February 7, 2022

Himamauli Das
Acting Director
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183

Re: Beneficial Ownership Information Reporting Requirements
Docket Number FinCEN 2021-0005 [RIN 1506-AB49]

Dear Mr. Das:

I am pleased to provide these comments regarding the proposed rule governing beneficial ownership information reporting requirements.[1] The proposed rule has major problems. I identify some but my list is far from complete. The proposed rule needs to be revised to avoid imposing ridiculous burdens on small businesses and to avoid burying law enforcement in mounds of useless paper that would seriously impede efforts to apprehend financial malefactors. Moreover, the cost estimates in the proposing release are objectively and demonstrably massively wrong. Basic errors were made by the economists who conducted the estimates.

General Observations

In my letter of May 5, 2021 to FinCEN on this matter I wrote:

> FinCEN is used to dealing primarily with large firms. It does not have a history of paying a great deal of attention to the costs it imposes on the private sector. This rulemaking needs to be different. In crafting the rules governing implementation of the CTA it needs to take special care that the rules governing beneficial ownership reporting are simple to understand and simple to comply with. Small businesses with fewer than 20 employees or $5 million or less in gross receipts do not have compliance departments and they do not have in-house counsel. They have very limited resources.
>
> FinCEN needs to do the hard work of writing the definition of beneficial ownership *in plain English in terms any normal small business person can understand*. It needs to provide examples. To fail to do so would be an abdication of FinCEN's duty to responsibly administer this law. FinCEN needs to clearly define terms in the rulemaking and systematically avoid weasel words like "substantially" and "significant" and "effectively." It needs to particularly focus on defining undefined and deeply ambiguous terms in the centrally important

[1] Beneficial Ownership Information Reporting Requirements, Notice of Proposed Rulemaking, Financial Crimes Enforcement Network, Department of Treasury, *Federal Register*, Vol. 86, No. 233, December 8, 2021, pp. 69920-69974.

> definition of "beneficial owner" including "indirectly," the phrase "arrangement, understanding, relationship, or otherwise," "substantial control" and "entity."[2]

FinCEN has demonstrated in the proposed rule that it currently plans to abdicate its duty to administer the Corporate Transparency Act responsibly. It has not done the hard work of writing the rule "in plain English in terms any normal small business person can understand." It has taken the "easy" road of providing virtually no meaningful guidance on central matters to the small firms that will be forced to comply with its rule, a rule that is replete with poorly defined and deeply ambiguous weasel words.

Reading FinCEN's collective mind should not be a prerequisite to lawfully operating a business in this country. FinCEN needs to actually write a rule that makes its intentions clear so that small businesses can actually comply with FinCEN's rule.

The proposed rule gives FinCEN virtually unfettered discretion because the proposed rule is about as clear as mud. It also, as written, is ridiculously overbroad and **will require reporting many tens of millions of people as beneficial owners who are ordinary employees or have an ordinary business relationship with the reporting company**. Even people operating in complete good faith will be unable to determine what the rule means. If the rule stands as proposed, then FinCEN will just make it up as it goes along and the small business community will have to endure regulation by enforcement. Only businesses that report something on the order of a quarter to a third of their workforce and many suppliers and customers as beneficial owners will be objectively safe from an adverse enforcement action. The requirements will not be defined by rulemaking but, instead, through expensive and potentially ruinous litigation with the government. Even small business owners that prevail against the government may be crushed by litigation costs. This is **NOT** how a responsible FinCEN should operate. Given the impact that this rule will have on **tens of millions** of people, FinCEN must do better.

Assuming *arguendo* that FinCEN knows what its own proposed rule means, then it needs to provide, in the rule, examples – many examples – to clarify what the rule means. Failure to do so is the height of irresponsible rulemaking and an abdication of FinCEN's duty to responsibly administer the Corporate Transparency Act. Each of the definitions discussed below should contain in the rule examples that clarify the meaning of otherwise ambiguous terms. Failure by FinCEN to do so constitutes the purposeful obfuscation of the rule's terms meaning. The objective by FinCEN should be clarity and compliance by the small firms that must comply with the rule. This objective is not furthered by the parroting of weasel words found in the statute or adoption of "standards" like "substantial influence over important matters" test in the rule.

