



Corporate Transparency Act Updates

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Corporate Transparency Act



The Corporate Transparency Act (CTA) has the potential to significantly change the privacy landscape for family offices and other organizations.

Passed on January 1, 2021, it established a set of beneficial ownership reporting rules that require compliance with certain disclosure rules regardless of whether “reporting companies” were established before or after the January 1, 2024, effective date.

The CTA is targeted at small, privately-held business entities and requires the entities to report their “beneficial owners” and “applicants” to the Financial Crimes Enforcement Network (FinCEN).

Established beneficial ownership reporting requirements that necessitate compliance with certain disclosure rules regardless of whether “reporting companies” were established before or after the January 1, 2024, effective date.

This presentation will help explain the reporting requirements and provide practical examples involving commonly used structures.



Why Did This Happen?



- **To fight money laundering and terrorist financing**
- **More than 2,000,000 corporations and limited liability companies are formed under the laws of the states each year**
- **Privately-held US companies are generally not required to identify owners. The US is one of the most secretive countries in the world with respect to finances. It has become the “Switzerland” of privacy, and US companies have been used for illegal and criminal activities**
- **The CTA is the most significant reformation of the Bank Secrecy Act and related anti-money laundering (AML) rules since the US PATRIOT Act and embodies years of efforts both domestically and abroad (the CTA was needed to meet Financial Action Task Force (FATF) standards)**
 - Also supported by the promulgation of Geographic Targeting Orders (started in 2016) which showed that a significant number of high value residential real estate transactions in major metro areas involved undisclosed owners of corporations and LLCs engaging in potential money laundering



Why Care About This Reporting?



- **Our clients value privacy**
- **Clients and advisers must discharge legal obligations**
- **Entity housekeeping (e.g., terminating unused entities, removing unnecessary officers, etc.) may reduce the scope of compliance**
- **There is plenty of flexibility offered by the ambiguity of the rules (i.e., many key terms are undefined)**
- **Managing disclosure through FinCEN identifiers may reduce compliance burdens**
- **Many foreign clients with US assets have immediate safety and/or related concerns**
- **Concerns may be mitigated by the access limitations in the statute and proposed access regulations (limited application, limited disclosure, etc.)**

What's the Cost?



- **32.6 million entities in the first year will need to report**
 - 5 million entities each year thereafter
- **The cost is expected to be at least \$22 billion in the first year**
 - Approximately \$5.6 billion each year thereafter
- **Each report is estimated to cost \$85.14 to \$3,614.87**
- **There is no fee to file**

Where We Are with Implementation of the CTA



- **Three sets of regulations are planned to be issued to implement the CTA relating to reporting, access and coordinating changes into FinCEN’s customer due diligence rules**
- **The first set of final regulations (the “Reporting Regulations”) were issued on September 30, 2022**
 - Proposed “Access Regulations” were issued on December 15, 2022
 - The Customer Due Diligence (CDD) regulations will be issued within one year of January 1, 2024
- **FAQs and other information were issued on March 24, 2023, including proposed draft versions of FinCEN Identifier applications and beneficial owner reports (see <https://www.fincen.gov/boi-faqs>)**
- **Enforcement is done by FinCEN**

Where We Are with Implementation of the CTA



Recent Developments

- July 13, 2023 - A new head of FinCEN was named unprompted (Ms. Andrea Gacki).
- July 18, 2023 - The House Financial Services Committee, Subcommittee on National Security, Illicit Finance, and International Financial Institutions held a hearing on the topic of small business readiness for BOI reporting. That hearing was well-attended, and a lot of the issues/practical considerations were discussed including extending the implementation date of the CTA consistent with proposed legislation (see next point).
- Two bills have been introduced in U.S. Congress to delay the implementation of the CTA reporting rules – H.R. 4035 and S. 2623, both titled the Protecting Small Business Information Act of 2023. The bills are identical. They would delay the start date of the rule until all regulations and guidance has been finalized. As of now, neither bill has passed their house of Congress.
- September 18, 2023 - FinCEN releases Small Entity Compliance Guide. Very high-level, but has helpful checklists and infographics.
- September 27, 2023 - Proposed regulations extending initial BOI report date for entities formed in 2024.
- September 28, 2023 – 30 day regulatory notices issued with newest draft versions of BOI report and FinCEN identifier application reflecting 60 day notice comments/changes

When Does Reporting Need to be Completed?



