

April 7 2022

Reporting beneficial owners of certain US companies: proposed regulations on who must file beneficial owner report

**Kozusko Harris Duncan | Private Client & Offshore Services - USA**

- › **Background**
- › **Proposed regulations and comments**
- › **Reporting company**
- › **US Virgin Islands entities and other US territories**
- › **Exemptions to reporting company**
- › **Registered to do business in United States**
- › **Comment**

On 7 December 2021, the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued proposed regulations with details to begin compiling a beneficial owner register for US companies under the Corporate Transparency Act (CTA). The register, which is not available to the public, will include details for US companies in a family's succession planning structure. This article is the first in a series reviewing the proposed regulations relevant to family advisors and noting continuing questions, beginning with who must file a report.

### **Background**

Enacted 1 January 2021, the CTA establishes a beneficial owner reporting regime for US companies, pursuant to which reporting companies must submit a report containing "beneficial owner" and "company applicant" information (together, "beneficial ownership information" (BOI)). FinCEN

SEVERIANO E ORTIZ,  
JENNIE CHERRY, BRYAN  
HOSEOK OK



will oversee implementation and enforcement. The stated goal of the CTA is to combat abuse of anonymous companies, money laundering, terrorist financing and other illicit activities (for further details please see "Reporting beneficial owners of certain US companies – details of new Corporate Transparency Act").

The proposed regulations are intended to clarify the various BOI requirements of the CTA, including:

- who must file a BOI report;
- what constitutes beneficial ownership;
- what information must be disclosed in a BOI report; and
- when the information must be reported.

This article summarises the proposed regulations regarding who must file a BOI report.

### **Proposed regulations and comments**

The CTA required FinCEN to issue implementing regulations by 31 December 2021. The proposed regulations are not final and a public comment period ended on 7 February 2022. FinCEN received over 230 comments. The Society of Trusts and Estate Practitioners, New York Branch (STEP NY) submitted comments to FinCEN on a select few topics relevant to STEP NY members and their clients,<sup>(1)</sup> as did various other similar organisations, including the American College of Trust and Estate Counsel (ACTEC).<sup>(2)</sup> The effective date of the final regulations will determine the timing of the required disclosures.

### **Reporting company**

Only a reporting company is required to file a BOI report with FinCEN. The CTA defines a "reporting company" as any corporation, limited liability company (LLC) or other similar entity that is created by filing a document with a US state or formed under the law of a foreign country and registered to do business in the United States. The proposed regulations further describe these two types of reporting companies as:

- "domestic reporting companies", which includes any entity that is a corporation, LLC or other entity created by filing a document with a

US state; and

- "foreign reporting companies", which includes any entity that is a corporation, LLC or other entity formed under the law of a foreign country and registered to do business in the United States by filing a document with a US state.

The proposed regulations interpret the CTA's statutory definition of "other similar entities" broadly as any other entity that is created by filing a document with a US state. Corporations and LLCs require the filing of a certificate of formation in order to take advantage of a state's limited liability laws. In addition, state law will generally require a filing to create limited partnerships, limited liability partnerships and business trusts (also known as "statutory trusts" or "Massachusetts trusts").

Traditional inter vivos succession planning trusts that are not statutory business trusts created by a state filing should not fall within the scope of the CTA. Likewise, a sole proprietorship or unincorporated association that has no legal existence separate from the associated individual or individuals should not be considered a reporting company for CTA purposes. However, FinCEN recognises that individual states may differ on whether certain types of entities, such as common law general partnerships, other types of trusts and sole proprietorships, are created by a filing, so the proposed regulations do not categorically include any particular legal forms other than corporations and LLCs.

The change from other "similar" entity to any other entity created by filing a document with a US state would seem to open the door to including a testamentary trust created by filing a decedent's will with a state court, although such a trust would generally not be considered a company.

### **US Virgin Islands entities and other US territories**

The proposed regulations define "state" as:

- any state of the United States;
- the District of Columbia;
- the Commonwealth of Puerto Rico;
- the Commonwealth of the Northern Mariana Islands;
- American Samoa;

- Guam;
- the United States Virgin Islands; and
- any other commonwealth, territory or possession of the United States.

Thus, even though a US Virgin Islands exempt company, which is sometimes used in family succession planning structures, is considered to be a foreign company for estate tax purposes, it will be a reporting company for CTA purposes (for further details please see "Estate and gift tax situs of assets – specific examples").

### **Exemptions to reporting company**

The proposed regulations generally adopt verbatim the CTA's statutory language exempting 23 specified entities from the definition of "reporting company". Those exempted entities are either already subject to regulations under which beneficial ownership is disclosed or are considered to be legitimate companies evidenced by their larger size with substantial operations in the United States (for further details please see "Reporting beneficial owners of certain US companies – details of new Corporate Transparency Act"). The proposed regulations do not add any new categories of exempt entities at the moment, but they have clarified some categories of exempt entities for which the statutory language is ambiguous.

