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Unpacking CTA Disclosure Complexity With Private Trust Companies

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With beneficial ownership reporting requirements under the Corporate Transparency Act soon to take effect, McDermott's Harry T. Dao and Elise J. McGee examine whether family-owned entities can lessen their compliance burden through a regulated private trust company.

Most family-owned entities will need to comply with beneficial ownership information reporting requirements under the final Corporate Transparency Act (CTA) regulations promulgated by the US Treasury on Sept. 30, 2022, to take effect as early as 2024.

The CTA—Sections 6401–6403 of the Anti-Money Laundering Act of 2020, Title LXIV—authorizes the Financial Crimes Enforcement Network (FinCEN) to collect from reporting companies the identities of their individual beneficial owners to help the government prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illegal activities, and to disclose the collected information to designated government authorities and financial institutions. This new disclosure regime may be particularly burdensome for families with extensive business holdings.

In this article, we will examine whether a private trust company (PTC) can help lessen the disclosure burden under the CTA. In particular, we will analyze whether a PTC itself can qualify for a CTA exemption and, more importantly, whether an entity owned by one or more trusts of which the PTC serves as a fiduciary (such entity, a “Fiduciary Subsidiary”) can qualify for a CTA exemption.

The effective date of the final CTA regulations is January 1, 2024. Reporting companies formed on or after that date will need to file the initial disclosure within 30 days of formation. Reporting companies formed before that date will not be required to file information until January 1, 2025, as stated in its Pre-

amble to the final regulations, hereafter “Preamble,” 87 Fed. Reg. 59,498 (Sept. 30, 2022), at 59,511. However, FinCEN recently submitted for review by the Office of Information and Regulatory Affairs a proposed regulation titled “Beneficial Ownership Information Reporting Deadline Extension for Reporting Companies Created or Registered in 2024.” While this proposed regulation has not been published as of the date of this article, its title may indicate a possible delay of the reporting deadline for reporting companies formed or registered on or after January 1, 2024.

Private Trust Companies

In general, a PTC is a legal entity authorized under applicable state laws to provide fiduciary services to one or more persons having a prerequisite relationship to a specifically designated individual. While a PTC typically serves as trustee of trusts held for the benefit of members of a particular family, the PTC also may hold other fiduciary roles such as investment adviser to direct trust investments or manager of a family-owned entity. PTCs are prohibited from providing services to the public. Depending on the state of formation, a PTC is subject to different degrees of regulatory oversight, and may have the option to be formally licensed by the state (*i.e.*, a regulated PTC) or remain unlicensed and subject to little to no state-level regulation.

Regulated PTC as a Bank

There are 23 exemptions to the CTA “reporting company” definition, including any “bank” as defined in section 2(a) of the Investment Company Act of 1940, under 31 C.F.R. §1010.380(c)(2)(iii)—see the final regulations, hereafter “Final Regs.” 87 Fed. Reg. 59,498 (Sept. 30, 2022), at 59,593—referring to 15 U.S.C.A. §80a-2(a)(5), which provides that the definition of a “bank” includes a trust company a substantial portion of the business of which consists of exercising fiduciary powers *and* which is supervised and examined by state bank regulators. Regulated PTCs should typically fall within this definition of a “bank.” As such, a regulated PTC likely is not itself a reporting company subject to beneficial ownership information disclosure requirements. Conversely, unregulated PTCs, which are subject to little to no state

supervision and examination, do not fall within the definition of a “bank” and are therefore not exempt under the CTA.

Subsidiary Exemption

Another exemption from the reporting company definition is the “subsidiary exemption,” under which “any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more” specified exempt entities (including a bank) is exempt from beneficial ownership information disclosure obligations, as stated in the [Final Regs](#) at 59,594. There is an open question as to whether a Fiduciary Subsidiary can qualify as an exempt entity under this subsidiary exemption. If the Fiduciary Subsidiary is not a reporting company, it should have no obligation to disclose information about itself or its beneficial owners, including any PTC decisionmaker making decisions for the Fiduciary Subsidiary. Importantly, the subsidiary exemption is different from the limited disclosure rule under 31 §1010.380(b)(2)(i) (*id.* at 59,592), which only limits the extent of, but does not eliminate, the need to disclose. *See* Jocelyn M. Borowsky and Elizabeth King, *Corporate Transparency Act Just Got Real for Common Law Trusts*, Tr. & Est. (Feb. 16, 2023).

