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Please Address Reply to:

Executive Director
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February 4, 2022

Policy Division, Financial Crimes Enforcement Network
P.O. Box 39
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RE: Docket Number FINCEN -2021-0005 and RIN 1506-AB49

Submitted electronically at www.regulations.gov

Corporate Transparency Act
FinCEN Notice of Proposed Rulemaking of Regulations for
Beneficial Ownership Information Reporting Requirements
ACTEC Replies to Questions 15, 16, 17, 20, & 21

Dear Ladies and Gentlemen:

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit comments pursuant to Notice of Proposed Rulemaking (NPRM), Docket Number FINCEN-2021-0005 and RIN1506-AB49.

ACTEC is a professional organization of approximately 2,400 lawyers from throughout the United States including 100 international members. Fellows of ACTEC are elected to membership by their peers on the basis of professional reputation and the ability in the fields to trusts and estates on the basis of having made substantial contributions through lecturing, writing, teaching and bar activities. Fellows of ACTEC have extensive experience in providing advice to taxpayers. ACTEC offers technical comments about the law and its effective administration but does not take positions on matters of policy or political objectives.

ACTEC and its Financial Action Task Force, ACTEC FATF Task Force, have chosen to limit ACTEC's comments to those questions posed in the NPRM that ACTEC believes are most closely related to the purposes and mission of ACTEC, and the situations in which ACTEC Fellows are most frequently involved with their clients.

Specifically, ACTEC has included in these comments a background discussion of common trust structures used in the U.S. and responses to NPRM questions 15, 16, 17, 20, and 21. We have organized our discussion into the following sections:

I. Background on Common Trust Structures Used in the US
II. Beneficial Owner - Responses to NPRM Questions 15, 16, & 17
III. Company Applicant - Response to NPRM Question 20
IV. Reporting Company - Response to NPRM Question 21

If you would like to discuss these comments, please contact the primary drafters who are the Co-Chairs of the ACTEC FATF Task Force, Carolyn A. Reers at, creers@wiggin.com; Lyat Eyal at lyat@are-legal.com , and Glenn G. Fox, at glenn.fox@bakermckenzie or Deborah O. McKinnon , ACTEC Executive Director at domckinnon@actec.org.

Respectfully submitted,

Ann B. Burns, President

February 4, 2022

Corporate Transparency Act
FinCEN Notice of Proposed Rulemaking of Regulations for
Beneficial Ownership Information Reporting Requirements
ACTEC Replies to Questions 15, 16, 17, 20, & 21

The Corporate Transparency Act ("CTA") was enacted by Congress over President Trump's veto on January 1, 2021, as part of the National Defense Authorization Act. The CTA effectively creates a national beneficial ownership registry by requiring certain business entities to report their "beneficial owners" and "company applicants" to Treasury's Financial Crimes Enforcement Network ("FinCEN"). The reporting requirements of the CTA are an attempt to prevent the use of shell companies for evading anti-money laundering rules or hiding other illegal activities. Reporting obligations under the CTA will take effect on the effective date of the regulations thereunder, which were required to be promulgated by January 1, 2022, but may have an effective date thereafter.

On December 8, 2021 FinCEN issued a notice of proposed rulemaking (Docket Number 2021-26548 and RIN 1506-AB49, the "NPRM"). In the NPRM FinCEN promulgates proposed regulations that would implement Section 6403 of the CTA (the "Proposed Regulations"). Section 6403, among other things, amends the Bank Secrecy Act (BSA) by adding a new Section 5336, Beneficial Ownership Information Reporting Requirements, to Subchapter II of Chapter 53 of Title 31, United States Code. The NPRM requests comments on certain provisions in the Proposed Regulations and seeks guidance on how best to implement the reporting requirements of the CTA. FinCEN requires such comments to be submitted by February 7, 2022.