---

[2] Letter of David R. Burton to AnnaLou Tirol, Deputy Director, Financial Crimes Enforcement Network Re: Beneficial Ownership Information Reporting Requirements, May 5, 2021 https://downloads.regulations.gov/FINCEN-2021-0005-0132/attachment_1.pdf.

Definitions

Beneficial Owner

The term beneficial owner is effectively defined as someone who owns (in the conventional sense of the word) 25 percent or more of an entity or someone who exercises “substantial control” over the entity. The definition of substantial control (discussed below) is, as drafted, ridiculously overbroad.

Substantial Control

Substantial control means “service as a senior officer” and “[t]he term ‘‘senior officer’’ means any individual holding the position or exercising the authority of a president, secretary, treasurer, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.” This prong of the substantial control definition means that almost any operating company is going to have several and often half a dozen “senior officers” who must be reported as “beneficial owners” whether or not they actually own any of the company. As discussed below, this also means that the entire economic analysis contained in the proposing release is transparently wrong and inaccurate and vastly underestimates the time and costs involved in reporting. Other prongs make this problem dramatically worse.

Substantial control also means “Direction, determination, or decision of, or substantial influence over, important matters affecting the reporting company, including but not limited to:

(A) The nature, scope, and attributes of the business of the reporting company …;
(B) … ;
(C) Major expenditures … of the reporting company … ;
(D) The selection or termination of business lines or ventures or geographic focus of the reporting company;
(E) Compensation schemes and incentive programs for senior officers;
(F) The entry into or termination or the fulfillment of or non-fulfillment of significant contracts; and
(G) … .

This “substantial influence over important matters” test is about as clear as mud and, if taken seriously as written, it is ridiculous. Short of the lowest level employees, almost anyone working for the company has “substantial influence” over “important matters.” The chef or cook in a restaurant has substantial influence over the most important thing in a restaurant, its food. The personnel or HR person has substantial influence over the nature and attributes of the business and over the compensation schemes and incentive programs for everyone working for the business, including senior officers. The foreman running one of a few teams doing the actual work of a small business certainly has “substantial influence” over “important matters” relating to the “nature of the business.” The marketing and sales people do as well and they probably have influence over the “geographic focus” of the company since they decide where to advertise and schedule sale calls. Sales and marketing people also execute “significant contracts” with company customers. A purchasing agent enters into “significant contracts” involving “major expenditures” by the company with suppliers every day. And so on.

FinCEN states in the proposing release discussion that “[t]he ordinary execution of day-to-day managerial decisions with respect to one part of a reporting company’s assets or employees typically should not, in isolation, cause the decision-maker to be considered in substantial control of a reporting company, unless that person satisfies **another element** of the ‘substantial control’ criteria.”[3] This should be in the rule itself, not in the proposing release discussion that will never be seen by small businesses or their advisors and has minuscule legal importance. It should also be accompanied by *examples* illustrating what FinCEN thinks are “day-to-day managerial decisions with respect to one part of a reporting company’s assets or employees” that do not constitute substantial control of a reporting company. FinCEN should say what it means to require, not make those forced to comply guess what FinCEN might mean. Does a chef in a restaurant meet the subparagraph (A) element or not? That is, after all, “another element.” Must a purchasing agent that buys components for an original equipment manufacturer -- these are significant contracts – be reported as a beneficial owner. Must the CEO’s administrative assistant who chooses the two life insurance agents to come in to pitch the CEO’s wife who keeps the books (i.e. the CFO) on the life insurance benefit provided to all employees including “senior officers” (subparagraph (E)) be reported as a beneficial owner. Absent some revision to the proposed rule, the answer would appear to be a clear yes in all of these cases, which is ridiculous.

Under the proposed rule as written, somewhere between a third and a quarter of the workforce employed by small businesses may well be scored as “beneficial owners.” This will impose an unacceptable burden on small firms but it will also bury FinCEN in useless paper.

But wait, there’s more.

