Trusts & Estates Alert
February 2022

FinCEN Releases Proposed Rule on New Beneficial Ownership Reporting Requirements

After almost a year of waiting, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) released proposed regulations Dec. 7 implementing the beneficial ownership reporting requirements of the Corporate Transparency Act (CTA), enacted into law on Jan. 1, 2021, as part of the National Defense Authorization Act. (Read our initial alert on the CTA and its beneficial ownership reporting requirements here.)

Very generally, any business entity subject to the CTA (called a "reporting company" in the legislation) will be required to report its beneficial owners to FinCEN and will have a continuing obligation to file updates reporting any changes in its beneficial ownership. In the proposed regulations, FinCEN attempts to provide clarity on (1) who must file, (2) when they must file and (3) what information they must provide. The proposed regulations address several issues that are relevant to private clients, including:

- What types of entities are included in the definition of reporting company
- How to identify the beneficial owners of a trust
- When beneficial ownership reports are required to be filed
- When the new beneficial ownership rules will take effect

Key Takeaways:

- The new beneficial ownership reporting requirements will apply to privately held corporations, limited liability companies (LLCs) and other business entities that are formed or registered to do business in any state of the United States (or with any Indian tribe).
- The new beneficial ownership reporting requirements are not effective yet (i.e., no reporting is required yet). The reporting requirements will not take effect until FinCEN issues final regulations (the timing of which is unclear).
- The beneficial ownership information reported to FinCEN will not be part of any publicly accessible database.
- Most trusts used for estate planning purposes should not be considered reporting companies and should not be required to file reports with FinCEN disclosing their beneficial ownership. Information about a trust's beneficial owners (e.g., grantors/settlors, beneficiaries, trustees, etc.) may nonetheless be reported to FinCEN if the trust directly or indirectly owns an interest in a reporting company.

What types of entities are included in the definition of reporting company

The CTA defines reporting company to include:

1. Privately held corporations, LLCs and other similar entities formed under state law or the law of an Indian tribe
2. Non-U.S. entities that are registered to do business in any state of the United States or with any Indian tribe

The proposed regulations provide two new terms related to reporting companies: "domestic reporting company" and "foreign reporting company." Both new terms are generally consistent with the definition of reporting company found in the CTA.

In the notice of proposed rulemaking related to the proposed regulations, FinCEN provides practical insight on which type of entities are likely to fall within the definition of domestic reporting company:

> In general, FinCEN believes the proposed definition of domestic reporting company would likely include limited liability partnerships, limited liability limited partnerships, business trusts (a/k/a statutory trusts or Massachusetts trusts), and most limited partnerships, in addition to corporations and limited liability companies (LLCs), because such entities appear typically to be created by *a filing* with a secretary of state or similar office.

Also consistent with the CTA, the proposed regulations define foreign reporting company as a corporation, LLC or other entity that is formed outside the United States and that is "[r]egistered to do business in any State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe."

Pursuant to the CTA, only an entity that is created (or registered to do business) by filing a document with a U.S. state or Indian tribe falls within the definition of reporting company, which would exempt most trusts used for estate planning purposes. The proposed regulations do not change this result. In the Notice of Rulemaking, FinCEN plainly states that it "does not categorically include any particular legal forms other than corporations and limited liability companies within the scope of the definition" because it understands that "state and Tribal laws may differ on whether certain other types of legal or business forms – such as general partnerships, other types of trusts, and sole proprietorships – are created by a filing." The Notice of Rulemaking does acknowledge, however, that more types of entities may potentially fall within the definition of foreign reporting company because of the expansive scope of foreign entity registration requirements in certain states.

FinCEN is seeking comments on entity formation practices, as well as comments on what activities trigger foreign registration requirements, whether compliance with those requirements constitutes registering to do business and whether further clarification is needed.

How to identify the beneficial owners of a trust

A reporting company must disclose certain information about its beneficial owners. The CTA defines the term beneficial owner broadly to include any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, meets either of the below tests:

1. Exercises substantial control over the entity
2. Owns or controls not less than 25% of the ownership interests of the entity

The statute, however, does not define substantial control or ownership interest.

In the proposed regulations, FinCEN identifies three specific indicators of "substantial control":

1. Service as a senior officer of a reporting company
2. Authority over the appointment or removal of any senior officer or dominant majority of the board of directors (or similar body) of a reporting company
3. Direction, determination or decision of, or substantial influence over, important matters of a reporting company

The proposed regulations also include a catchall provision to make clear that substantial control can take additional forms not specifically listed.

The proposed regulations also attempt to address how to identify beneficial owners when a reporting company is held directly or indirectly by a trust. The proposed regulations specify that an individual may be a beneficial owner if he or she:

- Is a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust
- Is a beneficiary who is the sole permissible recipient of both income and principal from the trust
- Is a beneficiary who has the right to demand a distribution of or withdraw substantially all of the assets from the trust
- Serves as a trustee of the trust
- Has the authority to dispose of trust assets

In the Notice of Rulemaking, FinCEN clarifies that the categories outlined above have been included within the scope of beneficial ownership because "FinCEN believes that these circumstances comport with the general understanding of ownership and control in the context of trusts and further the CTA's objective of identifying true beneficial owners regardless of formalities that may vary across different jurisdictions." FinCEN, however, expressly acknowledges that "these concepts do not map easily onto every trust or similar arrangement." FinCEN is seeking comments on its general approach and the proposed examples for determining the attribution of ownership interests held in trusts or similar arrangements.

Most trusts used for estate planning purposes should not be considered reporting companies and should not be required to file reports with FinCEN disclosing their beneficial ownership. Information about the trust's beneficial owners (e.g., grantors/settlors, beneficiaries, trustees, etc.) may nonetheless be reported to FinCEN if the trust directly or indirectly owns an interest in a reporting company.

When beneficial ownership reports are required to be filed

Companies created before and after the effective date of the final regulations (which have yet to be issued) have different filing deadlines. Reporting companies formed or registered before the effective date must file initial reports no later than one year after the effective date of the final regulations. This is a change from the CTA, which allowed existing entities two years to file following the effective date. Entities formed or registered after the effective date must file an initial report within 14 days of the date they were formed or registered.

Reporting companies are also required to update information in a timely manner and correct any inaccurate information provided to FinCEN. The proposed regulations give reporting companies 30 days to file updates to previously filed reports (e.g., to report changes in beneficial ownership) and 14 days to correct inaccurate reports.

When the new beneficial ownership rules will take effect

It is unclear when the reporting requirements will become effective. While the CTA required FinCEN to issue final regulations by Jan. 1, FinCEN is seeking comments to the proposed regulations, which are not due until Feb. 7, after which FinCEN will consider the comments and issue final regulations. In the Notice of Rulemaking, FinCEN does not propose an effective date and is seeking views on the timing of the effective date.

Related Professionals

Rachel J. Harris . . . . rharris@loeb.com
Matthew McKim . . . . mmckim@loeb.com
Christina Hammervold . . . . . . chammervold@loeb.com
Di Fu . . . . dfu@loeb.com

6868 REV1 02-07-2022