**Steve Leimberg's Business Entities Email Newsletter - Archive Message #296**

**Date:** **28-May-24**

**From:** **Steve Leimberg's Business Entities Newsletter**

**Subject:** **Martin M. Shenkman, Thomas Tietz & Jonathan G. Blattmachr: Trusts and Trustees Under the Corporate Transparency Act**

*"Under the Corporate Transparency Act, certain information about the Beneficial Owners of certain 'small' entities must be provided to the Financial Crimes Enforcement Network of the US Treasury Department. When a trust is an equity owner of a reporting company, it can create significant reporting requirements for individuals named as powerholders in the trust. Which positions in a trust rise to the level of being a Beneficial Owner are based on the '[p]articular facts and circumstances…' of that trust. While FinCEN updated their Beneficial Ownership Information Frequently Asked Questions on April 30th and provided additional guidance on trusts, that guidance is in many cases ambiguous and there are many unanswered questions that create a minefield of issues for both clients and practitioners to address."*

**Martin M. Shenkman, Thomas Tietz** and **Jonathan G. Blattmachr** provide members with commentary that examines the reporting obligations of trusts and trustees under the Corporate Transparency Act.

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Here is their commentary:

## EXECUTIVE SUMMARY:

Under the Corporate Transparency Act ("CTA"), certain information about the Beneficial Owners of certain "small" entities (called a "Reporting Company" or "Reporting Companies") must be provided to the Financial Crimes Enforcement Network ("FinCEN") of the US Treasury Department.[i] When a trust is an equity owner of a reporting company, it can create significant reporting requirements for individuals named as powerholders in the trust. Which positions in a trust rise to the level of being a Beneficial Owner are based on the "[*p]articular facts and circumstances…*"[ii] of that trust. While FinCen updated their Beneficial Ownership Information Frequently Asked Questions ("FAQ") on April 30th and provided additional guidance on trusts, that guidance is in many cases ambiguous and there are many unanswered questions that create a minefield of issues for both clients and practitioners to address.

## COMMENT:

### Are Trusts Reporting Companies Under the CTA?

Most trusts are not Reporting Companies, but as the FAQs point out, as with the traditional joke about a lawyers answer to every question, the

FAQs begin with “It depends.” They continue to explain that a domestic entity such as a statutory trust, business trust, or foundation is a Reporting Company only if it was created by the filing of a document with a secretary of state or similar office.[iii] Most trusts do not file to be formed and are rather created by contract. But as with so many legal matters, state laws vary as to whether certain trusts (sometimes called “statutory” or “business” trusts) require the filing of a document with the secretary of state to be created. If a trust is created in a U.S. jurisdiction that requires such filing, then it is a Reporting Company, unless an exemption applies. But if a trust is a Reporting Company, it should then consider if it may nonetheless be exempt from filing. For example, a foundation may not be required to report beneficial ownership information to FinCEN if the foundation qualifies for the tax-exempt entity exemption.[iv]

Another exception that might apply to trusts is quite limited. If a trust registers with a court to establish the court’s jurisdiction over any disputes involving the trust, that alone would not constitute a registration that would trigger reporting under the CTA.[v]

## Beneficial Owners Owning or Controlling a Reporting Company Through a Trust

The FAQ provides the following guidance to this significant question for estate planning: “*Yes, beneficial owners can own or control a reporting company through trusts. They can do so by either exercising substantial control over a reporting company through a trust arrangement or by owning or controlling the ownership interests of a reporting company that are held in a trust.*”[vi]

In a simple trust situation, if a trust owns 25% or more of an entity that is classified as a Reporting Company, then the trust would be deemed an owner which is required to report Beneficial Ownership Information. If a trust owned less than 25% of an entity that is classified as a Reporting Company, then an analysis would have to be performed to determine whether the trust can exercise substantial control over the entity. But there is another prong to the analysis about which the FinCEN guidance provides little insight. If the trust might exercise substantial control over the Reporting Company, which individuals named in trust positions, powerholders, etc., could be those who exercise the requisite control. That might require an analysis of the trust instrument and any amendments. Given the complexity of modern trusts, if a powerholder acted, or a trustee decanted (that is, transferred the assets to another trust), or perhaps if a

trust director or protector (which might be labeled under different titles depending on the draftsperson involved) has acted, the ancillary documents evidencing those actions would have to be identified and evaluated. The Reporting Company's governing documents may be relevant to the analysis. There may be many other relevant documents apart from the obvious trust instrument and operating (or other) agreement for the Reporting Company that could impact the analysis. The FinCEN guidance does not provide any meaningful insight into this analysis.