If the Fiduciary Subsidiary qualifies as an exempt entity prior to the deadline for filing an initial beneficial ownership information report, it should not have to submit any such report to FinCEN. However, if the Fiduciary Subsidiary becomes an exempt entity only after having filed an initial report as a reporting company, the Fiduciary Subsidiary will need to file an updated report to indicate its exempt status. *See* 31 C.F.R. §1010.380(a)(2)(ii) (*id.* at 59,591).

There are arguments to support the interpretation that the combination of the bank exemption and the subsidiary exemption should cover a Fiduciary Subsidiary. However, as discussed below, this is not the only possible interpretation, and neither the CTA nor its regulations definitively define the contours of the subsidiary exemption. While there are strong policy reasons for a narrow reading of the exemption (*i.e.*, a Fiduciary Subsidiary is not exempt from beneficial ownership information disclosure), the language of the subsidiary exemption itself can reasonably support a broader interpretation. Both a textual analysis of the subsidiary exemption and the broader policy implications are discussed below.

Ownership vs. Control

The wording of the subsidiary exemption is disjunctive, referring to any entity whose ownership interests are either “controlled” or “wholly owned” by one or more specified exempt entities. Under this definition, a wholly owned subsidiary of an exempt entity

clearly should itself be an exempt entity. But what about an entity that is not wholly owned by the exempt entity but nevertheless subject to its control? Singular emphasis on ownership would make the word “control” redundant. Therefore, “control” for purposes of the subsidiary exemption necessarily means something other than full ownership (or the control resulting therefrom). Unfortunately, “control” is not expressly defined for purposes of the subsidiary exemption. This article explores its meaning by examining other provisions of the CTA regulations. Noteworthy, FinCEN acknowledged in the [Preamble](#) at 59,528, that “definitions of ‘control’ found elsewhere in the United States Code and the Code of Federal Regulations can be informative, [but] they are not dispositive” for purposes of the CTA regulations.

Ownership-Based Control in the Trust Context

As a starting point, the language of the CTA regulations indicates that control must relate to the ownership interests in the subsidiary. The subsidiary exemption requires that “ownership interests [of the subsidiary] are controlled or wholly owned” by other exempt entities ([Final Regs](#) at 59,594, emphasis added). Therefore, control that arises independently of ownership (*e.g.*, by virtue of being a manager of a manager-managed entity) should not trigger the exemption. In the context of a Fiduciary Subsidiary, the regulated PTC’s authority arises from its role as a fiduciary of the trust that holds the ownership interest in the Fiduciary Subsidiary. Therefore, a regulated PTC structure appears to satisfy this threshold requirement of the subsidiary exemption.

FinCEN applies a look-through approach with respect to trusts under the CTA regulations. Indeed, a trust is not itself a reporting company as it is neither created nor typically required to register to do business “by the filing of a document with a secretary of state or any similar office.” *See generally* 31 C.F.R. §1010.380(c)(1) (*id.* at 59,593). FinCEN instead examines the authority and beneficial interests of the parties involved, namely, the trustee, the grantor, and the beneficiaries of the trust, in determining whether each one of them is a beneficial owner of the reporting company owned by the trust. *See generally* 31 C.F.R. §1010.380(d)(1)(ii), (2)(ii)(C) (*id.* at 59,594–5). Applying the look-through paradigm to a non-directed trust, the trustee necessarily is the party with the *de jure* authority to manage the ownership interests of a trust-owned entity. Such management authority should constitute “control” for purposes of the subsidiary exemption.

This view of the trustee having “control” over the trust is consistent with other provisions of the CTA regulations. In particular, the concept of trusts appears in both the “substantial control” and the 25% “own-

ership or control” tests under the beneficial owner definition. See generally 31 C.F.R. §1010.380(d)(1)(ii), (2)(ii)(C) (*id.* at 59,594–5). The substantial control test at 31 C.F.R. §1010.380(d)(1)(ii) provides that “[a]n individual may directly or indirectly, including as a trustee of a trust or similar arrangement, exercise substantial control over a reporting company.” In the Preamble, at 59,529, FinCEN specifically noted that “a trustee of a trust can, in fact, exercise substantial control over a reporting company through the exercise of his or her powers as a trustee over the corpus of the trust, for example, by *exercising control rights associated with shares held in trust*” (emphasis added). It follows that if the trustee’s authority to exercise control rights meets the definition of “substantial control,” the same authority also should constitute “control” for purposes of the subsidiary exemption.