#### ***Large operating company exemption***

Under the CTA, the "large operating company exemption" exempts companies that:

- employ more than 20 employees on a full-time basis in the United States;
- filed in the previous year federal income tax returns in the United States demonstrating more than \$5 million in gross receipts or sales in the aggregate; and
- have an "operating presence at a physical office" within the United States.

The proposed regulations explain that an entity with an operating presence at a physical office within the United States means that the entity:

*regularly conducts its business at a physical location in the United States that the entity owns or leases, that is not the place of residence of any individual, and that is physically distinct from the place of business of any other unaffiliated entity.*

Moreover, the proposed regulations clarify that the \$5 million filing threshold is based on gross receipts or sales (net of returns and allowances) on the entity's Internal Revenue Service (IRS) Form 1120, IRS Form 1065 or other applicable IRS form, excluding gross receipts or sales from sources outside the United States, as determined under federal income tax principles.

### ***Subsidiary exemption***

The "subsidiary exemption" under the CTA exempts an entity from being a reporting company if its ownership interests are owned or controlled (either directly or indirectly) by another exempted entity. To meet this exemption, the proposed regulations clarify that the subsidiary must be owned entirely by one (or more) other exempt entities.

### ***Inactive entity exemption***

The "inactive entity exemption" exempts certain companies that existed for more than a year and satisfied certain other conditions. The proposed regulations interpret this exemption as a grandfathering provision applicable only to entities in existence for more than one year at the time the CTA was enacted (ie, an entity that was in existence on or before 1 January 2020).

### ***STEP NY comments***

STEP NY recommends that FinCEN extend the exemptions to include all professional service organisations that are regulated by licensing boards. In addition, STEP NY has suggested that FinCEN consider creating a new exempt category for foreign-owned disregarded companies that file IRS Form 5472 to report transactions with their foreign owners and related entities (for further details please see "Completing US tax forms: Form 5472 – foreign-owned disregarded entities").

### ***Claiming exemption***

The proposed regulations do not include any procedure for claiming an exemption from reporting company requirements. It is currently unknown whether there would be any kind of separate filing needed to claim an

exemption. Separate filings may be necessary for FinCEN to verify that companies are claiming valid exemptions and to aid in enforcement when FinCEN begins to follow up with companies that do not appear on the beneficial owner register.

### **Registered to do business in United States**

The proposed regulations define a "foreign reporting company" as any entity that is a corporation, LLC or other entity that is formed under the law of a foreign country and that is "registered to do business" in the United States by filing a document with the secretary of state or equivalent office under the law of a state or Indian Tribe. Generally, a jurisdiction within the United States will require any legal entity formed under the law of any other jurisdiction (including other US states) to register to do business as a "foreign" entity if it engages in certain types of transactions (each state has different rules). There are outstanding questions, however, about which FinCEN requested comments, including:

- what activities will trigger foreign entity registration requirements;
- whether compliance with those requirements constitutes "registered to do business"; and
- whether FinCEN should further clarify this "registered to do business" requirement.

ACTEC is of the opinion that the definition of "registered to do business" may be overly broad and leave room for ambiguity and cause disparate treatment among various states due to the variation among state laws. ACTEC proposes that FinCEN give this definition additional consideration and provide broad line tests to make it easier to determine whether registration requirements apply to a particular foreign entity.

### **Comment**

Only an entity that meets the definition of a "reporting company" is subject to the requirements of the CTA. Advisors to families with succession planning structures should take steps now to identify all entities within each structure that were created by filing a document with a US state or that were formed under the law of a foreign country and then registered to

do business in the United States. The proposed regulations provide sufficient clarity for the advisor to determine whether an exemption applies to any identified US entity.

While the proposed regulations provide guidance and clarification to some of the uncertainties raised by the CTA, especially in the context of family succession planning structures (for further details please see "Reporting beneficial owners of certain US companies: observations relevant to private client structures"), there are still outstanding issues and concerns requiring further clarification by final regulations.

*For further information on this topic please contact Severiano E Ortiz at Kozusko Harris Duncan's Washington DC office by telephone (+1 202 454 6721) or email ([sortiz@kozlaw.com](mailto:sortiz@kozlaw.com)). Alternatively, contact Jennie Cherry or Bryan Hoseok Ok at Kozusko Harris Duncan's New York office by telephone (+1 212 980 0010) or email ([jcherry@kozlaw.com](mailto:jcherry@kozlaw.com) or [bok@kozlaw.com](mailto:bok@kozlaw.com)). Please note that the authors are unable to provide legal advice to non-clients. The Kozusko Harris Duncan website can be accessed at [www.kozlaw.com](http://www.kozlaw.com).*

Copyright in the original article resides with the named contributor.

### **Endnotes**

(1) STEP is a global professional body, comprising lawyers, accountants, trustees and other practitioners that help families plan for their futures. For more information, [click here](#).

(2) ACTEC comments include a background discussion of common trust structures used in the United States and responds to questions related to beneficial owner, company applicant and reporting company. ACTEC's comments can be found [here](#).