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COMMENTARY

New FinCEN Rule on Transparency Reporting in Residential Real Estate Closings

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Real Estate

By Jonathan B. Wilson | September 17, 2024 at 05:00 AM



Until recently, many attorneys had never heard of FinCEN—the Financial Crimes Enforcement Network of the U.S. Treasury. FinCEN was formed soon after the 1970 Bank Secrecy Act, one of Congress' first attempts to fight money laundering that required banks to report “suspicious transactions.” FinCEN became more of a household word after Congress adopted the Corporate Transparency Act in 2020. That law, which took effect this year, will require more than 30 million companies to file beneficial ownership information reports with FinCEN. Now, FinCEN has expanded its reach with a new rule (to be published at 31 CFR 1031.320) that will require closing attorneys and title companies to file transparency reports in connection with many residential real estate closings. See 89 Fed. R. 70258.

Background

Illicit actors sometimes use nonfinanced transfers of residential real estate to launder money. Financed real estate transactions are subject to some scrutiny by banks and other financial institutions that have anti-money laundering and countering the financing of terrorism (AML/CFT) program and Suspicious Activity Report (SAR) filing requirements under the Bank Secrecy Act.

Illicit actors launder money by holding residential real estate in the name of a legal entity or trust, and then transferring the real estate to a second anonymous corporate entity. Cash exchanged in the transaction—in the absence of traditional financing—enables the illicit actor to “launder” illicit funds into legitimate gain on the transaction. Transfers that are both nonfinanced and involve a transferee that is a legal entity or trust are have higher risk of money laundering because the anonymous corporate entities obscure the interests of the ultimate beneficial owners.

Through its new real estate rule, FinCEN hopes to reduce money laundering through such residential real estate transactions.

Under its authority under the Bank Secrecy Act, FinCEN for several years has issued residential real estate geographic targeting orders (GTOs) to require title insurance companies to file reports identifying the beneficial owners of legal entities that make certain nonfinanced purchases of residential real estate in select jurisdictions in the United States. The real estate rule will replace the GTO program with a nationwide transparency reporting program.

Summary of the Real Estate Rule

The real estate rule requires “reporting persons” performing specified closing or settlement functions in certain reportable transfers of residential real property to report specified information to FinCEN about the transfer. The reported information includes information about the parties to the transfer and the property itself.

Reportable Transfers of Residential Real Property

A transfer is reportable if it meets the following criteria: the property is residential real property; the transfer is nonfinanced; the property is transferred to a legal entity or trust, and an exemption does not apply.

A reportable transfer must be reported regardless of the purchase price or value of the property. As a result, even gift transfers are subject to the rule. However, transfers made directly to an individual are not covered by the rule.

Definition of Residential Real Property

The real estate rule applies only to residential real property located in the United States. Reportable property includes single-family houses, townhouses, condominiums, and cooperatives, including condominiums and cooperatives in large buildings containing many such units, as well as entire apartment buildings designed for occupancy by one to four families. The rule will also cover transfers of land on which the transferee intends to build a structure designed for occupancy by one to four families. Furthermore, a transfer of property may be reportable even if the property is mixed use, such as a single-family residence that is located above a commercial enterprise.

Definition of Nonfinanced Transfer

For a transfer to be reportable, it must be non-financed. The real estate rule defines “nonfinanced” as a transaction where there is no extension of credit to a transferee that is both secured by the transferred property and extended by a financial institution subject to an AML program and Suspicious Activity Report (SAR) obligation. (Banks and nearly all traditional mortgage lenders are subject to AML and SAR obligations under the Bank Secrecy Act.)

Transfers that are financed only by a lender without an obligation to maintain an AML program and file SARs, such as a non-bank private lender, are treated as non-financed transfers are potentially reportable.

Definitions of Transferee Entity and Transfer Trust

A transfer of residential real property must be reported if at least one of the new owners of residential real property is a “transferee entity” or “transferee trust.” These terms include limited liability companies, corporations, partnerships, and trusts. Both domestic and foreign entities and trusts are covered by the real estate rule.

The real estate rule includes some definitional exemptions for highly regulated types of legal entities and trusts that are less likely to be used by illicit actors.

Exemptions From Reporting

The real estate rule exempts certain common, lower-risk transfers. A reportable transfer does not include:

- a transfer of an easement;
- a transfer resulting from the death of an individual, whether pursuant to the terms of a decedent’s will or the terms of a trust, the operation of law, or by contractual provision;
- a transfer incident to divorce or dissolution of a marriage or civil union;

- a transfer to a bankruptcy estate;
- a transfer supervised by a court in the United States;
- a transfer made for no consideration by an individual, either alone or with their spouse, to a trust of which that individual, their spouse, or both of them, are the settlor or grantor;
- a transfer to a qualified intermediary for purposes of a like-kind exchange under Section 1031 of the Internal Revenue Code; and
- a transfer for which there is no reporting person.