- **For new companies, reporting must be done:**
 - Within 90 days of formation/registration for entities formed on or after January 1, 2024 and before January 1, 2025
 - Within 30 days of formation/registration for entities formed on or after January 1, 2025
- **For existing companies going all the way back to the beginning of time, the reporting needs to be completed by January 1, 2025**
- **For any change in reportable information with respect to any beneficial owner, an updated report will be due within 30 days**
- **Changes requiring an updated report:**
 - A change to the beneficial owner(s) (e.g., gift of interest in company)
 - A change to the reportable Information for any particular beneficial owner (e.g., address)
 - When a reporting company meets requirements for an exemption (note that this should not apply to entities that meet the requirements for an exemption from inception)

Corporate Transparency Act



- A reporting company needs to report on itself, its beneficial owners and the company applicants (only for companies formed on or after January 1, 2024, must report company applicants)
- There are two types of reporting companies:
 1. **Domestic reporting companies, which include corporations, LLCs, LPs, LLLPs and “other similar entities” formed by filing a document pursuant to the laws of any state, which includes the US Virgin Islands, Puerto Rico and other US possessions. It would also capture Delaware statutory trusts and New Hampshire foundations**
 - However, it would not include common law trusts or unregistered general partnerships
 2. **Foreign reporting companies are corporations, LLCs and similar entities formed under the law of a foreign country and registered to do business in the US per a filing in any state**
 - A foreign corporation whose activities do not require registration to do business in a state would not need to file reports regarding such entity’s beneficial owners under the CTA.
 - Each state has its own rules but, generally, making passive portfolio investments into the US for its own account or holding real estate do not require registration to do business.

Exemptions



- **There are 23 exemptions, all with varying utility and generally apply to highly regulated businesses (e.g., banks, insurance companies, utilities, securities exchanges, tax-exempt entities, etc.)**
- **We will cover some in detail in this presentation, but some others include the following:**
 - Tax-exempt entities: 501(c) organizations, political organizations, and trusts under §4947(a)(1) or (2) of the Internal Revenue Code ("IRC") (note: common law trusts are not excluded as exempt; rather, they appear to fall outside the definition of a reporting company).
 - Any broker or dealer, as defined in section 3 of the Securities Exchange Act of 1934, that is registered under section 15 of that Act (15 U.S.C. 78o)
 - Certain types of investment companies as defined in section 3 of the Investment Company Act of 1940, or investment advisers as defined in section 202 of the Investment Advisers Act of 1940
 - Certain types of pooled investment vehicles
 - Publicly traded companies

Closely Held Business Notable Exemptions



Large Operating Company Exception

- **Contains 3 requirements:**
 - Must employ 20 full time employees in the US
 - Must have an operating presence at a physical office in the US
 - Must have filed a US federal income tax return reporting at least \$5M in US source gross receipts
- A full-time employee is an employee who provides an average of 30 hours of service per week.
- The requirement to employ 20 employees raises some important questions for seasonal businesses and those whose employment numbers fluctuate throughout the year
- Consolidated reporting can be considered to meet the \$5 million gross receipts test

Bank Exception

- A regulated private trust company is likely exempt through the incorporation of the definition of a bank in the Investment Company Act of 1940.
- The Investment Company Act of 1940 includes in the definition of a bank, a trust company, a substantial portion of the business of which consists of, exercising fiduciary powers, and which is supervised and examined by state bank regulators.
- Possibly a false victory because the level of disclosure and cost of becoming a regulated private trust company will far exceed the level of disclosure and cost of compliance
- Unclear whether entities owned by the PTC in its fiduciary capacity are exempt under the subsidiary exception—*currently there is a reasonable argument for yes but the better answer long term is likely NO (one FAQ away from being NO)*