The FAQs elaborate on trust ownership or control of a Reporting Company. FinCen poses the question: "*Who are a reporting company's beneficial owners when individuals own or control the company through a trust?"*[lviii]

Following is the text of FAQ D.15, which will then be analyzed:

"*A beneficial owner is 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. Exercising substantial control or owning or controlling ownership interests may be direct or indirect, including through any contract, arrangement, understanding, relationship, or otherwise."*

In the context of a trust with one beneficiary and one trustee, this is the trustee, as indicated above. However, consider what this might mean if a complicated trust is involved. A trust might have an investment advisor or trustee who can exercise control over trust investment assets. The person serving in that capacity would seem to be an individual who exercises substantial control over a Reporting Company holding investment assets owned by a trust. Some trusts have several different investment advisor roles. A trust might name a different trust advisor for marketable securities, for life insurance, and for private equity. In such a situation, it would seem that only the trust advisor with authority over private equity assets would be deemed a Beneficial Owner. Trusts may hold entities where the only asset is a residential property occupied by a beneficiary. For those entities (which under the CTA are typically considered a Reporting Company) trust terms may dictate a distribution trustee or advisor has substantial control over the entity. In addition, might there be a distinction between a trust that is a directed trust (in which the investment advisor directs the trustee as to what actions to take with respect to trust investment assets) and a delegated trust (in which the trustee may delegate to the named person investment decisions but for which the trustee nonetheless retains some measure of oversight responsibility)? It would seem, given the lack of specific FinCEN

guidance and the potential severity of penalties for failing to file,[viii] that the prudent approach would be to have all such persons file and not to endeavor to parse through whether the person holding delegated investment authority or distribution authority might avoid filing because of the responsibility retained by the trustee.

*"Trust arrangements vary. Particular facts and circumstances determine whether specific trustees, beneficiaries, grantors, settlors, and other individuals with roles in a particular trust are beneficial owners of a reporting company whose ownership interests are held through that trust."*

The FAQ's above language seems to acknowledge that "other individuals with roles in a particular trust" suggests or encompasses the wide array of positions, powerholders, etc., that the myriad varieties of trusts might include. All individuals named in the trust must be evaluated to ascertain whether they are Beneficial Owners required to report.

*"For instance, the trustee of a trust may be a beneficial owner of a reporting company either by exercising substantial control over the reporting company, or by owning or controlling at least 25 percent of the ownership interests in that company through a trust or similar arrangement. Certain beneficiaries and grantors or settlors may also own or control ownership interests in a reporting company through a trust. The following conditions indicate that an individual owns or controls ownership interests in a reporting company through a trust:*

- *"a trustee (or any other individual) has the authority to dispose of trust assets;"*

The authority to dispose of trust assets could include various modern trust positions. In many trusts, a trustee may have that authority. Co-trustees would all seem to be Beneficial Owners. The authority to dispose of investment assets could be controlled instead, as discussed above, by an investment advisor or director. Someone holding a lifetime power of appointment who could, by the exercise of that power, shift the interests in a Reporting Company held by the trust to a new trust or person would also seem to hold the "authority to dispose of trust assets." A person holding power to loan trust assets to the settlor, a power that has been used historically to characterize a trust as a grantor trust for income tax purposes pursuant to Section 675(4)(C) of the Internal Revenue Code (Code), but

which more recently has been used to provide another potential means of access to trust economic value to a settlor, would also seem to be characterized as a Beneficial Owner. Many modern trusts have positions such as a trust protector, whose rights and power can vary dramatically. In a narrow drafting, a trust protector may only have the power to remove and replace a trustee or change the situs and governing law of a trust. In a broader context, some draftspersons give an array of powers to the trust protector. So, whether a trust protector has the power to "dispose of trust assets" will depend on the terms of the governing instrument and perhaps state law as well. But even if the trust protector avoids Beneficial Owner status by not being able to "dispose of trust assets," the control that the trust protector may exercise over the persons who directly can "dispose of trust assets," such as the power to remove and replace those persons, may itself characterize the trust protector as a Beneficial Owner.

