By **Domingo P. Such III, Jamie A. Schafer** & **Gerard F. Joyce, Jr.**

The Corporate Transparency Act Six Months In

Despite hope for overturn or repeal, prepare to file on time

We last wrote about the Corporate Transparency Act (CTA) in the July/August 2023 issue of *Trusts & Estates,* when we were still months away from its Jan. 1, 2024 effective date. A lot has transpired since then, including recent constitutional challenges to the CTA and the Financial Crimes Enforcement Network's (FinCEN) periodic updates in the form of FAQs. We'll discuss these updates and their implications for entities deciding how and when they should file.

CTA Overview

The CTA was enacted in 2021 as part of the National Defense Authorization Act and is the latest extension of the anti-terror and money laundering programs of the Patriot Act. It was scheduled to be effective on Jan. 1, 2024 and went live then despite numerous calls for a delayed implementation. The CTA requires all legal entities formed before Jan. 1, 2024 to make their initial filing by Jan. 1, 2025. Entities formed in 2024 originally had only 30 days after formation to make their filing under the CTA but now have 90 days to do so as a result of a change FinCEN made on Dec. 1, 2023. Starting in 2025, newly formed entities will be subject to a 30-day deadline. For more detailed information about the CTA requirements, see "Key Concepts of the Corporate Transparency Act," pp. 62-63.

(From left to right) **Domingo P. Such III** and **Jamie A. Schafer** are partners and **Gerard F. Joyce, Jr.** is senior counsel, all at Perkins Coie



The FinCEN system to record the required beneficial ownership information (BOI) data has worked well, with no initial stoppages or outages, as feared, given the experience with the Affordable Care Act system for health care insurance. Much has been written about this system, particularly about IT security issues and the access afforded to governmental authorities and private parties.

By March of this year, it was clear that the CTA was facing significant pushback. The CTA is currently the subject of three federal court cases, and at least two new pieces of legislation have been introduced to either repeal or closely monitor this massive sharing of private information with the government. One proposed bill, entitled "Repealing Big Brother Overreach Act," doesn't leave one wondering what the bill's author thinks of the CTA.

In our discussions with clients and family offices, it's apparent that while many more are aware of the law, they seem unaware of its intricacies and uncertainties. Moreover, many haven't begun to plan adequately for their CTA filing while there's still time to do so. Our response is that planning and preparing to file must begin now as otherwise the CTA's complexities and ambiguities may prove too much for many affected entities—and deciding to delay planning based on the prospect of forthcoming judicial relief isn't a prudent bet given the potential penalties for not properly or timely filing.

Constitutional Challenge

Before we launch into an update on FinCEN guidance in the form of FAQs on topics ranging from IT security to how entities owned by trust companies are to be reported, we'll touch on what seems to be on the mind of nearly every individual or family office that's recently formed a limited liability company (LLC)

or other entity for business or estate-planning purposes: Is the CTA unconstitutional? Assuming the CTA is overturned, will relief come before the Jan. 1, 2025 deadline for filing BOI for so-called "existing" entities?

As of now, there are three court challenges to the CTA's constitutionality. First, there's *National Small Business United (NSBU) v. Yellen*,[1] in which a federal district court in Alabama declared that the CTA was unconstitutional because the commerce clause of the U.S. Constitution doesn't provide sufficient basis to authorize Congress to enact such legislation. In summary, in a well-written decision, the court held that the mere act of legal registration didn't give rise to interstate commerce and, therefore, the CTA interferes with each state's rights to govern the formation of entities within its jurisdiction. The decision has been criticized by those who call for repeal because it appears to give Congress (or possibly just FinCEN) the "roadmap" by which it can cure the constitutional defects. For example, if the CTA were limited to foreign entities doing business in the United States, as well as domestic entities that engage in interstate commerce, the district court might have upheld the CTA as constitutional.

The other two cases, one in Ohio and the other in Maine, deal with more fundamental constitutional breaches by arguing that the CTA violates the Fourth Amendment and the Bill of Rights because the information it requires ordinary citizens to reveal is along the lines of an unreasonable seizure of private information. The Maine case bases its objection on the argument that the CTA is an improper infringement of states' powers by the federal government. These constitutional claims get to the heart of personal freedoms and the limits on government, whereas the *Yellen* decision could be read to imply that Congress is permitted to require the entities to provide such information if it perhaps tweaks the scope of the CTA.

