

Corporate Transparency Act Reporting for Covered Entities Owned by Trusts

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We are now six months into the new compliance regime instituted by the Corporate Transparency Act (CTA) and practitioners should be aware of the reporting obligations to assist clients with required disclosures. This article limits its focus to trusts. Specifically, estate planners should be able to advise their clients as to which parties to a trust need to report under the CTA when a trust owns business interests.

Reporting Requirements

Effective January 1, 2024, the CTA requires that “reporting companies”[1] disclose to the US Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) certain information about the company including, but not limited to, its beneficial owners.

Trusts themselves generally are not considered reporting companies because the CTA only applies to entities created by filing an organizational document with a state authority such as a secretary of state; however, when a trust owns interests in a reporting company, all parties associated with the trust may be considered beneficial owners of the reporting company.

The CTA defines a beneficial owner as any individual who either: (1) exercises substantial control over a reporting company, or (2) owns or controls at least 25 percent of a reporting company’s ownership interests.[2]

Individuals can substantially control or own a reporting company through trust arrangements. Substantial control is broadly defined[3], and there is no limit to the number of individuals associated with a trust who may need to be reported for exercising substantial control, and thus considered a “beneficial owner.” Given the far-reaching meaning of substantial control, any number of individuals that may constitute a beneficial owner with respect to a trust, including the trustee, beneficiary, grantor, or other individuals such as trust protectors, distribution trustees or advisors, investment trustees or advisors, members of the trust protector committee, holders of a power of appointment, or other power holders, whether directly or indirectly through contracts, arrangements, understandings, relationships, or otherwise.

If a trust owns or controls at least 25 percent of a reporting company’s ownership interests or exercises substantial control over a reporting company, then the parties to the trust that meet the following conditions are considered beneficial owners and must provide beneficial ownership information to FinCEN: Any party to the trust who:

- Has authority to vote 25 percent or more of the interests of the reporting company.
- Has authority to dispose of trust assets.
- Has authority to remove and replace trustees or direct investments.

- Is the sole permissible recipient of trust income and principal.
- Has the right to demand a distribution.
- Has the right to withdraw substantially all of the trust assets.
- Has the right to otherwise control the trust's activities.
- Has the right to revoke the trust or withdraw trust assets.
- Has the right to swap assets with the trust and reacquire assets from the trust.

Once it is determined who is a beneficial owner, such parties must furnish to the reporting company their full legal name, date of birth, residential address, and an identification number from a driver's license, passport, or other state-issued identification along with a copy of the identification document. Any time this information changes, the reporting must be updated.

Corporate Trustees

If the beneficial owner is a legal entity such as a corporate trustee, the reporting company should determine whether any of the corporate trustee's individual beneficial owners indirectly own or control at least 25 percent of the ownership interests of the reporting company through their ownership interests in the corporate trustee.

The following examples are provided by FinCEN:

- If an individual owns 60 percent of the corporate trustee of a trust, and that trust holds 50 percent of a reporting company's ownership interests, then the individual owns or controls 30 percent ($60 \text{ percent} \times 50 \text{ percent} = 30 \text{ percent}$) of the reporting company's ownership interests and is, therefore, a beneficial owner of the reporting company.
- If the same trust only holds 30 percent of the reporting company's ownership interests, the same individual corporate trustee owner only owns or controls 18 percent ($60 \text{ percent} \times 30 \text{ percent} = 18 \text{ percent}$) of the reporting company, and thus is not a beneficial owner of the reporting company by virtue of ownership or control of ownership interests.

The reporting company may, but is not required to, report the name of the corporate trustee in lieu of information about an individual beneficial owner only if all of the following three conditions are met:

- The corporate trustee is an entity that is exempt from the reporting requirements;
- The individual beneficial owner owns or controls at least 25 percent of ownership interests in the reporting company only by virtue of ownership interests in the corporate trustee; and
- The individual beneficial owner does not exercise substantial control over the reporting company.

It may also be necessary to consider whether any owners of, or individuals employed or engaged by, the corporate trustee exercise substantial control over a reporting company. The factors for determining substantial control by an individual connected with a corporate trustee are the same as for any beneficial owner.

Exemptions from the Definition of Beneficial Owner

When any of the following individuals qualifies for an exception, the reporting company does not have to report that individual in its beneficial ownership information report to FinCEN.

- Minors (Parent or legal guardian of the minor must report instead)
- Nominees, intermediaries, custodians, or agents
- Remainder beneficiaries (Once the individual inherits the interest, this exception no longer applies, and the individual may qualify as a beneficial owner)

- Creditors

Penalties for Noncompliance

While attorneys and beneficial owners are not directly responsible for filing reports with FinCEN—the onus falls on the reporting company itself—attorneys should be prepared to advise their clients whether a trust falls within the purview of the CTA and which parties associated with a trust must provide beneficial ownership information. Penalties for failing to comply with the CTA may be steep.

Parties to a trust who are considered beneficial owners must provide the reporting company with complete and accurate beneficial ownership information. If an individual willfully fails to do so, an enforcement action may be brought against such party because someone who willfully causes a reporting company's failure to submit complete or updated beneficial ownership information to FinCEN is in violation of the CTA.

Violations can result in fines of \$500 per day, up to \$10,000 (both adjusted for inflation), and imprisonment for up to two years.

Civil and criminal liability may be avoided if an individual who submitted an original, erroneous report did not knowingly submit inaccurate information and submits an updated report correcting the inaccurate information within ninety days.

Conclusion

The beneficial owner information reporting analysis is complex and must be done on a case-by-case basis. A practitioner must review the extensive CTA information published on FinCEN's website. There is no doubt that clients with trusts and trust-owned businesses will have questions about CTA compliance.

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[1] Reporting companies—defined as any company with twenty or fewer employees formed by filing with the Secretary of State or equivalent official—created or registered prior to January 1, 2024, have until January 1, 2025 to file an initial report; reporting companies created or registered after January 1, 2024 and before January 1, 2025, will have ninety days after creation or registration to file a report. Entities created on or after January 1, 2025 will have 30 days to submit the reports to FinCEN. The CTA exempts around two dozen categories of entities, including companies that

- are publicly-traded;
- have more than twenty full-time US employees;
- filed a previous year's tax return showing more than \$5 million in gross receipts or sales;
- have an operating presence at a physical US office location;
- operate in a regulated industry, such as banking, utilities, or insurance, that already imposes similar reporting requirements; or
- are subsidiaries of exempt organizations.

The exemptions, which generally include larger companies already subject to regulation, underline the primary purpose of the CTA: to combat money laundering and other illicit activities conducted via small, private, and anonymous shell companies.

[2] There are other nuances to this rule if no single owner owns more than 25%.

[3] An individual or trust exercises substantial control over a reporting company if the individual or trust meets any of four general criteria: (1) the individual is a senior officer; (2) the individual or trust has authority to appoint or remove certain officers or a majority of directors of the reporting company; (3) the individual or trust is an important decision-maker; or (4) the individual or trust has any other form of substantial control over the reporting company.

