COMMITTEE REPORT:
ULTRA-HIGH-NET-WORTH FAMILIES & FAMILY OFFICES

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Prepare to Comply With Upcoming Corporate Transparency Act Reporting Rules

Implications for family offices and their advisors

You're likely already aware that the 2021 National Defense Authorization Act included a controversial new law, the Corporate Transparency Act (CTA), which directed the U.S. Department of Treasury to promulgate sweeping new corporate beneficial ownership reporting requirements relating to U.S. companies. This law represents the most significant revision to the U.S. anti-money laundering/countering the financing of terrorism (AML/CFT) compliance framework in more than 20 years—since the USA Patriot Act of 2001, which introduced and imposed "Know Your Customer" (KYC) 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 as well as foreign companies doing business in the United States, with the exception of a handful of specifically exempted entity types. Treasury's Financial Crimes Enforcement Network (FinCEN) implemented the requirements through final regulations issued on Sept. 29, 2022. With regard to reporting for newly created entities, the requirements are currently slated to become effective on Jan. 1, 2024. Entities created before the Jan. 1, 2024 date will have until Jan. 1, 2025 to make their initial filing.

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Ultra-high-net-worth (UHNW) families and family offices will be especially impacted by the CTA as they're often associated with multiple corporations and other entities and may maintain complex ownership structures as part of their estate and tax planning. While there are many exemptions to the CTA reporting requirements, as discussed below, it seems that few will be available to the types of corporate structures created to hold assets and investments of UHNW families and family offices. As a result, many UHNW family members and family offices will find themselves squeezed by these new rules, particularly with regard to maintaining personal privacy over their confidential personal information, assets and investments.

It bears noting that there are still important aspects of the reporting scheme to be worked out, including who will have access to the database of beneficial ownership information and under what circumstances as well as the technical particularities and data security considerations around collection and retention of the information. There are also multiple ongoing lawsuits challenging various aspects of the legislation. In light of these open issues, it's possible that the effective date of the rule could be delayed. However, FinCEN hasn't yet indicated that it will delay the effective date.

Here's a summary of some key concepts as well as pressure points and potential next steps to assist family offices and their advisors in preparing to navigate these new reporting requirements.

Key Concepts

Broad definition of "reporting company." Reporting obligations will apply to U.S. domestic and foreign registered companies. Under these new rules, unless specifically exempted, beneficial ownership

information will be required to 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 will be 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 won't exempt entities owned by trusts from reporting.

FinCEN 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.

Reporting requirements. FinCEN will require a reporting company to report the following information regarding all individuals and entities identified as "company applicants" 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 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) will be required to be included with these filings.

"Beneficial ownership" is 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, to include 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: (1) 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 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 with regard to how it will view beneficial ownership in the context of entities that are 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 other individuals (if any) 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 assets from the trust.
- Any grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust.

While ambiguities as to application of these rules remain, it's clear that FinCEN anticipates reporting to broadly sweep in the group of individuals associated with each reporting entity. These expectations raise significant privacy implications for individuals holding ownership stakes in reporting companies as well as vast numbers of individuals who are

associated with such companies 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 in the case of 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.

Pressure Points

There's no doubt that UHNW families and family offices will be impacted by the breadth of these new reporting requirements, even beyond the far-reaching definition of "beneficial ownership" with regard to trust beneficiaries and grantors. For example, in light of complex tax and family planning considerations, entities associated with relatively wealthy individuals or families will often be integrated into complicated corporate ownership structures that may be particularly difficult to unpack and accurately characterize to FinCEN.