Other Exceptions

- **Subsidiary Exception**
 - Applies to entities whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more exempt entities.
 - Requires control or 100% ownership over ownership interests of subsidiary entity, and it can apply to a company owned 50/50 by two exempt entities.
- **Inactive Exception**
 - were in existence on January 1, 2020,
 - are not engaged in an active business,
 - are not owned in whole or in part by a foreign person,
 - have not experienced a change of ownership in the past 12 months,
 - have not received funds in an amount greater than \$1,000 in the preceding 12-month period, and
 - do not hold any assets

Closely Held Business Notable Exemptions



Generally speaking, exemptions from BOI reporting are available for **regulated entities**. Given the majority of family office vehicles are not registered, it is unlikely family office entities will qualify for the below detailed exemptions, but it is possible for entities to meet these categories under the right circumstances:

There are two main categories of BOI reporting exemptions for registered entities:

- 1) US-domiciled entities if:
 - a) the entity is an SEC-registered adviser, or
 - b) a venture capital exempt reporting adviser
- 2) Private investment funds affiliated with exempt private fund managers, provided they qualify as “pooled investment vehicles” (“PIVs”).

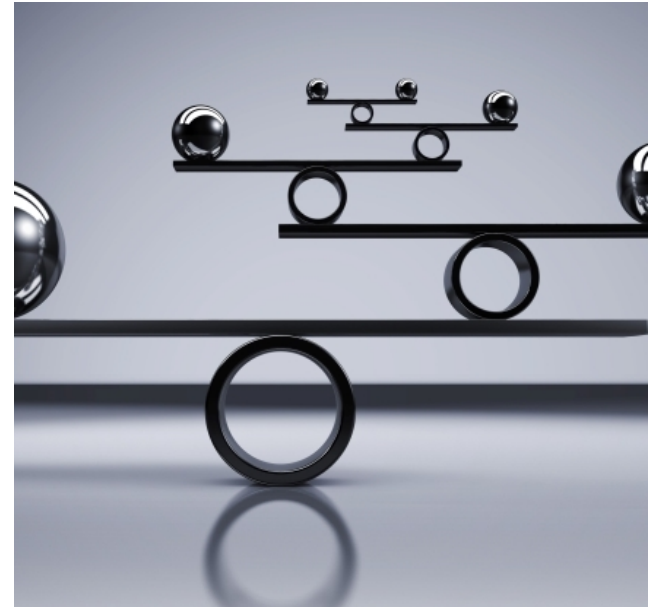
The CTA identifies two kinds of exempt PIVs:

- Any entity that qualifies as an investment company under Section 3(a) of the Investment Company Act of 1940 (“ICA”) (e.g., registered funds or funds investing primarily in securities but relying on other exemptions such as ICA Section 3(c)(5) used by certain real estate funds); or
- Any entity (e.g., a private fund) that (i) relies on a 3(c)(1) or 3(c)(7) exemption from the ICA and (ii) is (or will be) identified by its legal name on an investment adviser’s Form ADV.

Does the Subsidiary Exemption apply to a company that is 100% owned by a regulated PTC in its capacity as trustee of a family trust?



- **Additional analysis of the subsidiary exemption:**
- **Language: “Any entity whose ownership interests are controlled or wholly owned, directly or indirectly by an exempt company.”**
- **Control – Control for purposes of the Subsidiary exemption is not defined in the CTA. Based on the preamble, FinCEN believes that the word control in this context is the equivalent of “wholly controlled”**
- **Control Over “Ownership Interests” – The Subsidiary Exemption looks for control over the ownership interest of the company and not control over the activities or decisions of the company (which is a “Substantial Control” test concept for “Beneficial Owner” – more on this on the next slide)**



Who gets reported? Or should we ask who doesn't?



