

## Corporate Transparency Act: Not to Be Ignored

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### You Should Start Planning Now as You May be Affected

The Corporate Transparency Act (“CTA”) is a new federal law, enacted as part of the National Defense Authorization Act for fiscal year 2021, that will impact most owners of business entities (not just corporations, as the name suggests) and owners of limited liability companies used to hold rental property, partnerships, and other entities used as part of estate and asset protection plans, and many more people. The CTA is very broad and is estimated to impact nearly 32 million entities. That statistic, however, understates the reach of the CTA. When the entities report (“Reporting Entities”), what they must report is information on “Beneficial Owners.” And that term too is a misnomer, as it is not just owners who might be affected. Anyone who owns an interest in an entity, and anyone who could broadly be deemed a “Control Person,” could have to report. That could affect key employees, officers, directors and others. In the context of trust and estate planning, the CTA can cast a wide net. Trustees of trusts that own or control entity interests may have to provide information to the Reporting Entity. But the CTA goes much further. Beneficiaries may be ensnared by the reporting requirements. Trust protectors, persons holding powers of appointments, or someone holding the power to loan trust assets or to swap trust assets (common mechanisms included in many irrevocable trusts to provide characterization of the trust as a grantor trust for income tax purposes) may have to report. There is considerable uncertainty over how CTA rules may be applied to trusts. But no one that might even possibly be impacted by the CTA should risk ignoring the law without confirming specifically whether or not they must report because the penalties are potentially incredibly costly.

The CTA will be administered by the U.S. Treasury’s Financial Crimes Enforcement Network (“FinCEN”), which has already issued more than 300 pages of Regulations, FAQs and other guidance.

All these concepts will be explained in more detail below, but the bottom line is that anyone that might be ensnared by the CTA reporting requirements should immediately take action to determine their obligations and what steps might be advisable to take in that regard. For many people, given the uncertainty over CTA requirements, the safer option might be “When in doubt, report.” That being said, almost every individual having to report will be uncomfortable with the invasive nature of the reporting. Finally, don’t let the simplistic sounding reporting cause you to assume that the CTA is not complex. Some situations will be quite simple, example you own a wholly owned LLC that owns a rental property. Other situations will be incredibly complex, e.g. a family business with officers, directors, and key employees, interests of which are owned by various trusts, all with different provisions.

### Why was the CTA Enacted?

Much of the industrialized world requires detailed reporting about the people behind entities and even trusts. The U.S. has been a standout for not doing that. Now it is starting on the path. While trusts are not directly affected by the CTA, if they own entity interests, they may be required to report. The CTA is an effort to combat money laundering, terrorism, tax evasion and other financial crimes by helping the government identify the puppeteers behind entities so that entities cannot as readily be used to disguise inappropriate activities. The CTA will create a database that law enforcement can use in combating these concerns. The fact that you may have no involvement with any such activities has no impact on whether or not you may have to report under the CTA.

## Key Dates

**January 1, 2024:** Generally, any entity created after January 1, 2024 will have to meet its CTA reporting requirements within thirty days of formation. That will likely mean that whoever is forming an entity will include the steps to meet the CTA filing requirements in the organizational process. For example, as an attorney collects the information to create an entity, it is likely that they will also collect (or recommend someone else assume that responsibility) the information necessary to consummate any required CTA reporting.

**January 1, 2025:** Generally, any entities created before 2025 will need to have their CTA report filed by this date. That will encompass the 32 million estimated entities existing on January 1, 2024. You should not be lax about following up on the CTA requirements until late 2024, as it may take considerable time and analysis to collect the necessary information and make the required decisions to determine who must report. Also, it should be anticipated that any advisers or services that aid in the reporting will be inundated with CTA work as the end of 2024 approaches.

**30 Days:** This is a tough one, and it is explained in more detail below, but any information about a Beneficial Owner required to be reported under the CTA will have to be amended within 30 days of a change in that information. That is a really tight deadline, and as mentioned above, the penalties for non-compliance are significant.

## Who Might Help You With the Filing

Who will become involved in CTA filings is still being evaluated but consider the following:

**Yourself:** If you have a simple filing, you might just handle it on your own. You would simply go to the FinCEN portal and complete the necessary information, upload the documents required and be done. But given the tough penalties, and risks of not filing an amendment when due, even in the case of a simple filing, you might still opt to involve a professional adviser or use a reporting service.