- *"a beneficiary 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; or"*

In a simple trust, a person may be named as the sole permissible recipient of income and principal and hence be deemed a Beneficial Owner. For example, in a QTIP marital trust[ix] the surviving spouse may be named as the sole "permissible recipient of income and principal from the trust." But what if, for example, in a second or later marriage situation, the surviving spouse is not named a beneficiary of principal (but only if income)? It would seem that the spouse might not, under such trust terms, be a Beneficial Owner. But what if the surviving spouse is named as only an income beneficiary, but the trust is governed by the laws of a state, like New Jersey, that has the power to adjust so corpus can be considered income? What if the trust is governed by the laws of a state, like Delaware, that permit a unitrust election that might once made require the payment of portions of QTIP corpus to the surviving spouse? Would either of those situations then make the surviving spouse qualify as a Beneficial Owner as then meeting the requirements of "*the sole permissible recipient of income and principal*?" Is it worth the cost of trying to evaluate these issues in light of the vagueness of the FinCEN guidance and when compared to the cost of having the surviving spouse (or other beneficiaries as applicable in another type of trust) simply obtain a FinCEN Identifier number and then provide it to the Reporting Company?

When might a beneficiary have "*the right to demand a distribution of or withdraw substantially all of the assets from the trust*?" In a Beneficiary Defective Irrevocable Trust, or "BDIT,"[x] the beneficiary may be given an annual demand power to withdraw assets. In the first year, the settlor, e.g., a parent of the beneficiary who will be characterized as the "grantor" of the trust for income tax purposes, may make a $5,000 gift to the trust. The beneficiary's right to withdraw that would constitute "*the right to demand a distribution of or withdraw substantially all of the assets from the trust*." What if, later that year, the beneficiary sells a valuable asset to the trust? In the following year, the value of the trust has grown substantially so that any withdrawal right would no longer constitute "*the right to demand a distribution of or withdraw substantially all of the assets from the trust*." Does that beneficiary no longer constitute a Beneficial Owner even though he or she had been one in the prior year? Does that constitute a change in Beneficial Owners that requires that an updated report be filed within 30 days?[xi] How, and more importantly, when might that change in Beneficial Owners have occurred? It would seem that the date on which the value of trust assets increases to the point that the beneficiary's "*right to demand a distribution of or withdraw*" no longer encompasses "*substantially all of the assets from the trust*." In most, if not all, instances BDIT transactions involve the sale of private equity. Is an appraisal required to determine when the threshold of "substantially all" is no longer crossed? As with prior discussions above, these requirements are unclear and likely impossible to meet.

The FinCEN Small Business Guide states: "*In addition to filing an initial BOI [beneficial owner information] report, reporting companies must also update and correct information in their previously filed BOI reports. Individuals who obtain FinCEN identifiers must also update and correct information previously reported to FinCEN*." The Guide provides: "*A change in beneficial owners, such as a new Chief Executive Officer, a sale that changes who meets the ownership interest threshold of 25 percent, or the death of a beneficial owner*."[xii] These seem focused on identifying information as to new Beneficial Owners. The Guide provides that "There is no requirement to report a company's termination or dissolution." But it does not address the cessation of Beneficial Owner status. Thus, a change in Beneficial Owners, even if it does not result in a new Beneficial Owner may have to be reported. Certainly, with the specter of a $500/day inflation-adjusted fines, etc., it may be sensible to err on the side of reporting rather than not reporting.

