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A Guide to the Corporate Transparency Act for Individuals with Closely-Held Businesses and State-Monitored Entities Created for their Estate Planning

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In an effort to curb money laundering, tax evasion, and other corrupt activities conducted through shell companies and synthetic identities, the world's developed nations have worked for over a decade to create a system of disclosure to combat bad actors through the Financial Action Task Force ("FATF"). The United States has been one of the last of over 200 members of FATF to implement disclosure rules, but has finally done so through the Corporate Transparency Act ("CTA"), enacted by Congress on January 1, 2021. The CTA requires "reporting companies" to report their "beneficial owners" (Beneficial Ownership Information or "BOI") to a division of the Treasury Department, the Financial Crimes Enforcement Network ("FinCEN"). The CTA is effective on January 1, 2024, and will apply to eligible companies formed both before and after the effective date.

Through the use of a case study, this advisory summarizes the CTA and the final regulations relating to BOI reporting most relevant to individuals who have closely held businesses or who have created LLCs, limited partnerships, and other state-monitored entities as part of their estate planning. It also specifies a list of action items that reporting companies and beneficial owners must fulfill to ensure compliance.

CASE STUDY: Len and Kerry, a married couple, created Legendairy Ice Cream LLC, a Delaware limited liability company, to administer a family business with fewer than 15 employees and annual gross revenue of $9,000,000. They have two children, Chip and Berrie, who are named as the managers of Legendairy Ice Cream LLC. Len's revocable trust, the Len Revocable Trust, has a 20% interest in the Legendairy Ice Cream LLC, Kerry's revocable trust, the Kerry Revocable Trust, has a 50% interest, and Len's irrevocable gifting trust, the Raz Irrevocable Trust, has a 30% interest. The trustee of the Len Revocable Trust is Len. The trustees of the Kerry Revocable Trust are Kerry, Mint, and Neapolitan. The trustee of the Raz Irrevocable Trust is Cookie Dough. Each revocable trust is for the benefit of the settlor during the settlor's life. The Raz Irrevocable Trust is for the benefit of Chip and Berrie during their lives.

1. Which companies must report?

The CTA applies to both domestic and foreign companies. A domestic reporting company is a corporation, a limited liability company, or other entity that is created by filing a document with a secretary of state or any similar office under state or Indian tribe law. This would generally exclude general partnerships and almost all trusts.

Many larger companies and charitable entities are exempt because they are already subject to federal or state regulations which require the reporting of BOI and which would make CTA reports redundant. Larger companies are defined as those with over 20 employees, more than $5,000,000 in gross revenue, and a physical operating presence in the United States.[1]

Application: Legendairy Ice Cream LLC qualifies as a domestic reporting company as it is a company with less than 20 employees which is registered with Delaware's secretary of state. None of the trusts qualify as a reporting company.

2. What company information must be reported?

All reporting companies must provide their full legal name, all trade and d/b/a names, and the street address of their principal place of business. This principal place of business may not be a home address because it requires an office address where people meet regularly to conduct business. This will be a problem for those fully remote companies that do not have a brick-and-mortar location.

Application: The Legendairy Ice Cream LLC would report to FinCEN: “Legendairy Ice Cream LLC, at 123 Sprinkles Street, Dover, Delaware 56789”.

3. What is a beneficial owner?

A beneficial owner is any individual who (directly or indirectly) (a) exercises substantial control over the company or (b) owns or controls at least 25% of the company’s ownership interests.[2] A form of substantial control is control of direction, determination, or decision of, or substantial influence over, important decisions affecting the company. While not clear, the intent of the legislation is to aggregate different types of beneficial ownership so that if an individual owns 25% or more through different individual or representative capacities, it is all attributed to that individual. All of the beneficial owners of a company must be reported, even if one of them does not control the outcome (for example, because the trust requires majority action). The person must be considered a beneficial owner at the time of reporting.

In the event of a trust arrangement, the CTA explicitly identifies the following as potential beneficial owners of the trust.

i) A trustee of the trust or other individual (if any) with the authority to dispose of the trust assets. It is unclear who would be the individual reporting information on behalf of a corporate trustee.
ii) A beneficiary who is the sole permissible recipient of income and

principal from the trust; or has the right to demand a distribution of or withdraw substantially all of the assets from the trust. This is usually the case in a self-settled asset trust or revocable trust during the grantor's lifetime.
iii) A grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust.[3]

While not expressly addressed in the legislation, a beneficial owner may include those quasi-fiduciary positions, such as trust protectors, persons holding powers to veto certain trustee actions or powers to remove trustees, or distribution advisors. While there are some unknowns, the analysis for who has substantial control should be applied carefully to each person named in the trust to determine whether or not he or she is a beneficial owner.