Similarly, the 25% test provides, under 31 C.F.R. §1010.380(d)(2)(ii)(C)(1) (Final Regs at 59,595), that in the case of a trust that holds ownership interests in a reporting company, “an individual may directly or indirectly own or control an ownership interest . . . [a]s a trustee of the trust or other individual (if any) with the authority to dispose of trust assets.” In other words, the trustee’s ability to determine disposition of the trust assets constitutes “ownership or control” over the ownership interest of the reporting company. Assuming the use of the phrase “ownership or control” in both the subsidiary exemption and the 25% test is not a mere coincidence, the regulated PTC’s authority to exercise rights associated with the ownership interests of the Fiduciary Subsidiary should likewise constitute “ownership or control” for purposes of the subsidiary exemption.

In the context of applying the 25% test to a trust, we suggest that the trustee’s authority over the trust corpus is best characterized as “control” while the grantor’s authority to revoke the trust or the beneficiary’s power to withdraw the trust property is more in line with “ownership” because the latter powers can be exercised to vest the beneficial ownership of the trust property in the powerholder. In any case, drawing a distinction between ownership vs. control here is unnecessary because both the subsidiary exemption and the 25% test use variations of the same phrase “own or control.”

Extent of Control

The difference between the language of the CTA and regulations also informs the meaning of “control.” The statutory text at 31 U.S.C. §5336(a)(11)(B)(xxii) refers to an entity “of which the ownership interests are owned or controlled” by one or more exempt entities. In contrast, the regulations at 31 C.F.R. §1010.380(c)(2)(xxii) (Final Regs

at 59,594) read “any entity whose ownership interests are controlled or wholly owned” by one or more exempt entities. In adopting the regulations, FinCEN in the Preamble at 59,543 interpreted “the definite article ‘the’ in the quoted statutory text as requiring an entity to be owned *entirely* by one or more exempt entities” (emphasis added). In other words, “the ownership interests” refers to the entirety of the “ownership interests” in the subsidiary entity. As such, FinCEN changed the word “owned” into “wholly owned” and omitted the article “the” from the text of the final regulations.

Under FinCEN’s interpretation of the statutory language, the regulated PTC’s authority also will need to extend to the entirety of the ownership interest of the Fiduciary Subsidiary. If the regulated PTC has control over only a portion of such ownership interest (*e.g.*, the Fiduciary Subsidiary is only partially owned by one or more trusts of which the regulated PTC serves as trustee), the subsidiary exemption likely will not apply. Similarly, if the ownership of an entity in a multi-tier structure is not fully attributed to one or more trusts of which the regulated PTC serves as a trustee, that entity and all of its subsidiaries should not qualify for the subsidiary exemption.

Nonexclusive Control

The absence of the “wholly” modifier to the word “control” in the text of the subsidiary exemption under CTA regulations is meaningful. In the Preamble, FinCEN noted that “[m]any commenters urged FinCEN to clarify that the exemption would apply only to ‘wholly controlled or wholly owned’ subsidiaries (versus the proposed rule that reads ‘controlled or wholly owned’) in order to make the exception as narrow as possible and avoid creating a loophole to evade reporting requirements” (at 59,543) and that it deliberately chose not to adopt this suggestion, explaining that “FinCEN does not need to add ‘wholly’ before ‘controlled’ because FinCEN assesses that the latter covers the intended concept of control set out in the CTA” (*id.*). Therefore, whatever “control” means, it is not “whole” control. This suggests the exempt entity’s control over the subsidiary in question need not be exclusive.

This nonexclusive view of control would allow other parties to have concurrent control over the subsidiary entity. This would be an eminently sensible interpretation of the subsidiary exemption that reflects the complexity of commercial reality. Even in the most simplistic scenario of a wholly owned subsidiary, multiple parties within the organizational structure of the parent exempt entity (*e.g.*, its officers, board of directors, owners) may have concurrent authority over the subsidiary. In addition, third parties can have rights that constitute control over a reporting

company, as FinCEN itself recognizes, acknowledging in the Preamble “that it would be fruitless to attempt to enumerate, or even describe, the universe of creditor rights that do not amount to ownership or control” (at 59,535) and the difficulty in enumerating the “types of creditor rights that do amount to assertions of ownership or substantial control in the guise of a debt agreement” (at 59,536). A nonexclusive view of control would avoid many potential difficulties in the CTA implementation.