- *“a grantor or settlor has the right to revoke the trust or otherwise withdraw the assets of the trust.”*

The obvious type of trust that would be subsumed by the criteria “*a grantor or settlor has the right to revoke the trust*” is a revocable trust, sometimes called a “living” trust. The typical revocable trust provides the grantor the unfettered right to modify or revoke the trust at any time. What if the settlor’s power to revoke is contingent upon the approval of an independent, non-adverse person, such as the settlor’s attorney? That type of mechanism is sometimes used to endeavor to reduce the risk of elder financial abuse by having a check and balance on a family member or home health aid from manipulating an elderly or infirm settlor into modifying a revocable trust to change the dispositive plan favoring the perpetrator. If that type of mechanism is used, does the settlor still meet the criteria of the above requirement to be deemed a Beneficial Owner? Perhaps. More nettlesome, does the person holding the approval power, e.g., the family attorney, now become characterized as a Beneficial Owner who is required to report? Perhaps, maybe probably. But as with several similar ambiguities above, given the penalties and lack of clear guidance, is it worth the risk of not reporting? Is it worth the cost of having counsel analyze the document and FinCEN guidance knowing that there is likely no clear answer worth incurring in lieu of filing, which might be required, or even if not required, likely advisable, in any event?

A person holding a power to swap or substitute trust assets would certainly seem to meet the above criteria. That person is typically the settlor of the trust, but according to some commentators, can be another person as well. So, the governing trust instrument, as well as any ancillary documents modifying the trust instrument, will have to be reviewed to ascertain who that person may be. In some instruments, if the grantor designated as holding the power to substitute cannot serve because of incapacity, the trust may name the agent under the grantor’s durable power of attorney to instead hold the power. Thus, the agent may also be required to file. But if the grantor is not incapacitated, or if the durable power of attorney is a springing power (that is, one that becomes effective upon the occurrence of a future event), it would seem that would not be required initially. However, might that then imply that if the grantor is incapacitated and a named successor (whether the agent under the grantor’s power of attorney, someone designated as successor powerholder in the instrument, or

someone appointed as a successor if and as that may be permitted in the instrument) steps in, it would trigger the need to file updated information for all Reporting Companies affected within 30-days as a change in Beneficial Owners? What if the named successor takes office only upon agreeing in writing to serve?

Because there are no uniform standards for drafting the powers given to the array of positions that a modern trust might include, nor to the titles of persons holding those rights, each trust will have to be reviewed in some measure of detail to ascertain which persons might be caught in the Beneficial Owner net. But in the end, it seems that for many trust situations, obtaining a FinCEN Identifier number for almost anyone involved and providing that information to the Reporting Company may be the prudent and economical approach. But, even that approach is not without issue since each person filing will then be obligated to file updates within 30 days if their Beneficial Owner Information changes. In addition, if they are no longer deemed a Beneficial Owner, then it appears that the Reporting Company will have to report that.

FinCEN concludes this FAQ with the following: *"This may not be an exhaustive list of the conditions under which an individual owns or controls ownership interests in a reporting company through a trust. Because facts and circumstances vary, there may be other arrangements under which individuals associated with a trust may be beneficial owners of any reporting company in which that trust holds interests*."

It is a common practice for some practitioners to appoint entities instead of individuals for various positions in a trust, such as the trust protector. Some believe that the use of an entity might insulate the person (or persons, as committees of people are sometimes used) from liability. Also, if the person is resident in a state other than the state where the trust is formed, that second state may use the person's residency as a basis to assert jurisdiction over the trust. For example, the settlor creates a trust in a trust-friendly jurisdiction like Nevada but is a resident in a state like New York. The person that the settlor wishes to name as trust protector resides in New York. Perhaps creating an entity in Nevada to "house" the person serving in that role and having the entity, not the person, named in the trust instrument might remove the potential connection to New York by one measure. Now, under the CTA, it is likely that the entity will be considered a Reporting Company and must file, and the person named in that entity

serving must provide information as a Beneficial Owner of that entity if a Special Purpose Entity ("SPE") holds no assets and does not engage in an active business., could it meet the inactive entity exemption? [xiii] If the trust for which the entity serves as a trust protector in turn owns interests in other entities that are considered Reporting Companies, the individual in the trust protector entity may also have to be indicated as a Beneficial Owner of those entities as well. Remember the funhouse mirrors where you look in one mirror and another is directly behind you, and it appears as if you have an infinite number of reflections?

