

Corporate Transparency Act and Trusts

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Take-Away: The Corporate Transparency Act as applied to a conventional estate planning trust that holds a reporting entity leads to a lot of unanswered questions on who exactly a beneficial owner is who must be disclosed to FinCEN.

Background: We know that a conventional estate planning trust is technically not covered by the Corporate Transparency Act (CTA) unless, that is, that the trust holds a large interest in a reporting entity which is an entity that is created by filing a document with a Secretary of State, e.g., a corporation, limited partnership, or an LLC [ignoring the 23 statutory exceptions to the CTA.] Some parts of the CTA are easy to apply to trusts that may hold an interest in a reporting entity. Regarding ownership of a reporting entity, any individual may directly or indirectly own or control an interest in a reporting entity. The Regulations that implement the CTA provide four examples of how this general rule applies to a trust.

- i. A beneficiary of a trust will be treated as indirectly controlling an ownership interest in a reporting company if that beneficiary is the sole income and principal beneficiary of the trust.
- ii. A trust beneficiary who has the right to demand a distribution or withdraw substantially all the trust assets will also be an indirect owner of the trust assts.
- iii. A grantor who can revoke the trust is treated as indirectly controlling any interest in a reporting company held by the trust.
- iv. What seems to cause much confusion is that a “trustee or any other individual, if any, with authority to dispose of trust assets” will be treated as having indirect control over those trust assets.

The first three situations are easy to identify in which ownership of a reporting entity held in a trust is attributable to an individual deemed to be a beneficial owner. For example, the spouse-beneficiary of a QTIP trust that holds an interest in a reporting entity will have any entity ownership attributable to the surviving spouse, since a marital deduction trust can have only one beneficiary.

Power to Dispose: It is that last situation, where the authority to dispose of trust assets causes the confusion, and for which there is no guidance in the form of a Regulation to interpret the CTA. An example follows where this last situation can create confusion of who must be reported as a beneficial owner of the reporting entity that is held in an irrevocable trust.

Example: Rob creates an irrevocable discretionary trust for the benefit of his wife Laura and their son Ritchie, and Ritchie's two sons, Allan, and Brady. Laura is given limited powers of appointment, both lifetime and testamentary, over the trust, to appoint the trust assets among Rob's descendants. Rob names his employer-friend Mel as the trustee. This is a directed trust where Rob's neighbor Jerry (a financially successful dentist) is named as the investment trustee, and Rob's co-worker Sally is named as the distribution trustee. Another co-employee of Rob's, Buddy, is named as the trust director (protector) with the ability to remove and appoint the administrative trustee (Mel). Rob's trust holds 100% of the membership units of Petrie Investments, LLC, which LLC holds marketable securities. So, who are the beneficial owners of the LLC, who must be reported to FinCEN to comply with the CTA?

Look-Through Rule: While Rob's trust is the sole owner of Petrie Investments, LLC, (LLC) that does not make the trust the beneficial owner of the LLC. The LLC must look through any entity owner that is not itself an exempt entity and identify the individuals who are the 'true' beneficial owners of the LLC.

25% Ownership: An individual is a beneficial owner of the reporting entity if that individual either: (i) owns or controls at least 25% of the reporting entity, or (ii) exercises substantial control over the reporting entity. Rob's trust owns 100% of the LLC, so it satisfies the CTA's 25%+ ownership requirement.

Dispose of Trust Assets: As noted, there is no guidance from Treasury on what it means to dispose of trust assets. This then begs the question of how broadly the word 'dispose' is interpreted for purposes of reporting beneficial ownership information when dealing with a complex or sophisticated trust.

Mel the Trustee: The ability to sell an interest in the LLC that is owned by Rob's trust seems to be the ability to dispose of that asset. Consequently, Mel as the trustee of Rob's trust that owns the LLC should therefore be imputed ownership of the LLC held by the trust because Mel controls the trust investments.

[However, see below when this might not be correct.] Mel possesses the power to distribute trust assets to any of the trust beneficiaries, so his ability as the trustee to transfer assets would seem to fall within the concept dispose.

Laura the Power of Appointment Holder: Laura holds lifetime and testamentary powers of appointment over the trust assets. Thus, Laura is the holder of a presently exercisable power of appointment, and she is therefore able to 'dispose of trust property' during her lifetime. Therefore, the trust's ownership interest in the LLC will be imputed to Laura, the power of appointment holder. Note that if Laura only held a testamentary power of appointment over the trust assets, she would not have a present power of disposition and she would not need to be reported as holding a beneficial interest in the trust.