There are a number of exemptions to the beneficial owner definition:

i) Minors (if their parent or guardian's information is reported).
ii) An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual (for example, a lawyer or accountant who works with a reporting company).
iii) An individual acting solely as an employee of a reporting company (but not if said individual is a senior officer).
iv) An individual whose only interest in the reporting company is through future right of inheritance. Such person would only become a beneficial owner when he or she inherits the pertinent ownership interest.
v) The creditor of a reporting company.

Application: For Legendairy Ice Cream LLC, there are a number of beneficial owners:

> The managers, Chip and Berrie, are beneficial owners because they control the day-to-day decisions per the operating agreement. Please

note that all high-ranking employees of a company should be analyzed for substantial control as it varies based on the operating agreement.

The Kerry Revocable Trust and the Raz Irrevocable Trust are beneficial owners as each owns more than 25%. The Len Revocable Trust is not a beneficial owner as it owns less than 25% and does not share any beneficial ownership with the other trusts.

As a beneficial owner, the Kerry Revocable Trust would have a variety of individuals reporting their personal information:

Kerry, Mint, and Neapolitan, as the trustees of the Kerry Revocable Trust, are the beneficial owners and must report their personal information. Although the trust provides that Kerry must be included in all majority votes, all three trustees would be beneficial owners.

Kerry is the sole current permissible beneficiary of the Kerry Revocable Trust and thus a beneficial owner.

Kerry is also the settlor with the right to revoke and amend the trust, again qualifying as a beneficial owner.

There is a trust protector serving after Kerry's death, but given that the trust protector is not currently serving, the trust protector is not a beneficial owner.

As a beneficial owner, the Raz Irrevocable Trust would have a variety of beneficial owners as well:

Cookie Dough as sole trustee of the Raz Irrevocable Trust.

Chip and Berrie are the beneficiaries of the trust. Berrie has a withdrawal right at age 45 and thus is a beneficial owner. Chip, as a simple discretionary beneficiary with no withdrawal right, does not have to report personal information.

4. What Beneficial Ownership Information must be reported?

For each beneficial owner, the company must report name, date of birth, and residential address. (This address does not need to be in the U.S., but it cannot be a P.O. Box.) In addition, it must provide an identifying number and image from a nonexpired (i) U.S. passport, (ii) state, local, or tribal identification document, (iii) state-issued document, or, if none of the prior three are available, (iv) foreign passport. It is unknown whether the company will need to report or otherwise identify the basis on which identified individuals are considered beneficial owners.

Beneficial owners and reporting companies may apply for a FinCEN identification number if the individual or entity provides FinCEN with its BOI.[4] If the beneficial owner provides his or her FinCEN identifier to the reporting company, the company may provide FinCEN with this identification number instead of a full BOI.[5] This provides the beneficial owners some privacy from the reporting companies.

This information will be held by FinCEN in a secure national database, the Beneficial Ownership Secure System (BOSS). It is not a public system, although similar registries in other countries implementing FATF guidance have had an increasing number of law enforcement and other government agencies gain access to the registry over the course of time.[6] There are general protocols and procedures to regulate who and which agencies have access to this information, and civil and criminal consequences are available for breaches by those not authorized. FinCEN will be publishing more guidance on this.[7]

Application: Kerry and Neapolitan must provide Legendairy Ice Cream LLC with their beneficial owner information. Kerry provides her name, date of birth, residential address, driver's license number, and a picture of her license. Neapolitan provides his name, date of birth, residential address, passport number, and a picture of his passport. Mint reported the same to FinCEN and received a FinCEN identifier. Mint provides Legendairy Ice Cream LLC with that number to report to FinCEN.

5. When must companies update their reports?

Companies must report any changes in their BOI information within 30 days of such change. “Changes” include a change in the party or parties holding beneficial ownership, a previously exempt minor reaching the age of maturity, and a change to reported information (for example, a change in address). Note that if a person dies, that is also a “change”; however, the change is deemed to have occurred on the date the estate was settled, rather than the date of death. Changes in information provided to FinCEN must be updated. An expired passport is not enough to warrant an update, but a change in the address on the passport, whether expired or not, warrants an update. If companies submit an inaccurate report, they have a 90-day safe harbor to correct said report.

If the reporting company finds information that is inaccurate, the reporting company has 30 days to correct such information from the date it first becomes aware or has reason to know, of the mistake. There may be additional guidance released on this in the future.