Beneficial Owners (BOs)

A BO is any individual directly or indirectly through any contract, arrangement, understanding or relationship exercises

- 1) substantial control over a reporting company (Substantial Control Prong)
or
- 2) owns or controls, directly or indirectly, not less than 25% of the reporting company (Ownership or Control Prong)

Neither Substantial Control nor Ownership or Control is defined in the CTA but defined under the regulations. The CTA does not define what constitutes ownership or how to calculate 25%, but this is addressed in the regulations

The depth and breadth of the definition of substantial control cannot be understated. It includes, *“an individual exercises substantial control over a reporting company if the individual...has any...form of substantial control over the reporting company...directly or indirectly...through... any...contract, arrangement, understanding, relationship, or otherwise”*

Company Applicants

These are required to be reported after January 1, 2024, and may be as few as one but are capped at two

It includes the one who physically files the document with the State Corporation Commission and the one who is primarily responsible for directing the filing

None of the company applicants need to be reported for companies formed prior to January 1, 2024

Who gets reported? Beneficial Owners



Substantial Control Prong: Determined directly and indirectly. FinCEN expects that a reporting company would identify at least one beneficial owner under the substantial control prong

De Facto Authority (Reported): This would include the senior officers (Chief Executive Officer (CEO), Chief Financial Officer (CFO), General Counsel (GC), Chief Operating Officer (COO), although some officers, such as the secretary and treasurer, appear to be exempt)

De Jure Authority (Reported): Individuals with (1) appointment/removal authority of senior officers or dominant majority of BOD of company or (2) control over important matters of the company (e.g., major business decisions - list in regulations)

Catch All Authority (Reported): Any other form of substantial control over reporting company. This definition is very broad and casts a wide net which could lead to over-reporting. More than one person may exercise substantial control

Ownership or Control Prong: Ownership interests defined in regulations. What you would expect (equity like interests and derivatives thereof). Ownership interests are aggregated to determine if threshold met

For trusts, the following individuals are deemed to own/control an interest through a trust:

1. A trustee of the trust or other individual (if any) with the authority to dispose of trust assets;
2. A beneficiary who (a) is the sole permissible recipient of income and principal from the trust, or (b) has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or
3. A grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interest of the reporting company; or through any other contract, arrangement, understanding or relationship

What information gets reported?



- **For the reporting company, it's the name, doing business as, physical address (not registered agent address), the jurisdiction of formation/registration and the Taxpayer Identification Number (TIN) (foreign TIN for foreign entities without an Employer Identification Number (EIN))**
 - Any changes must be reported within 30 days
- **For the beneficial owners, it includes the full legal name, date of birth, residential address, unique identifying number from an identifying document (e.g., US passport/ID/Drivers License, or foreign passport if none of these) and an image of an identifying document. Alternatively, it would be the individual's FinCEN Identifier if they get one.**
- **For the company applicant, the name, date of birth, business address rather than the residential address, and unique identifying number**
- **All individuals that could become reportable should strongly consider getting a FINCEN Identifier to keep custody of their own information**

FinCEN Identifiers



Under the CTA, individuals and some entities are allowed to obtain unique identifiers, called "FinCEN identifiers" and provide those identifiers in lieu of providing information about themselves.

The regulations give further guidance on obtaining and using a FinCEN identifier:

- Beneficial owners and company applicants can apply for a FinCEN identifier by submitting an application containing the information that a reporting company would otherwise be required to provide in its BOI report with respect to such beneficial owners and company applicants.
- Similarly, reporting companies can apply for a FinCEN identifier by submitting an application with or after an initial BOI report with FinCEN.
- Once a FinCEN identifier is obtained, individual and reporting companies may use that number for future FinCEN reports instead of providing the full list of required information in each report.
- The use of FinCEN identifiers could prove very useful given the ongoing obligation on reporting companies to update their BOI filings if/when beneficial owner or applicant information changes.

What Info Does Not Get Reported?



- **NO financial information is reported**
- **NO company business information is reported**
- **Reported information is NOT available to the public**

What Are the Penalties for Failing to Properly File?



Penalties for violating the CTA are as follows:

- Willfully providing or attempting to provide false or fraudulent beneficial ownership information
- Willfully failing to report, complete or update beneficial ownership information
- \$500 per day up to maximum of \$10,000
- Possible imprisonment of up to two years

Under the regulations, it is unlawful for any person to willfully provide, or attempt to provide, false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, to FinCEN; or to willfully fail to report complete or updated beneficial ownership information to FinCEN in accordance with this section

- The regulations clarify that any individual, in addition to the reporting company, will be liable and subject to the civil and criminal penalties

There are no penalties for non-willful violations or negligence pursuant to the rules and published guidance

Who Can Access This Information?



