris Duncan argued that the rules have been made a little easier to comply with the changes to company applicants, noting that updated reports are now explicitly for the reporting company or beneficial owner following the removal of an applicant. He also said that while the definition of company applicant has been streamlined, there is still a gray area in identifying the individual "primarily responsible for directing or controlling the filing."

"Was this meant to only refer to the person who directly instructed the actual filer to file, or is it meant to identify the person who made the decision to create the entity, in which case it could be the entity's owner [or] an officer at another company who made the final decision to move forward with a plan to create the entity?" Ortiz asked. "In the former, it is read literally, but the latter leaves room for interpretation."

Ortiz said penalties might still apply to company applicants if they cause a reporting company to fail to complete or update beneficial ownership information. He also noted that anyone using a FinCEN identifier now has an affirmative duty to update their application after a change.

"This makes sense and makes it easier for the reporting company to not have to keep track of people, especially since most company applicants will prefer to obtain a FinCEN identifier for privacy purposes," Ortiz said.

Ortiz added that even with the changes to the company applicant rules, there remains the "potentially Herculean task" of identifying substantial control and ownership since those rules are still complex and expansive.

Harmony and Timing

While the proposed regs didn't include an effective date, the final rules are effective from January 1, 2024.

Unchanged from the proposed regs is that companies created before the effective date have one year to file reports. While FinCEN had the authority to extend that timeline to two years after the effective date, it declined to do so, as it believed requiring information to be filed by January 1, 2025, gave companies sufficient time. The preamble explains that removing the need for these companies to submit company applicant information should further minimize their burden.

The final regs provide that companies created after the regs become effective have 30 days to file after receiving notice of their creation or registration. Previously, the deadline was 14 days.

"FinCEN believes that these changes will relieve burdens on reporting companies unique to company applicant information, while still ensuring that the database is highly useful," the preamble states. "An expanded 30-day timeframe will provide more time to reporting companies to acquire [taxpayer identification numbers] and other identifying information, which is critical to the ability of FinCEN to distinguish reporting companies from one another, which in turn is necessary to create a highly useful database."

By setting the deadline for newly created entities to update and correct reports at 30 days as well, the final regs sought to "harmonize" their rules on filing. Under the proposed regs, the deadline for correcting reports was 14 days.

While some commentators had asked for a lengthier time frame to submit updates, the preamble states that even though 30 days may be more burdensome, reporting companies should know who their beneficial owners are, and the time frame is in line with international practice.

The final regs provide a triggering event for the initial report, set at the earlier of the company receiving actual notice of its creation or registration, or a secretary of state providing public notice of the creation or registration.

Zagaris said the final regs would bring the United States closer to compliance with international rules on entity transparency, but he offered a caveat given that the rules won't take effect until 2024 and previously created reporting companies have until 2025 to file.

"By then, the international standards will have moved further," Zagaris said. "For instance, unlike the U.S., the EU and many countries include in their entity transparency standards reporting on trusts. In addition, the EU and the international standard is to have public registries."

Striking a Balance

Modifications were also made to the definitions of ownership interest and substantial control for the sake of clarity and compliance, according to the preamble.

The potential reach of the substantial control definition had been of great concern to businesses and trade groups, including the National Association of Manufacturers.

While the final regs largely adopt the definition of substantial control from the proposed regs, they put more focus on the senior officer element and eliminate "dominant minority" of the board of directors as constituting control.

"FinCEN believes that the definition of substantial control in the final rule strikes the appropriate overall balance: it is based on established legal principles and usages of this term in a range of contexts (as explained in the [notice of proposed rulemaking]) and provides specificity that should assist with compliance, while at the same time being flexible enough to account for the wide variety of ways that individuals can exercise substantial control over an entity," the preamble states.

Corporate secretary and treasurer are no longer included in the definition of senior officer in the final regs. And while some commentators had expressed concern that a tax professional could be viewed as exercising substantial control when acting under a power of attorney arrangement, the preamble offers assurances that such ordinary, arm's-length advisory services would not be considered as such since senior officers and board members remain primarily responsible for decisions.

Ortiz said that the rules surrounding substantial control "remained very broad and inclusive," although the final regs made room for several notable carveouts. To exert direct or indirect exercise of substantial control now requires actual exercise with the presumption of the right being removed, he said. He also pointed to the addition of a trustee or trust as someone who might exercise substantial control.

Ownership interests modifications were both limiting and broadening, according to Ortiz. He viewed as a positive the exclusion from ownership of options and privileges created and held by third parties or held by third parties without knowledge or involvement in the reporting company.

"This will make it easier to identify the potential owners, providing the reporting company some assurance that they won't necessarily be responsible for including those third parties that they aren't involved with or don't know about," Ortiz said.

Proprietorship language was also removed, but Ortiz pointed to an expansion of the final regs regarding ownership to include voting powers and rights instead of shares as well as "any capital or profits interest in an entity."

What it means to exert direct or indirect ownership was also both broadened and narrowed, Ortiz argued. The regs change "control of such ownership interest owned by" another individual to through "another individual acting as a nominee, intermediary, custodian, or agent on behalf of such individual."

But they also remove the prong pertaining to ownership of trusts that relates to "through any contract, arrangement, understanding, or relationship."

"This will be a welcome modification to those concerned with trying to determine a trust-trustees role in direct and indirect ownership interests," Ortiz said.

Changes were also made to the 25 percent ownership threshold. Ortiz called this “basically a total rewrite” of the proposed regs, which had vaguely discussed ownership interests broadly as a percentage of outstanding ownership.

What’s Next

The senior Treasury official said the government expects most reporting companies to have simple management and ownership structures with only one or two beneficial owners. The rules should cost those companies only about $85 each to prepare and submit an initial beneficial ownership report. The official compared that with the state formation fee for LLCs, which ranges from $40 to $500. Given the large number of reporting companies, even at only $85 each, the aggregate cost will be $21.7 billion in the first year, the preamble notes.

“For these [simple] companies, we believe that the reporting requirements will be straightforward and less burdensome than for businesses with more complex structures,” the official said.

The official also said that FinCEN plans “extensive outreach” to the small business community to inform it of the new reporting requirements. In advance of the effective date, it also plans to develop guidance documents, including a small entity compliance guide, the official said.

The official also confirmed that two more sets of guidance are coming, as indicated in a September 29 Treasury release. FinCEN plans a notice of proposed rulemaking on access and disclosure of the beneficial ownership information, which can be expected in the near term, the official said. After that, there will be a proposed rule revising FinCEN’s customer due diligence rule to reflect CTA requirements.

Zagaris noted that FinCEN is already behind in releasing its access and customer due diligence rules.

“It is likely that the information on beneficial owners is kept by FinCEN and only can be accessed by law enforcement from federal, state, Indian tribes, and foreign governments and banks to verify customer due diligence. All will likely have to request access and then await processing by FinCEN,” Zagaris said. “FinCEN is seriously underresourced, especially in view of all the new regulatory projects. . . . The penalties for any misuse of the information are so harsh that banks receiving information will have to restrict it so that they can protect themselves from any penalties."