**Corporate Filing Service:** These are firms that have historically helped in filing the legal documents to form or modify entities, and who serve as registered agents for entities. These firms, if they opt to enter into CTA reporting services, will have the ability to readily obtain copies of current entity documents to determine the status of entities and which persons are listed as owners, etc. However, it is not certain that these companies will have the legal expertise to parse through complex corporate and other legal documents. They likely will not have the expertise to evaluate complex trusts. So, if they do enter this arena, they may need to rely on your independent attorney for input.

**CTA Reporting Service:** Independent companies have been created that will endeavor, for a fee, to assist you, your entity and/or your professional advisers in handling the CTA filing requirements. These are firms expressly organized to address CTA filings. Whether you handle the filing on your own, or you have a professional adviser handle it for you, you still might also work with a filing service. Consider that if the identification you submit to FinCEN, such as a state driver's license, has an expiration date, will you remember to update your CTA filing to reflect a new license? Perhaps getting a notification from a service provider that tracks dates might be invaluable. What if you have your attorney assist you? That might be fine, but is the law firm equipped and used to monitoring expiration dates? Do they have the type of calendaring system to assuredly notify you? Also, depending on the filing service you hire (and this is all so new that the services offered may evolve over time), the service might have attorneys on staff to make the legal determinations you require. How expert those attorneys are, and what guarantees (if any) they will provide as to their analysis, will likely vary from provider to provider.

**Attorney:** Lawyers may have to be involved in CTA filings, especially complex ones. Whether your attorney handles the actual filing or merely assists in evaluating legal documents to help determine who might have to file, it seems that the involvement of lawyers might be necessary for CTA reporting when the situation is complicated. For example, you might need the assistance of a corporate attorney to review a partnership agreement, employment agreement, or even a lease agreement, to identify who might be characterized as a Reporting Person under the CTA. That might be necessary whether you handle the filing yourself or have a CPA or filing service assist you. Similarly, if you have one or more trusts owning interests in an entity, the trustee may need legal guidance from a trust and estate attorney to parse through complex trust provisions to determine which persons named in a trust may have to provide information to the entity to report as Beneficial Owners, including perhaps as a control person. As a simple illustration, the person serving as "trust protector" might be a control person, depending on the powers that the trust agreement gives to that role. Since there are no standards about what a trust protector role might entail, the determination might differ from trust to trust. So, you might actually require two different lawyers to lend their expertise to the analysis of who should report under the CTA.

**Accountant:** Initially, many people thought that the CTA filings might best be handled by the CPA firm that routinely handles your income tax reporting. After all, CPAs regularly file reports and often have information on hand and a more regular relationship with you than perhaps an estate planner that you might only visit every three to five years. However, the challenge that CPAs undertaking CTA filings will have to address is whether they have the expertise to evaluate complex legal documents. Where that is not required, your CPA may feel perfectly capable of handling your filings. If legal guidance is required, your CPA might choose not to handle the filing at all, or instead might request that you authorize them to speak with your attorney to provide that input.

**Wealth Advisor/Family Office:** The resources and capabilities of firms can vary significantly. If the firm has the wherewithal to track filing requirements, and has in-house legal expertise, perhaps some wealth advisor firms or family offices might venture into CTA filings for their clients. This remains to be seen.

This is all quite fluid, and as the CTA filings begin to be made it might become more clear as to who can assist you and in what capacity. The key point is that you must make sure that entities you are involved with properly handle not only the initial filing, but all required amendments, all on a timely basis. If you work with one provider and they have limitations, e.g., lack the legal expertise to analyze a trust document, you will need assistance from your attorney. Not all law firms will be comfortable handling CTA filings. All of this is a reason you should start evaluating what your obligations are well in advance of forming a new entity and well before the end of 2024 when existing entities have to report.

## Who is a Reporting Company That May Have to Report

Generally, any legal entity that is created by filing paperwork with a Secretary of State (or an American tribal jurisdiction) may be a "Reporting Company" unless the company meets one of the limited exceptions to avoid reporting. Here's a general concept that might help in understanding the detailed exceptions to the CTA reporting requirements: Companies that are already subject to substantial regulatory reporting requirements, or that are quite large (20 or more full-time employees and \$5 million or more in revenues), do not have to report. While that is an oversimplification, it does provide a general idea of what the CTA is targeting. So, banks, insurance companies and other regulated businesses are exempt from the CTA. But that leaves a tremendous number of small entities formed for business, investment, estate planning and other purposes that are subject to CTA reporting requirements.