FinCEN does not require companies to file a report after their termination or dissolution. It also does not require companies to report changes to the BOI of their company applicant(s) (see number 8 below). However, it does require the company to file an updated report stating that it is no longer a reporting company.

Application: When Neapolitan, one of the trustees for Kerry Revocable Trust, moved from Arizona to Maine to stop melting year-round, Neapolitan had to report the change of residential address to Legendairy Ice Cream LLC, who in turn must report the change in address to FinCEN within 30 days.

6. What are the consequences of reporting violations?

Reporting companies who do not report their beneficial owners are subject to both civil and criminal penalties with both the company and individuals responsible for the violation subject to liability. An individual is considered to have “failed to report” a complete or updated BOI for the reporting company if such person (i) failed in their personal responsibility to report, (ii) directs or controls another person with respect to any failure to report, or (iii) is in substantial control of a reporting company when it fails to report. Beneficial owners only have a reporting obligation to the reporting company, not directly to FinCEN.

Generally, there is a civil penalty not exceeding $500 for each day that the violation continues or has not been remedied, capped at $10,000, and/or a criminal penalty of imprisonment up to 10 years. FinCEN will consider willfulness in considering enforcement penalties.

Given the heavy penalties and sensitivity of the information provided, beneficial owners should be careful of “official-looking” mail and solicitations to assist them with their BOI reports as some bad actors may be attempting to steal owners’ identities. There will probably be some legitimate services but better safe than sorry!

7. Reporting Checklist for Entities Formed Before January 1, 2024:

Companies predating the CTA’s effective date have until January 1, 2025, to provide the following information:

a) Company Information: Full legal name, all trade and d/b/a names, and the street address of their principal place of business.
b) BOI for all beneficial owners: Name, date of birth, residential address, and one of four acceptable identification documents.

a. Note: There is no requirement to report the BOI of company applicants (see below).

c) A certification from the reporting company that its report or application is true, correct, and complete

8. Reporting Checklist for Entities Formed After January 1, 2024:

The CTA goes into effect on January 1, 2024. **Companies formed after this date must provide the following information to FinCEN within 30 days of formation:**

a) Company Information: Full legal name, all trade and d/b/a names, and the street address of their principal place of business.
b) BOI for all beneficial owners: Name, date of birth, residential address, and one of four acceptable identification documents.
c) BOI for Company Applicant(s):

A company applicant is the individual who (i) directly files a document to create or register the reporting company or (ii) is responsible, if any, for directing or controlling such filing (e.g., the attorney directing the filing and an employee of a business formation service company).[8] Up to two individuals may be reported as company applicants.

d) A certification from the reporting company that its report or application is true, correct, and complete.

The CTA implements a wide-ranging system of reporting that will impact many estate planning clients. Please contact your G&S attorney to determine if these requirements apply to you or your company as a beneficial owner or reporting company.

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[1] There are 23 categories of exempt entities. **Exempt entities include public companies, banks, tax-exempt entities, inactive entities, and the following that are most often present in the estate planning practice:**

a) A legal entity that is a church, a charity, a nonprofit entity or other organization described in IRC § 501(c) and is exempt from income tax under IRC § 501(. Such a legal entity will remain a CTA-exempt legal entity for a period of 180 days following the loss of its tax exempt status.

b) A charitable trust or charitable split interest trust described in IRC § 4947(a)(1) or (2), which includes private foundations.

[2] 31 U.S.C. § 5336(a)(3)(A).

[3] 31 C.F.R. 1010.380(d)(2)(ii)(C)(3).

[4] The form application for a FinCEN Identifier is not available as of August 20, 2023.

[5] Note that for individuals who must report their residential address but are victims of violent crimes such as domestic violence or other sensitive circumstances, FinCEN will review these situations on a case-by-case basis if there is no future guidance.

[6] Financial Action Task Force (FATF), Recommendation 24 (may be found at https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf)

[7] On December 15, 2022, FinCEN released the Notice of Proposed Rulemaking to implement the BOI access and safeguard provisions of the CTA (the Access Rule NPRM). The Access Rule NPRM proposes regulations that would establish who may request BOI that will be reported to FinCEN, who may receive it, how recipients may use the information, how they must secure it, and the penalties for failing to follow applicable requirements. It also provides more information regarding the non-public database where all the BOI information will be entered and stored. We will publish a separate advisory with more details regarding these access and safeguard provisions once the final rule is published.

In addition to the BOI Reporting Rule and the Access Rule, FinCEN will release a third rulemaking to revise its customer due diligence rule no later than one year after the effective date of the BOI Reporting Rule (January 1, 2024).

[8] A business address may be used for a company applicant “who forms or registers an entity in the course of such company applicant’s business”.

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