There are five types of requesters, mostly associated with the US:

- 1. US federal agencies – including state and local enforcement agencies with court authorization**
- 2. US Department of Treasury – including the Internal Revenue Service (IRS)**
- 3. Financial institutions using the information to conduct legally required customer due diligence**
- 4. Federal and state regulators**
- 5. Foreign law enforcement agencies – foreign authorities who submit qualifying requests for the information through a US federal agency**

How Will FINCEN Protect The Beneficial Owner Information?



- **FinCEN will be implementing a cloud-based Beneficial Ownership Secure System (BOSS), which has not yet been fully developed or implemented**
- **While a draft of the proposed Beneficial Owner Information (BOI) report and FinCEN Identifier applications has been issued, the actual format and mechanism for filing the BOI report with FinCEN, including the form and instructions, are still under development and likely will not be released until January 1, 2024 at the earliest**



Observations



- 1. Privacy is affected, but very little information is actually disclosed – no financial information or trade secrets of the business or even the type of business are disclosed**
- 2. Getting FINCEN identifiers for reportable persons likely is the best approach long-term. This is because the burden of updating information of beneficial owners would be shifted to the individual and the reporting company would not need to update information on the beneficial owners via updated reports. This would isolate updated reports at the company level to just events were beneficial owners changed**
- 3. PIVs and RIAs may not be reporting companies under the CTA if they are regulated. The exemption however for PIVs cannot be passed down via the subsidiary exemption**
- 4. Identifying beneficial owners of trusts with respect to reporting companies is more complex as noted earlier**
- 5. There are only willful penalties for CTA-related violations. Accordingly, what is important is to come to reasonable reporting positions based on the rules and guidance available**

What Are FO Clients Doing



Audits and reviews of structures to identify compliance obligations and recommend changes prior to January 1, 2024

- **“Changes” include terminating unnecessary entities, restructuring entities, and/or restructuring controlling person roles to tailor to CTA reporting (along with FinCEN identifier planning)**

Assist creating CTA-related tools (e.g., checklists, process flow charts, etc.) – McDermott has some of these and the recently issued guide from FinCEN does too

Strategize regarding reporting and substantiating reasonable and defensible reporting positions and frameworks

Being more vigilant and purposeful with entity creation/use

- **Entities other than common law trusts, general partnerships, and other entities not created by filing/registration with a state will need to decide whether they would prefer to be regulated to qualify and be exempt from the CTA or deal with CTA reporting and compliance**

Case Studies – Roger Family Office, Inc.



- Roger set up a family office to help administer his investments and his real estate portfolio. Roger owns 51% of the stock of Roger Family Office, Inc., and his 5 children own the remaining 49% in equal shares.
- Roger made himself the President and CEO. He hired Andy, his favorite investment advisor, as CIO, but since Roger was more interested in golf these days, “Andy would be running the show.” He poached Lindy, his favorite lawyer, to serve as his general counsel. Finally, he brought Tandy, his favorite banker, as CFO.

Who are the beneficial owners?

- Under the ownership prong, the only beneficial owner is Roger. His children own less than 25%, and there is no family attribution under CTA.
- Under the substantial control prong, Roger, Lindy, and Tandy are caught because their titles are listed as senior officers per se in the CTA regulations. Andy, as CIO, is not deemed to have substantial control per se, but he is “running the show,” so he likely performs the functions of a CEO which means that he is deemed to have substantial control.

Is Roger reported as an owner or as a person with substantial control?

- Trick question! Under the form beneficial ownership report published by FinCEN, the category of beneficial owner is not reported so Roger is reported once with no indication of the basis for reporting him.