Jerry the Investment Trustee: If Jerry's position includes the power under the trust to determine whether to retain or sell an interest in the LLC, as the investment advisor/trustee Jerry can dispose of trust property, and he should have the ownership of the LLC owned by Rob's trust imputed to him. Jerry as the investment trustee may be a beneficial owner of the LLC if that attributed interest combined with any interest owned by Jerry himself directly exceeds 25% of the LLC.

Sally the Distribution Trustee: Since under Rob's trust Sally controls distribution of trust assets, including the possible distribution of the LLC units held in the trust, she too would be considered as a beneficial owner of the LLC.

Back to Mel, the Administrative Trustee: If the scope of the power of Jerry, the Investment Trustee, and the scope of power held by Sally, the distribution trustee, are sufficiently broad, then perhaps Mel is by default only the administrative trustee of Rob's trust. If that is the case, then Mel is best viewed as a nominee or agent, without any authority to dispose of trust assets, even though Mel owns legal title to the LLC. As a result, Mel as the administrative trustee would not be treated as a beneficial owner of the LLC. Yet, a conservative position might be to proceed and disclose Mel's beneficial owner information to FinCEN in the absence of any other guidance to the contrary since Mel technically owns the LLC.

Buddy, the Trust Director (Protector:) If an individual has substantial control over the reporting entity, he/she will be treated as a beneficial owner, even if the individual owns no equity in the reporting entity. An individual has substantial control over a reporting entity if that individual (i) serves as a senior officer of the entity; (ii) has authority to appoint or remove either a senior officer or a majority of its board of directors; or (iii) directs, determines, or has 'substantial influence' over important decisions of the reporting entity. With the example of Rob's trust, the trust owns 100% of the LLC. As such, Mel the trustee may have substantial control over the LLC because he can indirectly change the manager of the LLC or because he may have substantial influence over important LLC decisions. If Buddy, the trust director (protector), has the right to remove Mel as trustee and appoint a new trustee, that alone may be sufficient to conclude that Buddy may also be treated as a beneficial owner of the LLC. While Buddy has no direct control over the LLC, substantial control can be indirect. The power to appoint or remove a senior officer is treated as substantial control and makes the power holder a beneficial owner under the CTA. A similar result could be the case if Buddy can remove Mel as trustee, but perhaps not because the fiduciary duties of a trustee are materially different from those of a senior officer of the reporting entity.

The preamble to the final Regulations state that someone has 'substantial influence' over a reporting entity if they 'play a significant role in the decision-

making process and outcomes with respect to those important decisions. [87 Federal Regulations 59498, 59527 (September 30, 2022).] Admittedly it would be highly unusual for a trust director/protector to actually play any role in the decision-making process of a reporting entity that is owned by the trust. If the preamble provides some sort of direction, then perhaps a trust director (protector) will not be treated as a beneficial owner, but that is only a wild guess.

Providing Information: The last practical question without much guidance has to do with the trustee providing information to the reporting entity. Must the trustee furnish to the reporting entity a true and complete copy of the trust instrument? It is unlawful for a person to willfully fail to report complete or updated beneficial ownership information to FinCEN. FinCEN has made it clear that a beneficial owner who willfully causes a reporting entity to file required beneficial ownership information violates the statute and may be liable for civil or criminal penalties. It is not currently clear if a trust instrument is the type of information FinCEN referred to, or if it is limited to beneficial ownership information. And what about silent trusts that are soon to come to Michigan. Consider a trust beneficiary who only holds a limited power of appointment over a silent trust; how does the reporting entity go about obtaining the power holder's driver's license to fulfill its reporting obligation to FinCEN?

Conclusion: The CTA and its vague Regulations currently provide for broad ownership attribution from the trust to the trustee, to the trust beneficiaries, possibly to the trust's settlor, to holders of powers of appointment, and perhaps even to the power of a trust director (protector) to remove and replace a trustee. Additional attribution of ownership can also extend to trust directors or directed trustees (in their investment and distribution roles.) That is a lot of people who might have to be reported to FinCEN as beneficial owners of the reporting entity that is held in a trust. We can only hope that additional Regulations are published over the coming year that help trustees and reporting entities more easily identify who is a beneficial owner when a trust owns a 25%+ interest in a reporting entity.