<u>Direct or Indirect Exercise of Substantial Control</u>

The proposed rule contains this language:

> “Direct or Indirect Exercise of Substantial Control. An individual may directly or indirectly exercise substantial control over a reporting company through a variety of means, including … through arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees, or through any other contract, arrangement, understanding, relationship or otherwise.”

As noted above, the proposed rule adopts a “substantial influence over important matters” test for determining “substantial control.” It then layers on top of that a “formal or informal arrangement or understanding” test which means the universe of potential beneficial owners is expanded still further. A supplier to the local corner market undoubtedly has “substantial influence over important matters” (e.g. the nature, scope, and attributes of the business of the

[3] Proposing release, p. 69934 (col. 2).

reporting company) and undoubtedly has contracts and both formal and informal understandings and arrangements with the corner market. So is the guy who supplies the produce to the corner market a beneficial owner of the corner market? It would appear so. The freshness and variety of the produce is important and the supplier exercises substantial influence over the freshness and variety. And the supplier undoubtedly has contracts and understandings with the corner grocer regarding these matters. A business consultant or lawyer or accountant that has "substantial influence over important matters" would meet this test. So also might a business owner's mother who gives advice over the family dinner if she exercises "substantial influence." Again, it quickly gets ridiculous because the rule is so badly drafted. It is written so as to encompass reporting as a beneficial owner almost anybody that has "substantial influence over important matters" relating to a business. It is also almost entirely divorced from ordinary conceptions of ownership.

As discussed below, the economic analysis contained in the proposing release is transparently wrong and inaccurate and does not take any of this into account.

I presume FinCEN does not really mean for the rule to be as inclusive as it is as currently drafted. I know for a fact that Congress did not intend for it to be that inclusive. FinCEN needs to start over and write a rule that is not ridiculously overbroad and provide examples ***in the rule*** excluding the bulk of ordinary employees, suppliers, consultants, accountants, attorneys and so forth as beneficial owners. If FinCEN wants to include in its definition of beneficial owner certain people that are not owners but will be called such because they are having outsized influence over non-routine decisions, then FinCEN should write a reasonably tailored provision in the rule that says which non-owners have "substantial control." It should not write a rule that defines substantial control to include a quarter of the small business workforce, virtually all professional advisors providing advice to small businesses and both large customers and suppliers.

Fixing the massive ambiguities in this proposed rule is particularly important since the fines for non-compliance can be as high as $500 per day and involve imprisonment for up to two years.

<u>Applicant</u>

The Corporate Transparency Act is poorly drafted and contains numerous problems. The provisions with respect to "applicants" are one example. Many existing businesses don't have the slightest idea regarding the whereabouts or personal information of the applicant. In many cases, it will be a paralegal in a lawyer's office who did the original incorporation work decades ago. The law office may no longer exist. If it does, they may well not know the whereabouts of the paralegal, legal secretary or even the lawyer that filed the documents decades ago. They probably no longer have the relevant files unless the reporting company is still a client. Moreover, tracking this applicant down serves no purpose. The applicant probably knows nothing about the company and has no influence with respect to the company. He or she probably doesn't even remember filing the formation papers.

In many cases, finding the applicant will be quite literally be impossible. And, as the proposed rule acknowledges, the applicant may be dead. FinCEN should not require existing businesses to do the impossible. Nor, given the fact that applicants *quo* applicants are largely irrelevant to anything that FinCEN cares about, should small firms be forced to expend immense amounts of time trying to track down an applicant from years ago. Is FinCEN really going to force a small business to hire a private investigator to track down a 95 year old paralegal who filed incorporation papers in 1970 and to obtain a copy of his or her identification? Or even track down the 60 year old legal secretary that has moved, changed names and changed professions and who did the filing for daddy's incorporated automobile repair shop in 1985 (which the son inherited because daddy died in 2005)? This, by the way, is an expense that in certain instances would be quite large, if enforced. It was not taken into account by the economic analysis in the proposed rule.