We'll leave deeper legal analysis of these weighty issues to the constitutional scholars and the judges who are contending with the continued assault on privacy, this time using a federal database on privately owned entities. The earliest indication of whether these challenges will hold should come in the form of a U.S. Court of Appeals for the 11th Circuit decision in *Yellen* before year-end. Should the 11th Circuit uphold the decision in favor of the NSBU, we understand that the 11th Circuit couldn't increase the scope of the injunction, and the plaintiffs would then presumably seek an emergency injunction from the U.S. Supreme Court (SCOTUS). If SCOTUS were to issue a nationwide injunction, it would likely get Congress' attention, especially if the underlying grounds were based on violations of personal freedoms or on federal versus state power under our federal system.

Many argue that the CTA has certain flaws, including privacy concerns and ambiguities impacting trusts and estates.

Many may wonder why the Alabama court chose not to enjoin FinCEN on a nationwide basis and instead chose to limit the scope of its decision by deciding to enjoin the CTA's application to the members of the NSBU as of the time of the proceeding. The simple answer is that the lower federal courts are generally loath to issue injunctive relief, especially against regulatory bodies dealing with existing versus prospective regulations that are found to be problematic.

Pushback Against the CTA

Many argue that the CTA has certain flaws, including privacy concerns and ambiguities impacting trusts and estates. Some have called for a delay of the effective date or repeal of the law.

Privacy. Providing personal information about how one has structured their wealth only increases privacy concerns. Any discussion about the CTA includes the topics of who has to access such a vast amount of private data and how the government will ensure that this information doesn't become the headline for the next big data breach. FinCEN and Congress recognized the potential for this breach as the penalties for misuse of the FinCEN database are

Key Concepts of the Corporate Transparency Act

Requirements of the new legislation

As we noted in this article, the Corporate Transparency Act (CTA) represented the most significant and perhaps intrusive revision to the U.S. anti-money laundering/counter-terrorist financing (AML/CTF) compliance framework in more than 20 years—since the Patriot Act of 2001, which imposed Know Your Customer regulations on all banks in the United States and requires financial institutions to comply with rules regarding a "Customer Identification Program" and "Customer Due Diligence."

The CTA broadens reporting to U.S. authorities of information—and personal identification documentation—concerning beneficial ownership of nearly all U.S. companies and foreign companies doing business in the United States, with the exception of a number of specifically exempted types. Treasury's Financial Crimes Enforcement Network (FinCEN) implemented the requirements through final regulations issued on Sept. 29, 2022.

Broad definition of "reporting company." Reporting obligations apply to U.S. domestic and foreign registered companies. Unless specifically exempted, beneficial ownership information (BOI) must be reported to FinCEN by any domestic entity "created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe," as well as foreign entities registered to do business through such filings.[1]

While this will include most entity types, trusts are largely excluded from the direct reporting requirements because they aren't typically created by the "filing of a document with a secretary of state or similar office."[2] This is welcome news to estate-planning practitioners, although it bears noting that this exclusion doesn't exempt entities owned by trusts from reporting.

Congress also specifically exempted 23 types of entities from reporting, including U.S. Securities and Exchange Commission registered issuers, banks and other types of regulated financial institutions, pooled investment vehicles, tax-exempt entities, large operating companies (defined as entities with more than 20 U.S. employees, U.S. operations and greater than $5 million in annual gross receipt or sales) and inactive entities formed prior to Jan. 1, 2020, without foreign owners and that hold no assets. Subsidiaries of exempt entities are also largely exempted from the reporting requirements, but unless it's a wholly owned subsidiary, it may not qualify for this "subsidiary" exemption.

Reporting requirements. FinCEN will require a reporting company to report the following information regarding all individuals and entities identified as "company applicants" (applicable only to entities formed on or after Jan. 1, 2024) or "beneficial owners" under the rule: name; birth date; address; and unique identifying number and issuing jurisdiction from an acceptable identification document, along with an image of that document.

Company applicants. These include: (1) the individual who directly files the document that creates the domestic company or the document that first registers a foreign company; and (2) the individual who's primarily responsible for directing or controlling such filing (if more than one individual is involved). In this regard, FinCEN has made clear its expectation that lawyers, paralegals and other service providers engaged in entity formations are likely to be considered company applicants in many circumstances, and their information (and personal documentation) must be included with these filings.

Interestingly, in recent guidance, FinCEN stated that there can only be two company applicants. In a case in which there are arguably more than two potential company applicants, most practitioners would deem the lawyer overseeing the filing to be a company applicant rather than the paralegal making the filing under the lawyer's direction.