Determination of Reporting Persons

The real estate rule will apply to settlement agents, title insurance agents, escrow agents, and attorneys. Each reportable transfer must have only one reporting person.

The real estate rule allows the professionals involved in the closing to decide amongst themselves who will be the reporting person by entering into a “designation agreement.” If those professionals do not enter into a designation agreement, the real estate rule contains a cascading set of obligations that will impose the reporting duty on one of them.

The reporting cascade lists seven different functions that a real estate professional may perform in a transfer of residential real property. The reporting person for any transfer will be the professional that performed a function that appears highest on the list. For example, the first function on the list is the professional listed as the agent on the closing or settlement statement. If no such professional is involved in the transfer, then the reporting obligation applies to any professional that performed the second function on the list (i.e., the professional that prepared the closing or settlement statement), and so on down the list.

The real estate rule provides flexibility, however, by allowing the professionals to agree among themselves who will act as the reporting person through a designation agreement.

Required Information

If the real estate rule applies to a transfer, the reporting person must file a report with FinCEN that contains the following information about the reportable transfer:

- The reporting person;
- The legal entity (transferee entity) or trust (transferee trust) receiving ownership of the property;
- The beneficial owners of the transferee entity or transferee trust;
- Certain individuals signing documents on behalf of the transferee entity or transferee trust during the reportable transfer;
- The transferor (e.g., the seller);
- The residential real property being transferred; and
- Total consideration and certain information about any payments made.

A key point in the transparency report will require the reporting person to determine who are the beneficial owners of the transferee entity. An individual is a beneficial owner of a transferee entity if that individual either directly or indirectly, exercises “substantial control” over the transferee entity, or owns or controls at least 25% of the transferee entity’s ownership interests. This definition identical to the definition of a beneficial owner provided in FinCEN’s regulations under the Corporate Transparency Act. See 31 CFR 1010.380.

If a transferee entity is a trust, the reporting person will apply the same analysis to determine its beneficial owners, as would apply under the Corporate Transparency Act. An individual is a beneficial owner of an interest transferred to a trust if that individual is a trustee of the trust or an individual with authority to dispose of transferee trust assets; a

beneficiary who is the sole permissible recipient of income and principal from the transferee trust or who has the right to demand a distribution of, or to withdraw, substantially all of the assets of the transferee trust; is a grantor or settlor of a revocable trust; or is the beneficial owner of an entity or trust that holds one of the aforementioned positions in the trust.

The real estate rule will allow the reporting person to rely on information provided by others. Such reliance will be permitted, however, only if the reporting person does not have knowledge of facts that would reasonably call into question the reliability of the information.

With regard to the beneficial ownership information of transferee entities or transferee trusts, this reasonable reliance standard is slightly more limited. In these situations, the reasonable reliance standard applies only to information provided by the transferee or the transferee's representative and only if the person providing the information certifies the accuracy of the information in writing to the best of their knowledge.

Filing Real Estate Reports and Keeping Records

A reporting person must file the real estate transparency report by the later of either: the final day of the month following the month in which the reportable transfer occurred; or 30 calendar days after the date of closing.

The reporting person is not obligated to retain a copy of the report. However, the reporting person must keep for five years a copy of any certification, signed by the transferee or a transferee's representative, certifying that the transferee's beneficial ownership information, as well as a copy of any designation agreement signed. Other parties to the designation agreement similarly need to keep copies of the agreement.

The Future of Residential Real Estate Closings

The Real Estate Rule takes effect Dec. 1, 2025. By that time, attorneys, real estate agents and title companies will need to develop new procedures to managing their obligations under the real estate rule.

Real estate professionals will need to develop a form of designation agreement and set expectations for which party will act as the reporting person in a reportable transaction. In each real estate transaction, attorneys will need to make a threshold determination of whether the property is residential real property as defined in the rule, whether the transferee is a reportable transferee entity or transferee trust, and whether an applicable exemption would apply. This determination should be made jointly, or at least communicated broadly to the professionals involved, to eliminate a risk that some parties might disagree.

The reporting party will need a system to collect the information required for the real estate report. Since the information will include personally identifiable information about the beneficial owners, those individuals will need to consent to the collection of their personal information.

The reporting system will need to retain the requisite information, including the designation agreement, for at least the five-year period required by the Real Estate Rule. Other document retention rules may also apply.

Even though the implementation date of Dec. 1, 2025, might feel like a distant milestone, implementing changes to customary procedures around residential real estate closing will take time, coordination and training. Real estate attorneys, title agents and others involved in real estate closings will need to plan accordingly for the coming year.

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