A nonexclusive view of control also makes sense in the context of modern trust planning. For example, FinCEN views an individual with authority over the appointment and removal of certain control persons as having substantial control over a reporting company. See 31 C.F.R. §1010.380(d)(1)(i)(B) ([Final Regs](#) at 59,594). Under the same reasoning, a person who can remove and appoint the regulated PTC as trustee of the trust arguably can be viewed as having “control” over the Fiduciary Subsidiary. The nonexclusive view of control allows for the subsidiary exemption to apply beyond the most simplistic of trust structures.

Activities Constituting Control

Adopting a nonexclusive view of control naturally leads to the next question about which authority exercisable by the regulated PTC would constitute “control” for purposes of the subsidiary exemption. The definition of beneficial owners helps inform this analysis. Certain legal title holders such as nominees, intermediaries, custodians, or agents are excluded from the definition of beneficial owners under 31 C.F.R. §1010.380(d)(3)(ii) (*id.*), but trustees can be beneficial owners, according to 31 C.F.R. §1010.380(d)(1)(ii) and (2)(ii)(C)(1) (*id.*). A nominee or custodian generally performs only administrative functions and acts under the direction of the principal. In contrast, in the non-directed trust context, the trustee has the *de jure* authority to exercise discretionary management powers over the trust property without being directed by another. The difference in their legal authority would justify the different classifications between these two groups of legal titleholders.

What about in the directed trust context? We would not expect the subsidiary exemption to apply to entities the legal ownership of which is held by a purely administrative trustee that has some ministerial duties but no “real” discretionary power over the investment or distribution of the trust property. Indeed, the ability of the regulated PTC to exercise investment management and voting powers over ownership interests in the Fiduciary Subsidiary appears to be key to qualifying for the subsidiary exemption. In the context of the beneficial owner definition, the 25% test equates the trustee’s authority “to dispose of trust assets” to ownership or control (*id.*). While FinCEN does not ex-

plain the meaning of “dispose,” this provision should be equally applicable to a trust where the trustee is given full distribution discretion as to a trust whose trustee is responsible for mandatory payments but is not otherwise given distribution discretion (*e.g.*, a grantor retained annuity trust). Accordingly, FinCEN may be referring to the trustee’s investment management powers in this context. This is a reasonable conclusion given the substantial-control test similarly enumerates powers that would typically be associated with the exercise of voting powers by an owner of the reporting company, including “ownership or control of a majority of the voting power or voting rights of the reporting company” under 31 C.F.R. §1010.380(d)(1)(ii) (*id.* at 59,595). See also 31 C.F.R. §1010.380(d)(1)(i)(B) and (C) for a list of other owner-level voting powers constituting “substantial control.”

Nevertheless, the clearest position is to avoid a directed trust structure so that the regulated PTC has full authority over each decision affecting ownership interests in the Fiduciary Subsidiary.

Policy Considerations

There are strong policy arguments that favor a narrow interpretation of the subsidiary exemption. In the [Preamble](#), FinCEN noted that the “overriding objective of the CTA [] is to identify the individuals who own, control, and register each particular entity” (at 59,515). As such, “as a general matter, FinCEN believes it is appropriate to interpret ambiguities in [reporting company] exemptions reasonably narrowly” (*id.* at 59,539). Indeed, if the fundamental purpose of the CTA regime is the disclosure of the ultimate beneficial owners of an entity, a broad interpretation of the subsidiary exemption allowing the insertion of a legal titleholder to avoid disclosure is inconsistent with such purpose.

A broad interpretation of the subsidiary exemption, when pushed to its logical limit, can create seemingly unsettling results. For example, if full nonexclusive control is all that is required, what about an entity that is wholly owned by a convicted felon’s revocable trust of which the regulated PTC serves as sole trustee? What about a subsidiary entity that is wholly owned by a parent company of which the regulated PTC serves as its 1% sole managing member or even its sole (non-member) manager? In the Preamble at 59,543, FinCEN noted that its interpretation of the subsidiary exemption requiring full ownership by the parent exempt entity would “prevent[] entities that are only partially owned by exempt entities from shielding all of their ultimate beneficial owners—including those that beneficially own the entity through a non-exempt parent—from disclosure.” It seems strange to extend the exemption to a structure

where the exempt entity has no ownership interest in the “subsidiary” at issue.