These structures may also involve a myriad of individuals in family offices or otherwise serving in

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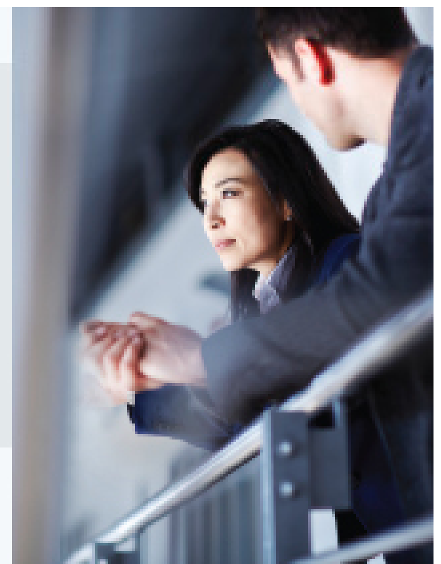


corporate service roles who will potentially trigger the substantial control definition under these rules. It may be logistically challenging to collect information and documentation for each of these individuals and ensure timely and appropriate updates to reports as structural changes are made. These individuals may also object to providing information and documentation required to make CTA reports or to serving in senior officer roles given the heightened potential liability for senior officers under the CTA.

Well-known celebrity and UHNW individuals and families will often have heightened privacy concerns, given their vulnerability to public attention and attacks and the impact that may have on their business interests. Information reported to FinCEN under these rules isn't contemplated to be publicly accessible and, in fact, it appears will be subject to some of the highest confidentiality designations available for governmental records. However, many federal agencies and even some state and local authorities will have access to CTA reports under certain circumstances. While the access rules haven't yet been finalized, it's expressly contemplated that banks and financial regulators will also have some level of access. The potential for leaks or hacks with regard to this information can't be discounted and raises considerable and valid concern, particularly with regard to individuals and entities that may be subject to heightened public interest.

What's Next?

The implementation of the CTA marks a sea change in the U.S. AML/CFT framework. While the final rule doesn't go into effect until Jan. 1, 2024, impacted individuals, family offices and entities should start preparing now. The best defense to potential allegations of willful violations under this rule will be robust procedures and documentation demonstrating good-faith in relation to compliance with the new regime.

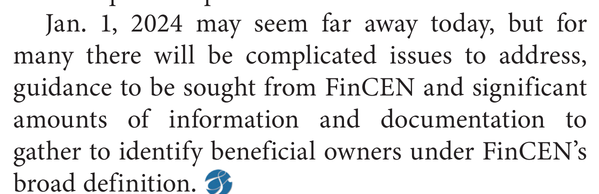
Recommended best practices will include: (1) developing an appropriate process to identify reporting requirements; (2) gathering required information and documentation from impacted individuals; (3) documenting exception decisions; and (4) monitoring for necessary updates to CTA reporting. Appointing a dedicated reporting individual to adopt this practice is recommended. A common approach being adopted by family offices is to have the job responsibility of the person handling financial KYC regulatory reporting to also include responsibility for CTA reporting. Reporting companies must submit reports within 30 days of corporate formation and update reports with any changes within 30 days. This will be a shortfused timeline in many circumstances involving complex ownership structures or ambiguous application of the rules.

Even when exemptions apply, decision makers should carefully document decisions regarding the application of exemptions to the reporting requirements to be positioned to address potential future regulatory inquiries regarding failure to report. Relatedly, given that these reports will be filed with federal regulators, internal procedures should include robust processes for vetting the fulsomeness and accuracy of all disclosures made under the rule to avoid future claims regarding willful false statements (or false statements or omissions made with willful blindness).

After an initial report is made, companies will also need a process to monitor changes to ensure that updates to CTA reports are made as required, which may be a daunting task if there are many individuals associated with an entity, for instance, as senior officers.

Thinking ahead to the Jan. 1, 2025 reporting requirements for entities formed prior to Jan. 1, 2024, compliance will require a process for identifying and inventorying these historical entities and gathering information and documentation to make required reports.

Jan. 1, 2024 may seem far away today, but for many there will be complicated issues to address, guidance to be sought from FinCEN and significant amounts of information and documentation to gather to identify beneficial owners under FinCEN's broad definition.



Endnotes

1. *See* 31 C.F.R. 1010.380(c).
2. *Ibid.*
3. 31 C.F.R. 1010.308(d)(2)(i)(D).
4. 31 C.F.R. 1010.308(f)(8)).
5. 31 C.F.R. 1010.308(d)(1)(i)(C) and (D).