It is also important to understand that generally it is the Reporting Company (not the Beneficial Owners) that is required to file the CTA reports. The actual Beneficial Owners are not required to file, but as explained below, their filing to obtain a FinCEN Identification Number may actually be a prudent step for entities to insist upon to limit their exposure.

So, if you are involved in an entity that may be a Reporting Company, you should start evaluating now about how that entity will meet its CTA reporting requirements, what role you have to serve in that process, who will be responsible for assuring that the entity complies, and how the entity will gather and track all information required to report and future changes to that information.

Consider when evaluating the above that a Reporting Company that you have involvement with might have multiple Beneficial Owners. For example, it could have several Beneficial Owners who exercise substantial control over the Reporting Company. It might have other Beneficial Owners who do not own or control at least 25% of the ownership interests of the Reporting Company. Those smaller equity holders may avoid filing, or may be required to file because of the control they have over the Reporting Company, even though they own less than 25% of the entity. There are no maximum number of Beneficial Owners that may be required to report.

Examples of entities that might be required to report include:

- An LLC formed for a small home-based business.
- An S corporation formed for a consulting business, even if a primary purpose was to minimize payroll taxes.
- A limited partnership or LLC formed to hold a family vacation home.
- An inactive entity that still has a bank account.
- An entity formed for a professional.
- A family business that has less than the 20 employees or less than \$5 million in revenue. Be careful because a change in employees or decline in revenues might trigger reporting.

- An LLC formed to hold a rental property.
- A family limited partnership organized decades ago to facilitate discounts as part of a gift plan.

## What Reporting Companies Have to Report to FinCEN

Reporting Companies will have to file reports that provide the required information about the business entity involved, and information about any individual who is deemed under the complex CTA rules to be a “beneficial owner.” Those rules are discussed later. The information that will have to be reported includes:

- The legal name and any trade names such as DBAs (doing business as) of the entity. This means the exact legal name as reflected on the documents used to create the entity and all names under which the business operates.
- The actual street address for the company’s principal place of business. You cannot use a P.O. box, or care of your lawyer or other adviser’s address. For virtual companies, it is not clear what address might have to be used.
- The name of the state in which the entity was formed. It does appear that states in which the business entity was authorized to conduct business, outside its state of formation, are required to be reported.
- The Tax Identification Number (TIN) for the business. For some business entities, this might require that they first obtain a TIN. For example, a pass-through disregarded entity like a single member limited liability company (“LLC”) may not have had a TIN and may have used its owner’s Social Security Number (or if owned by another entity or trust, the identification number of that other entity or trust). In those case,s a new TIN may have to be obtained to complete the CTA reporting. FinCEN may also issue unique identifying numbers.
- An identifying document from the state in which the entity was formed (the “issuing jurisdiction”) will have to be uploaded. This could be, for example, a certificate of incorporation, limited partnership certificate, articles of formation, etc. The terminology will differ by state. If your entity is old, that information may not be readily available and you might need to contact the state of formation (or use your attorney or corporate filing service) to obtain a copy. Again, while this should be a simple formality, it might take time.
- Reporting Companies must also report information on their Beneficial Owners. This is confusing in that the impression many get is that the Beneficial Owners themselves file, and that is not fully correct. Beneficial Owner information has to be filed by the Reporting Company. However, the scope of the information the Reporting Company has to file for any of its Beneficial Owners will be reduced if the Beneficial Owner themselves files directly with FinCEN to obtain a FinCEN reporting number.

## Who Is a Beneficial Owner

The determination of who is a Beneficial Owner that a Reporting Company must report information about can range from simple and obvious to impossibly complex.

**Simple Example:** John Jones owns a rental property 50/50 with his brother. The rental property is held in an LLC. The LLC is a Reporting Company, and as 50% owners and members managing the LLC, both John and his brother are Beneficial Owners and must provide the required FinCEN information to the LLC to report. There is no one else affected by the reporting.