"Beneficial ownership." This is more of a term of art as it's defined extraordinarily broadly under these new rules to include any—and all—individuals who, directly or indirectly, either:

> (1) exercise "substantial control" over a reporting company, or (2) own or control at least 25% of the ownership interests of a reporting company, including contingent rights (that is, "put, call, straddle, or other option or privilege of buying or selling"[3]). Substantial control individuals required to be reported under the rules explicitly include: senior officers (for example, "president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar

(Continued on p. 63)

Key Concepts of the Corporate Transparency Act

(Continued from p. 62)

function"[4]) and

(2) anyone else who "directs, determines, or has substantial influence over important decisions made by the reporting company" or has "any other form of substantial control over the reporting company."[5]

Notably, FinCEN has provided explicit rules about how it will view beneficial ownership in the context of entities owned through trust structures. FinCEN will look through revocable trusts and single beneficiary trusts as well as many non-discretionary trusts. In that context, individuals who will be required to be reported as beneficial owners of reporting entities owned by trusts will generally include:

- trustees of the trust or any individual with the authority to dispose of trust assets.
- any 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 trust assets.
- any grantor or settlor who has the right to revoke the trust or otherwise withdraw the trust's assets.

While ambiguities regarding the application of these rules remain, it's clear that FinCEN anticipates reporting broadly covering the group of individuals associated with each reporting entity. These expectations raise significant privacy implications for individuals holding ownership stakes in reporting companies and vast numbers of individuals associated with such companies, such as senior officers, managers and company applicants.

Consequences of non-compliance. Violations trigger civil penalties of $500 per day for each day a violation is outstanding up to a maximum of $10,000 and criminal penalties of up to two years imprisonment. However, unlike most other AML/CTF reporting violations, penalties for violations of these rules will apply only with regard to willful violations (for example, willful failure to file, willful provision of false or fraudulent information or willful failure to provide complete or updated beneficial ownership information). The CTA doesn't provide for penalties for negligent or reckless failures.

Notably, a "willful" violation could include circumstances involving "willful blindness" or "conscious disregard" that leads to a failure or false filing, substantially expanding the potential for inquiries and enforcement. Even more, the rules also provide for criminal or civil liability for "causing" a violation, increasing the pool of individuals who could be targeted for their role in failures beyond the individual or entity who technically files the report.

FinCEN "Identifiers." Using FinCEN Identifiers is a huge time saver compared to updating BOI every time a beneficial owner moves or their ownership share rises above the 25% threshold. In fact, getting an Identifier is very easy and takes less than 15 minutes. Individuals who can act under a power of attorney can also apply for the Identifier on behalf of the other person.

Subchapter S corporations. The updated FAQs clarify that Subchapter S corporations must comply with the CTA.

Filing fees. There's no fee for making the BOI report or for obtaining a FinCEN Identifier.

Parent companies. A parent company isn't allowed to file a consolidated report on behalf of its subsidiaries.

Financial institution access to BOI. A financial institution must obtain consent before obtaining any information from FinCEN.

Endnotes

1. *See* 31 C.F.R. 1010.380(c).
2. *Ibid.*
3. 31 C.F.R. 1010.380(d)(2)(i)(D).
4. 31 C.F.R. 1010.380(f)(8).
5. 31 C.F.R. 1010.380(d)(1)(i)(C) and (D).

— By Domingo P. Such III, Jamie A. Schafer & Gerard F. Joyce, Jr.

more severe than those for not complying with the CTA itself.[2]

IT security. A major portion of the FAQ updates issued by FinCEN in April 2024 covers user access and the safeguarding of BOI data by the BOI database users. Access to the BOI database will be rolled out with an initial "pilot" phase for select federal agency users, followed by more expanded federal access for agencies with agreements in place to handle Bank Secrecy Act information. A third phase slated for state and local agencies will start this fall, with foreign governments being able to request access this winter. Lastly, with the account holder's approval, financial firms will have access in spring 2025.

While the CTA may not be constitutionally vague or defective, the initial verdict seems to be that the CTA is wanting or, at best, unclear where it intersects with trusts and estates.

The FAQs also prescribe IT security protocols for BOI database users. For example, FAQ O.5 states that such users must have procedures in place to safeguard data and establish or designate a secure system approved by FinCEN for BOI data. There are also audit requirements for the system itself, and FinCEN must perform audits internally.

Potential data breach. If there's a BOI database breach despite these security precautions, there will likely be significant public and political backlash, as the recent Internal Revenue Service data breaches have underscored in the tax arena. A BOI database breach may spark an even stronger reaction as it would call into question why the government is collecting information that has, in most cases, been provided to the financial institution with whom the reporting entity has a financial account. Many may see that the IRS needs its information to enforce taxes, but the justification for FinCEN may not be as apparent, especially if it can't warehouse such information securely.