An existing firm that was formed more than a few years ago should not be required to report with respect to applicants. A provision similar to the provision in the proposed rule for deceased applicants should apply for all applicants with respect to reporting companies formed more than three years before the effective date of the rule.[4]

---

[4] It is clear that Congress intended for FinCEN to be able to take steps to avoid needless burdens on the small business community. See 31 U.S. Code § 5336(b) Beneficial Ownership Information Reporting.—
(b)(1) Reporting.—
(F) Regulation requirements.—In promulgating the regulations required under subparagraphs (A) through (D), the Secretary of the Treasury shall, to the greatest extent practicable—
(i) establish partnerships with State, local, and Tribal governmental agencies;
(ii) collect information described in paragraph (2) through existing Federal, State, and local processes and procedures;
(iii) minimize burdens on reporting companies associated with the collection of the information described in paragraph (2), in light of the private compliance costs placed on legitimate businesses, including by identifying any steps taken to mitigate the costs relating to compliance with the collection of information.

(b)(4) Regulations.—The Secretary of the Treasury shall—
(A) by regulation prescribe procedures and standards governing any report under paragraph (2) and any FinCEN identifier under paragraph (3); and
(B) in promulgating the regulations under subparagraph (A) to the extent practicable, consistent with the purposes of this section—
(i) minimize burdens on reporting companies associated with the collection of beneficial ownership information, including by eliminating duplicative requirements; and
(ii) **ensure the beneficial ownership information reported to FinCEN is** accurate, complete, **and highly useful**.

(g) Regulations.—
In promulgating regulations carrying out this section, **the Director shall reach out to members of the small business community and other appropriate parties to ensure efficiency and effectiveness of the process for the entities subject to the requirements of this section**.

Economic Analysis

The economic analysis in the proposing release makes major, major errors. They are not subtle errors. The analysis is objectively and demonstrably wrong to a massive degree.

<u>Error One: Factually Impossible, Radical Underestimate of the Number of Beneficial Owners</u>

Take, for example, Table 3. It assumes that the number of beneficial owners per report will be one or two in 87 percent of the cases. But that is impossible given the definition of beneficial owner proposed by FinCEN. **The economists who did the analysis made the same mistake that most small business owners will probably make. They assumed that beneficial ownership under the rule has something to do with actual ownership. It does not.** All senior officers will be scored as beneficial owners. Any corporation has a President or CEO, a Treasurer or CFO and a corporate secretary. Ergo, it will have, at the very least three beneficial owners plus any actual 25 percent or more owners. So, using FinCEN economists' assumptions regarding actual owners, most reporting companies will have four or five. But that is much too conservative an estimate given the rule's language. Any other "senior officer" will be added to the list. And any other person that meets the "substantial influence over important matters" test will be added to the list.

So instead of most reporting businesses reporting one or two beneficial owners, they will generally have at the very least four or five and probably more like 15-25. **So the estimates provided by FinCEN in its proposing release are off by at least 400 percent and quite likely several times that.**

Table 4 (relating to updated reports) is off by similar magnitudes. It assumes that 87 percent of reporting companies will have one or two beneficial owners. In point of fact, this is impossible because any normal corporation will have at least three senior officers and potentially many more. And again, this ignores the countless numbers of people that will meet the "substantial influence over important matters" test or senior officers that are not the CEO, CFO or corporate secretary.

Given the proposed rule's language, it is literally impossible that the cost estimates are correct.

<u>Error Two: Ignoring Major Costs</u>

The analysis entirely ignores the potentially massive costs involved in tracking down applicants from years ago.

Error Three: Radical Underestimate of Compliance Time

The analysis makes the ridiculous assumption that anyone can familiarize themselves with all of the complexity discussed above, collect the required information relating to, and required documents from five to 25 people and make the required filing in 70 minutes.[5]

Error Four: Radical Underestimate of Wage Rate Used to Monetize Compliance Time

The analysis also cooks the books by using an unrealistically low wage rate to monetize the costs of this ridiculously low compliance time estimate. It assumes that the appropriate wage rate is $27 per hour (which corresponds to roughly $54,000 annually) which is based on the average wage rate for all employees.[6] In reality, this process is going to be undertaken by senior management or highly-paid professionals. The cost per hour is going to be two to three times the figure chosen.

Sincerely,

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
202-608-6229 (direct dial)
David.Burton@heritage.org

[5] See proposing release at p. 69964.
[6] See proposing release at p. 69964.