**Complex Example:** Continue the above example. John Jones, as part of his estate plan, creates an irrevocable trust for his children and gifts his half of the rental real estate LLC to that trust. John’s adult children are all current beneficiaries of the trust. They may have to report. The trustee of the trust may be a Beneficial Owner. The trust names a Trust Protector who can remove and replace trustees. That Trust Protector may have to report as a person with Substantial Control. To assure that the trust is a grantor trust for income tax purposes, John retains a power to substitute assets of the trust. That power likely makes John continue as a Beneficial Owner because of the control that provides. John’s college roommate, Steve Smith, was given the power, in a non-fiduciary capacity, to loan John money from the trust. That power might have been used to provide John the potential to access trust assets and/or to support characterization of the trust as a grantor trust for income tax purposes. Steve may have to report. There are several family members and others given various powers of appointment. The trust and CTA Regulations will have to be evaluated to determine whether those persons have to report. The safer option, if they are willing, might be to have them report to avoid any issues of non-compliance.

More specifically, an individual will be deemed a “Beneficial Owner” if he or she has an ownership interest or control position. Meeting either of the tests suffices to require reporting. Owning 25% or more of an entity makes you a control person. But “ownership” is not an obvious concept. If you own directly or indirectly at least 25% of a Reporting Company, then you are a Beneficial Owner and must report under the CTA. But “ownership” includes many types of rights that extend well beyond owning 25% of a partnership interest. Ownership can include your holding a profits interests, convertible instruments, warrants, options, puts, calls, and more. What if you loaned money to a company, that would at first look be debt and should not trigger a reporting requirement as a Beneficial Owner. But what if the loan document provides you with the ability to convert debt to equity? What if the loan agreement gives you control over a wide array of entity transactions? That “debt” might be viewed as equity under the CTA rules. Ownership might be held through a trust arrangement or other indirect arrangement that could trigger reporting. Determining what rights are an “ownership interest” that triggers CTA reporting may require the review of the governing documents (e.g., shareholders’ agreement), loan documents, employment agreements, and other ancillary documents as well.

There is a second aspect to determining if you are a “Beneficial Owner” based on your having “Substantial Control” over the entity, even if you own nothing. So, you may have no ownership at all and yet still be considered a “Beneficial Owner” required to report. The CTA terminology is quite confusing, and that could inadvertently cause you to misunderstand your obligations.

But there is a second prong to the definition that reaches any person who has “substantial control” over a company. This could include a wide array of people, such as a manager, director, or officer of any entity that is a Reporting Company. These persons if they have Substantial Control, are characterized as “Beneficial Owners,” even if they do not own any interests in the entity. But there is considerable uncertainty. Is a chief financial officer a control person? The determination might be based on the terms of an employment agreement or other legal document. What about the head of a family office that manages family entities even though that person does not have a title like “manager”? If you have the authority to appoint or remove a senior officer or the majority of a corporation’s board of directors, even if you don’t have a particular “title,” you will be a Substantial Control person.

Consider how much more complex these entity decisions become when trusts own interests.

**Example:** A trust provides for an investment trustee or investment advisor. That person likely would be a person with “Substantial Control” and hence a “Beneficial Owner” because of their authority to take action with respect to the entity. If the grantor of the trust holds that power, there may be a limitation on that power that the grantor cannot vote stock that might, as a result of that voting right, be included in the grantor’s estate under Code Section 2036(b). Many trusts include a carve out, giving another person the right to vote such stock, rather than the grantor, to protect against the possible application by the IRS of that estate inclusion position. Thus, that other person also may be deemed to have Substantial Control. Therefore, in this relatively simple example, four people (the trustee, the investment advisor, the special voting person and the trust protector) all may have to file under the CTA, in addition to persons who have to file as a result of their positions with the entity.

## Special Rules for Minors

Minors are often addressed in estate planning, such as the recipient of gifts of entity interest to fractionalize ownership or shift value to the next generation. It had been common, before exemptions were so high, for taxpayers to make gifts each year of the annual exclusion amount in the form of entity interests to minors. While that always raised issues, now it pre-sents the possible reporting implications of the CTA.

The CTA provides an exception so that minors who are Beneficial Owners do not have to report. However, that exception, while helpful, raises additional issues that you might need to address. The CTA provides that no reporting is required for information about a Beneficial Owner of the reporting company who is a minor child. However, the parents of the minor have to report their required information as the parent or legal guardian of the non-reporting minor. But if you report as a parent or legal guardian instead of the minor child’s information, then you must indicate in your Beneficial Owner report that the information relates to you in your capacity as a parent or legal guardian of the minor child. Consider the difficult issues this exception might create. What if you and your spouse are separated or divorced? Which parent reports? Consider what happens if your ex-spouse owns an entity and your child owns an interest. Will you want to give confidential information to your ex-spouse.