Unanswered questions and ambiguities. Another example of insufficient guidance is that there's no clarity on whether an entity wholly owned by a bank/trustee qualifies for the subsidiary exemption, and the issue gets even murkier if the trustee is a regulated private trust company. Modern trusts also use several roles beyond just trustees, such as protectors, directed trustees, distribution committees and appointers. FinCEN has yet to offer guidance to clarify whether these roles trigger BOI reporting. Likewise, common techniques like granting a so-called swap power or powers of appointment (POAs) aren't specifically addressed in the regulations or the FAQs. Regarding distribution committees, which likewise aren't mentioned in the CTA regulatory framework, does it matter whether there are two or seven committee members? Does a larger number imply that each committee member has insufficient control and isn't a beneficial owner? The same question arises for other roles ranging from protectors to appointers. These roles or rights may require a sophisticated legal assessment of how much authority or ownership they actually convey to determine control over a reporting entity.

While the CTA may not be constitutionally vague or defective, the initial verdict seems to be that the CTA is wanting or, at best, unclear where it intersects with trusts and estates. What's disappointing is that FinCEN has devised a massive data-gathering framework focused on private entities and the structures used to hold them, and yet it's left numerous questions unanswered regarding what must be reported.

Delay or repeal. A wide range of small business trade associations have called for the repeal of the CTA, with one letter claiming that 83% of its members were unaware of its requirements. Even the American Institute of Certified Public Accountants, representing the accounting industry, has called for a delay in implementing the CTA given its complexity and a lack of awareness in

general by small business clients about the BOI reporting requirements.

What to Do?

Yes, the CTA may ultimately be found to be unconstitutional. It's also true that the CTA framework isn't well adapted to the trusts-and-estates planning world that routinely uses entities and trusts to transfer and safeguard great wealth. Likewise, it isn't apparent how effective it will be in helping the government catch bad actors. This skepticism is carried by one legislator who's proposed that reports on CTA compliance be made to Congress periodically so its efficacy can be gauged (it's pointedly named the "Small Business Red Tape Relief Act of 2024").

In our discussions with attorneys, family office executives and individual clients, we've been struck by the hesitation that many clients and family offices have about starting a process to comply with the CTA for existing entities based on the hope that the courts will intervene to overturn the CTA. Even if it's declared unconstitutional, it could be well past the 2024 year-end date before the lower or intermediate appellate courts rule definitively on the issue. As a result, we see no choice but to be prudent and take steps to comply and file on time. For newly created entities facing a 90-day filing deadline, this is even more so as it's possible that the filing deadline will come before a court ruling.

Best Practices

Despite these objections, we stand behind our previous advice that follows the adage "hope for the best and plan for the worst." To this end, we reiterate the best practices:

(1) develop an appropriate process to identify reporting requirements;
(2) gather required information and documentation from impacted individuals;
(3) document exception decisions;
(4) monitor for necessary updates to CTA reporting; and
(5) appoint a dedicated reporting individual to adopt this practice. Family offices have adopted a common approach to have the responsibility of the person handling financial Know Your Customer regulatory reporting also to include responsibility for CTA reporting.

For now, (1) above is crucial. We suggest that all those involved with existing legal entities triage their situation. If it's simple, such as an LLC owned by just one individual (or an individual and their spouse), then waiting until later this fall makes sense as it's relatively simple to file in a timely manner once the judicial and legislative response is clear. If the situation isn't simple, it's best not to wait, as it may be much more complex than anticipated.

In complex structures, working with professionals from the outset is likely the best and, ultimately, fastest way to determine what needs to be reported. For example, if a structure has a series of generational trusts owned by a private trust company that also has protectors and a distribution committee along with swap powers and POAs, it's likely to require a series of legal judgments, perhaps interrelated, about the level of control that such individuals may or may not have.

Also, regarding (4) above, not only are some families choosing a person to be responsible for CTA compliance, but they're also maintaining such information on a CRM (client relationship management) system to warehouse the data and to draw connections between people and entities.

Those who choose to delay planning to file until the end of the year may find that there isn't enough time to analyze the structure to identify every person whose information needs to be reported properly.

Endnotes

1. *National Small Business United v. Yellen*, No. 5:2022cv01448 (N.D. Ala. 2024).
2. 31 U.S.C. Section 5336(h)(3)(B) with potential imprisonment of up to five years and potential fines of up to $250,000.