Insight

Treasury Proposes Beneficial Ownership Reporting Requirements To Crack Down On Shell Companies

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Executive Summary

- The Department of Treasury's Financial Crimes Enforcement Network (FinCEN) is meeting its obligations to Congress by proposing a rulemaking that requires companies to report beneficial ownership data to FinCEN for the first time in the history of U.S. federal law.
- Proponents of the new requirements hope that a registry of beneficial owners will help prevent bad actors from using shell companies in the pursuit of financial crimes ranging from tax evasion to the financing of global terrorism.
- The new registry poses an enormously costly logistical challenge to FinCEN and it is not clear that law enforcement will achieve any greater success prosecuting bad actors with this information than they do with the suspicious activity reports (SARs) generated by the existing anti-money laundering (AML) regulatory framework.

Introduction

The Department of Treasury's Financial Crimes Enforcement Network (FinCEN) has released a notice of proposed rulemaking that would require certain companies to report beneficial ownership data to Treasury with a view to preventing bad actors from concealing illicit funds behind anonymous shell companies.

Beneficial Ownership and Shell Companies

A beneficial owner is any person or group of people (not, however, a company) that enjoys the benefits of ownership even though the title to some form of property (for example securities, or real estate) is held in another's name. Beneficial ownership is distinct from legal ownership, although they will usually be the same person. Examples of this practice could include the registration of publicly traded securities under the name of a broker, or the wealthy or famous withholding their names on the titles to properties they own appearing on public records by forming a trust to manage the property. Beneficial ownership is typically defined as an individual who has "substantial control" over an organization or who owns at least 25 percent.

A shell corporation (more commonly referred to as a shell company) is a common tool used in this practice. In this scenario, a corporation is formed that does not have active business operations, significant assets, or anything more than the bare minimum of personnel. Shell companies are used not just by individuals but also by companies – Apple and many other companies use shell companies based out of tax havens, recognizing their profits in countries with more favorable tax codes.

It is important to note that none of these practices are illegal. Critics, however, point to the lack of transparency caused by this regulatory legerdemain as a significant contributor to a wide range of financial and social ills, from tax evasion to the financing of global terrorism. For this reason, laws (or proposed laws) regulating beneficial ownership and shell companies are often considered in the same breath as being under the umbrella of anti-money laundering (AML) regulations. This is particularly pressing in the United States given that the existing AML framework is decades out of date, largely ineffective, and creates billions of dollars in compliance costs for American banks (for a primer on AML regulation, see here).

Regulatory Context

FinCEN's proposed rule comes to meet the requirements of the Corporate Transparency Act, enacted as part of the Anti-Money Laundering Act of 2020 within the National Defense Authorization Act for 2021. The proposed rule also comes hot on the heels of the Monday release by the administration of a United States Strategy on Countering Corruption which includes a section on curbing illicit finance.

Requirements of the Proposed Rule

The proposed rule covers who would be required to file a beneficial ownership information (BOI) report, what information must be included, and the timing of reports.

Reporting Companies

Two categories of reporting company are identified: domestic and foreign. In either case, the rule is designed to capture corporations, limited liability companies (LLCs), and any similar financial vehicle created by the filing of a document with a secretary of state or equivalent. This requirement is then undercut dramatically by several classes of exemptions: First, the rule would exclude 23 types of entities, including banks, insurers, brokers, and investment advisors; second, the rule would exclude entities with at least either 20 full-time employees in the Unites States or $5 million in gross receipts or sales.

Information to be Included

When filing a BOI report with FinCEN a reporting company must include the name, birthdate, address, and a unique identifying number (such as a passport number) for all beneficial owners and the company applicant. Going forward, FinCEN would create a "FinCEN identifier" that could be provided in lieu of the required information.

Timing

A BOI report would need to be filed within 14 days of either the creation or registration of a reporting company or within 30 days when subsequent events render the initial report inaccurate. Existing domestic and international covered reporting companies would have a year in which to submit a BOI to FinCEN.

The notice of proposed rulemaking is not heavy on details about the actual BOI registry that would be created, noting that it would be accessible by law enforcement and other "authorized users," thereby excluding public access.

Analysis

The proposed rule would create the first federal system of reporting and tracking beneficial ownership; the United States will finally join the more than 80 international jurisdictions that have a similar regime in place.

Many states already have a beneficial ownership regime in place (with a few notable exceptions, including Delaware); the rule can be viewed charitably as codifying existing practice. The proposed rule, however, goes significantly less far than most international reporting regimes, including the European Union, by severely limiting the scope of entities covered by the rule and treating beneficial ownership information as confidential. While AML experts praise this plug to a long-outstanding loophole in the system, the rule represents a small step that is largely incidental to the pressing reform needs of the money laundering regime more broadly.

While the laundry list of exemptions to the proposed rule would seem to exclude – practically everybody? – it is important to note that these entities are not usually the beneficiaries of beneficial ownership, despite their common use of shell companies. Banks and their ilk are not the intended targets of this rule making, with the Bank Policy Institute's Angelena Bradfield noting that the law targets the *individuals* who use "the anonymous shell company loophole that criminals have exploited to launder money – through the purchase of luxury New York penthouses and other creative schemes – in support of drug trafficking, human trafficking and arms smuggling." More worrying is the exemption-by-omission of a certain class of trusts that do not require that they be filed with a secretary of state; FinCEN, however, specifically recognizes this risk and seeks public input.

Although the scope is narrow, the reporting burden will be felt by some. FinCEN notes in the accompanying fact sheet that projected costs are likely to be in the range of $50 per report; the proposed rulemaking goes into more detail estimating a Year 1 cost of $1.26 billion and 33 million hours, a staggering cost given how few reporting entities the rule would cover.

FinCEN also noted in its accompanying fact sheet that it would begin the infrastructure development required to administer the new beneficial ownership information program. FinCEN is infamously under-resourced and the development and administration of the new framework will likely severely tax the unit in budget, resources, and manpower. The existence of a new data registry itself also poses some troubling questions; those nervously watching an already-troubled federal IT system highly exposed to security breaches have reason to be concerned about this new liability.

Next Steps

FinCEN's proposed rule is open to public comment until February 7, 2022. FinCEN gave no estimation as to when the rule might come into effect. This is the first in a three-part rulemaking by FinCEN; the second is expected to cover access to the database and the third may impact bank due diligence rules and the AML framework more broadly.

Conclusions

While a highly targeted regulatory response addressing a long-awaited financial security imperative is much welcomed, the joy is somewhat muted. The new regulation will pose a great expansion of the role of a traditionally resource-strapped unit and entail the creation of yet another mysterious database vulnerable to security breach. Perhaps the most pressing question left unaddressed by the proposed rulemaking is what FinCEN will *do* with the reports they receive; it is hard not to consider the analogy of the trillions of data points already filed with FinCEN in suspicious activity reports (SARs) by way of the existing anti-money laundering framework that warrant an average of follow-up by law enforcement roughly 0.44 percent of the time. After all, there is something bitterly appropriate about the creation of a highly opaque reporting regime accessible only to "authorized users" *as a response* to a lack of transparency in corporate structures.