When the child attains the age of an adult, then the CTA report you filed will have to be amended to remove your information and instead reflect the information of your now adult child. That is another date to calendar and not miss,

as the filing will be required to be made within 30 days of the child attaining adulthood.

## What Information Must Reporting Companies Report For their Beneficial Owners who Obtain FinCEN Identification Numbers

A Reporting Company must report information about all of its Beneficial Owners. If a particular Beneficial Owner obtains a FinCEN Identification Number by filing directly with FinCEN, then the Reporting Company will only have to report the name of that Beneficial Owner and the FinCEN Identification Number of that Beneficial Owner.

That is the recommended approach to consider with many Reporting Companies, as then the Beneficial Owner, not the Reporting Company, will have the obligation to file amendments with FinCEN if information changes. Changed information might include:

- Change in name.
- Change in home address.
- Change in the documentation submitted to FinCEN proving identity (e.g., a driver's license expires).

## What Information Must Reporting Companies Report For their Beneficial Owners who Do Not Obtain FinCEN Identification Numbers

The information that is generally required to be reported by every Reporting Company for each Beneficial Owner will include the following:

- The Beneficial Owner's full legal name. This requires the "full legal name," not a middle initial or nickname.
- Date of birth.
- Home street address. It is not permissible to use a P.O. box or in care of the Beneficial Owner's lawyer or other adviser's address even if that is used on income tax returns.
- A PDF (photocopy) of the individual's U.S. passport or state driver's license. This could be problematic for older individuals who may no longer drive or travel. They may have to obtain another government-issued identification that will satisfy FinCEN.

The above information is more personal and invasive than the information that many people have ever disclosed, and many will be uncomfortable with these requirements. There are no other options. This could become quite problematic. Consider the following example.

**Example:** Jane Doe created an irrevocable spousal lifetime access trust ("SLAT") in 2012 before the exemption might have been reduced from \$5 million inflation adjusted to a mere \$1 million inflation adjusted in 2013. That change never occurred. Jane named her friend, Sandy Smith, as trust protector in that trust, and Sandy's powers include the right to remove and replace the trustee. That power would seem to make Sandy a person with Substantial Control under the CTA. Sandy never was asked to sign a counterpart to the trust document and was never informed that she held this position. Jane and Sandy have not spoken much in the past decade. Jane's trust owns 50% of a family LLC. Now, in order to comply with the CTA, the trustee of Jane's trust (and/or the manager of the family LLC) has to contact Sandy, inform her of her role that she was unaware of, and that she has to file a report with FinCEN or give the LLC the personal information listed above. Sandy may be extremely uncomfortable divulging personal information and refuse to provide a copy of her driver's license. Sandy then has to be informed that she might face \$500/day fines for non-compliance and potential jail time up to two years, if the penalties apply to the BOI and not just the entity.

Perhaps as a last resort, the trustee and manager of the LLC could explain to Sandy that as a Beneficial Owner, she may obtain a special identification number from FinCEN and that number alone may be disclosed to the LLC instead of disclosing all the information otherwise required.

## Documents You Might Update

Given the importance of properly complying with the CTA initial reporting and required amendments, when information changes, you might consider addressing CTA requirements in various legal documents and changing some of the

administrative steps you take. Consider:

- **Entity Documents:** This could include a shareholders' agreement, operating agreement, partnership agreement, etc. You might consider adding provisions wherein every owner signing the agreement acknowledges their obligations to file for a FinCEN Identification Number and to provide that on a timely basis to the entity and to keep their FinCEN filing information current.
- **Divorce Agreements:** Should issues about who will report what information as to a minor child be addressed in your marital settlement agreement?
- **Trust Agreements:** Should a trust have all persons who have any appointment sign the trust or a counterpart and include on the signature page that person's agreement to comply with CTA reporting requirements if they are deemed a Beneficial Owner? That would at minimum avoid people given positions in the trust from not being aware of the appointments, and not being caught off guard by the CTA requirements. It may also require that these persons agree promptly to apply for a FinCEN Identification Number and provide it to the general trustee within 30 days (perhaps 20 days) of signing the trust agreement. That might facilitate giving the trustee sufficient time to add that person's name and FinCEN Identification Number to its report.

## Conclusion

The CTA is will require tens of millions of entities, trusts and individuals to file sensitive information with FinCEN. The determination of which entities constitute Reporting Companies, and which individuals associated with a Reporting Company constitute Beneficial Owners is very broad, and very nuanced. Everyone who might be affected should begin planning how they will respond immediately.

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