## How Does A Reporting Company Report A Corporate Trustee As A Beneficial Owner?

The FAQ provides: "*For purposes of this question, 'corporate trustee' means a legal entity rather than an individual exercising the powers of a trustee in a trust arrangement. If a reporting company's ownership interests are owned or controlled through a trust arrangement with 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."* [xiv]

The above comment presumes a "corporate" form of ownership for the institutional trustee (perhaps a better phrase for FinCEN to have used in this FAQ), but it would seem that the guidance of this FAQ would apply even if the institutional trustee were organized as a limited liability company or other entity.

- *For example, 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 percent × 50 percent = 30 percent) of the reporting company's ownership interests and is therefore a beneficial owner of the reporting company.*
- *By contrast, 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 percent × 30 percent = 18 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*.

Consider that the corporate trustee may be an exempt entity itself, but if the trust over which the corporate trustee serves as a trustee owns sufficient interests in a Reporting Company, based on the above FAQ, a controlling equity holder of the corporate trustee may be deemed a Beneficial Owner of the Reporting Company. Assume that the equity holder obtains a FinCEN Identifier number and provides that to the Reporting Company. If there is a change in ownership of the exempt corporate trustee, the Reporting Company may be obligated to report that change within 30 days.

"*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.*

The above discussion in the FAQ may permit a Reporting Company to avoid reporting information about the equity holders of a corporate trustee in a common trust structure. For example, the settlor created a grantor trust and transferred sufficient interests in a family business to that trust such that the trust, but for it being exempt from CTA reporting, would otherwise be a Beneficial Owner. As is common, but far from universal, the trust is structured as a directed trust with a family member, perhaps the settlor, serving as an investment adviser. The institutional trustee's equity holders' only involvement with or interest in the Reporting Company is that the institutional trustee of which they are an equity holder serves as trustee of the trust, owning an interest in that Reporting Company. That would seem to avoid a need to report information on the institutional trustee's equity holders in many, perhaps most, estate planning trust structures. The FAQ provides in such instances that the Reporting Company may only have to report the name of the institutional trustee. It would seem that the only further obligation of the Reporting Company would be to report a change in the name of the institutional trustee.

The FAQ continues: *"In addition to considering whether the beneficial owners of a corporate trustee own or control the ownership interests of a reporting company whose ownership interests are held in trust, it may 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*."[xv]

If the trust is not structured as a directed trust, an institutional trustee may have sufficient responsibility or control over the Reporting Company that the equity holders of the institutional trustee may have to report as Beneficial Owners. Does the trustee's duty of loyalty, which requires a trustee to act solely in the interests of the beneficiaries, affect this analysis? Even if the trust instrument requires that the trustee continue to hold a particular business interest, the trustee may have a duty under state law to diversify that holding. If that is the case, would that impact the level of control the trustee is deemed to have and, hence, the obligation to report under the CTA?

## Conclusion

The CTA remains opaque at best. Despite a laudable amount of guidance from FinCEN, many common trust arrangements and how they should be handled remain unaddressed or, if addressed, unclear. While the refrain "when it doubt file" may have some validity for CTA filing questions generally, it is not without potentially adverse implications as filings, once made, may trigger the requirement for updates. With substantial penalties for foot faults, the CTA, especially as it pertains to complex trust planning, remains worrisome.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!**

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## CITATIONS:

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[i] Small Entity Compliance ("Guide"), Chapter 2.3.

[ii] FinCen FAQ D.15.

[iii] FAQ C. 3. Are certain corporate entities, such as statutory trusts, business trusts, or foundations, reporting companies?

[iv] 31 CFR § 1010.380.(c).2.xix.A

[v] FAQ D.13.

[vi] FAQ D.14.

[vii] FAQ D.15.

[viii] The CTA includes both potential civil and criminal penalties. The civil penalties are $500 a day, inflation adjusted ($591 in 2024) and criminal penalties are $10,000 and up to 2 years in prison. 31 U.S.C. §5336(h)(3)(A).

[ix] Described in Section 2057(b)(7) or 2523(f) of the Code.

[x] Described in Section 678 of the Code.

[xi] See FAQ H. 2.

[xii] Small Business Guide Sec. 6.1.

[xiii] FAQ L. 2.

[xiv] FAQ D.16.

[xv] See Chapter 2.1 of FinCEN's Small Entity Compliance Guide, "What is substantial control?" for additional information on how to determine whether an individual has substantial control over a Reporting Company.