However, there may be good responses to these potentially strange outcomes. At least in a non-directed trust context, the regulated PTC has substantive legal authority and fiduciary obligations to make proper (and legal) decisions affecting the ownership interest in the Fiduciary Subsidiary. The trust structure fundamentally alters the legal relationship between the trust beneficiaries and the underlying assets when compared to outright ownership (where the beneficial owners directly exercises control over the assets) or other forms of legal ownership (such as nominees, intermediaries, custodians, or agents who often are directed by the beneficial owners and have little independent decision-making authority). Stated differently, the assumption of trusteeship by the regulated PTC should not be equated to the simple insertion of a legal titleholder.

Moreover, the requirement that the regulated PTC have control over the entire ownership interest of the Fiduciary Subsidiary represents an important limitation and a significant constraint on the potential application of the (broader) subsidiary exemption. We would expect only a vertically integrated structure with relatively direct control by the regulated PTC to qualify under the broader read of the subsidiary exemption. Similar to a trust-owned structure designed to meet the material participation test under I.R.C. §469, each Fiduciary Subsidiary throughout the chain of ownership can be managed by its members or owners so that the regulated PTC is able to exercise direct management authority with respect to even the lowest-tier entity. *See* Richard L. Dees, *20 Questions (and 20 Answers!) on the New 3.8 Percent Tax*, Tax Notes (Aug. 12, 2013), at 15.

Most importantly, the overall purpose of the CTA regime beyond its disclosure mechanics is to “[prevent] illicit actors from using legal entities to conceal their ownership and activities,” according to FinCEN (Preamble at 59,546). The rationale for creating the various reporting company exemptions is that “[m]any of these exempt entities are already subject to substantial federal and/or state regulation” (*id.* at 59,539). This is particularly true in the case of a regulated PTC, where decision-makers may have to make extensive disclosure as part of the initial licensing or approval process. The regulated PTC itself has to operate in compliance with various anti-money laundering control procedures and is subject to periodic audit and examination by the state banking regulator. As a result, a regulated PTC is arguably subject to more regulatory scrutiny than many other forms of exempt entities (for example, an entity wholly owned by a charitable split-interest trust). The difficulty of conducting illicit activities through a Fiduciary Sub-

sidary controlled by a regulated PTC supports a broader interpretation of the subsidiary exemption.

Consequences of Violations

The penalty for a *willful* violation of the CTA disclosure requirements can be substantial and involve risks of incarceration. *See* 31 U.S.C. §5336(h)(3)(A). In particular, the civil penalty can be up to \$500 for each day the violation continues, and the criminal penalty can include a fine of \$10,000 and a two-year imprisonment. However, as stated at 31 U.S.C. §5336(h)(6), for the violation to be “willful,” it must result from a “voluntary, intentional violation of a known legal duty” FinCEN specifically stated in the Preamble at 59,546 that “[w]illfulness is a legal concept that is well established in existing caselaw.” While the CTA does not expressly include a safe harbor for reliance on a reasonable legal interpretation, in the absence of further guidance to clarify the scope of the subsidiary exemption, a Fiduciary Subsidiary arguably does not have a “known legal duty” to make the beneficial ownership information disclosure. FinCEN itself noted in the Preamble at 59,515 that “as a general matter, FinCEN does not expect that an inadvertent mistake by a reporting company acting in good faith after diligent inquiry would constitute a willfully false or fraudulent violation.”

What’s Next?

FinCEN acknowledges that “further guidance and FAQs may be needed to provide guidance in specific factual circumstances” (*id.* at 59,536). Until it issues such guidance, a careful review of a family’s trust and corporate structure is necessary to determine if any reporting exemption might apply. In some cases, families with unregulated PTCs might consider transitioning to regulated PTCs to minimize reporting obligations under the CTA. However, the authors caution families to weigh the benefits and detriments of disclosure relative to the increased regulatory burdens of a regulated PTC structure. Further, advance planning is critical as the formation and licensing process for a regulated PTC often takes time. Given the complexities of disclosure, it is important, at the very minimum, to have a game plan in place.

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