Case Study – Roger Family, LLC



Roger's Family Estate

Roger dies and leaves significant wealth to his 5 children held in 5 separate trusts (one for each of his children and his/her descendants)

Each trust owns a 20% interest in a Delaware family investment vehicle (Roger Family LLC)

The trustee of the trusts is a corporate administrative trustee in Delaware

Sandy is the smartest of the siblings and is selected as investment adviser of all 5 trusts

Sandy is also the manager of the LLC, but delegates all activities to the CEO, Mandy

Who are the beneficial owners?



The siblings are unlikely to be treated as BOs of the LLC because none of their trusts owns or controls 25% of the ownership interests

- Moreover, neither is the grantor, a trustee, a sole beneficiary or has a right of withdrawal with respect to his or her trust, so they do not meet any of the specific examples in the CTA of beneficial ownership through trusts



Sandy likely controls a 100% ownership interest in Roger Family LLC under the Ownership or Control prong because she presumably is an individual with the authority to dispose of the assets of the trusts (as investment adviser) and could direct the trustee to sell 100% of the interests in the LLC (i.e., control over more than 25%)

- Sandy is separately also a beneficial owner under the Substantial Control prong because she has substantial control over the LLC in her capacity as the manager—which is the case even though she delegated all authority to the CEO



Mandy is a BO of the LLC because she has “substantial control” as a senior officer of the LLC (CEO) pursuant to the Substantial Control prong



Case Study – Roger Family LLC (Continued)

Real life scenarios that may require updated reporting to FinCEN



1 Sandy throws her hands up in the air and resigns as investment adviser of the trust and Manager of the LLC

Is Sandy still a beneficial owner of Roger Family LLC?

- She no longer has control of the ownership interests through the trusts because she is no longer the investment adviser with power to dispose of trust assets.
- She no longer has substantial control because she does not have the power to remove and replace senior officers since she resigned as Manager of the LLC

2 What if Sandy has the power to remove and replace the trustee?

Does this make Sandy beneficial owner of Roger Family LLC?

- There is no indication that the CTA rules would attribute the power of the trustee to Sandy absent more – BUT see next answer below

3 What if the trustee was a pushover that did anything Sandy says?

Does this make Sandy beneficial owner of Roger Family LLC?

- An individual exercises substantial control over a reporting company if the individual has any other form of substantial control over the reporting company directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise

Case Study – Roger Family LLC (Continued)

Real life scenarios that may require updated reporting to FinCEN



<p>4 What if Roger Jr., the prodigal son, is redeemed from the structure?</p>	<p>Are the remaining children now beneficial owners of Roger Family LLC?</p>	<ul style="list-style-type: none">• The four remaining siblings are now probably treated as BOs of the LLC because each of their trusts now owns or controls 25% of the ownership interests.
<p>5 What if Sandy comes back as investment advisor and manager now that Roger Jr. is out?</p>	<p>Does the report for Roger Family LLC need to be updated?</p>	<ul style="list-style-type: none">• No update should be required because Sandy was already reported as a beneficial owner under the ownership prong and based on the draft report, the basis for reporting does not need to be included.
<p>6 What if Roger Family LLC becomes a large operating company?</p>	<p>Does Roger Family LLC just forget about CTA forever?</p>	<ul style="list-style-type: none">• Roger Family LLC would have 30 days to file a “final” report informing FinCEN that it has now qualified for the large operating company exemption. Note that although a reporting company that qualifies for an exemption must report, an entity that qualified for an exemption from inception does not need to file any reports.



Case Study – Roger Family LLC (Continued)

Real life scenarios that may require updated reporting to FinCEN



7

The four beneficial owners admit one new 4% owner to bring their ownership to 24%

Are the four children still beneficial owners of Roger Family LLC?

- The CTA is not subject to “economic substance” rules or other equitable doctrines, moreover the penalty standard requires willfulness. As a result, this likely works and the four children would no longer be beneficial owners.

8

What if the four children were locked into a side pocket without the ability to admit the new member into the side pocket?

Are the four children still beneficial owners of Roger Family LLC?

- The side pocket is not a separate reporting company, so it should not impact the analysis at the reporting company level beyond factoring into the determination of overall ownership percentages—i.e., each sibling may own a sliver more than 24%



Thank You

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