The American College of Trust and Estate Counsel (ACTEC) is a nonprofit association of lawyers and law professors skilled and experienced in the preparation of trusts and wills; tax and estate planning; and the administration of trusts and estates. ACTEC and its FATF Committee have chosen to limit ACTEC's comments to those questions posed in the NPRM that ACTEC believes are most closely related to the purposes and mission of ACTEC, and the situations in which ACTEC Fellows are most frequently involved with their clients.

Specifically ACTEC has included in these comments a background discussion of common trust structures used in the U.S. and responses to NPRM questions 15, 16, 17, 20, and 21. We have organized our discussion into the following sections:

I. Background on Common Trust Structures Used in the US
II. Beneficial Owner - Responses to NPRM Questions 15, 16, & 17
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I. <u>Background on Common Trust Structures Used in the US</u>

Preliminarily, we will describe two of the most common trust structures used in the United States today, as well as the role of various fiduciaries named in current trust instruments and the evolved role of the trustee. This will provide necessary content to some of our responses set forth below.

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The first trust structure is a "revocable trust" (also called a "living trust"). This is a trust created by an individual (called the "grantor" or "settlor") which normally also names the grantor as the initial trustee. The grantor further retains unfettered access to the assets of the trust during the grantor's lifetime, and retains the right to revoke or amend the trust in any manner during his or her lifetime. This trust is described in Prop. Reg. § 1010.380(d)(3)(ii)(C).

Revocable trusts have become widely used over the last twenty or so years as the preferred instrument to provide for the distribution of assets at death (as opposed to under a Will) for the following primary reasons: (i) a revocable trust can serve as an effective vehicle for the management of assets in the event the grantor becomes incapacitated, (ii) transferring assets to a revocable trust before death allows those assets to pass outside of a court-supervised probate proceeding at death which can be time-consuming and expensive, (iii) a revocable trust may avoid the need to commence a probate court proceeding for the appointment of a successor trustee, and (iv) a revocable trust is not made public upon death whereas a Will filed in a probate court is a matter of public record.

The second trust structure is a "discretionary trust". This is a trust created by an individual (called the "grantor" or "settlor") which names one or more individuals, <u>excluding</u> the grantor, or a corporation (such as a bank or trust company) as trustee(s). The trust is irrevocable and often intended to continue for multiple generations. The grantor designates a class of individuals (sometimes including charities) who can receive distributions from the trust at the discretion of the trustees. A common distribution clause might read, "My trustees may distribute to one or more of my descendants as much of the net income and principal of the trust as the trustees may at any time and from time to time determine in such amounts or proportions as the trustees may from time to time select for any purpose." It is also very common for discretionary trusts to last for the lifetime of the beneficiaries, with no specific age or milestone event triggering a binding requirement on the trustees to make a distribution or to terminate the trust. Particularly when substantial family wealth is involved, these trusts have become a prevalent since they allow for changing circumstances and provide a level of creditor protection since a trust with these terms is an unattractive target for claims by a divorcing spouse or other creditor of a descendant.

It is obvious from this description of a discretionary trust that the trustee has very substantial powers over the assets held in the trust. This has led to many states enacting laws that allow for the grantor to limit the trustees' powers by dividing the powers among multiple parties (called "investment advisors", "distribution advisors" or "trust directors" among other names) and by providing for another individual (called a "trust protector") to have the power to remove and replace the trustee.

Under traditional common law trust principles, trustees retained full responsibility (and liability) over how trust assets were managed, invested and distributed. More modern trust laws (enacted over the last twenty to thirty years) allow a trustee's duties, and liability for the performance or non-performance of those duties, to be allocated among the trustee and other individuals who may be more familiar with the family or better able to carry out certain trust objectives. For example, under Delaware law, a grantor can appoint a "distribution advisor" who is not the trustee but rather a trusted family member to oversee distributions from the trust, and can appoint an "investment advisor" who is not the trustee but perhaps the family financial advisor to make investment decisions. This division of the traditional roles of the trustee is very useful in situations where trusts hold concentrated investments or assets, such as a closely-held business or significant amounts of real estate. Professional trustees typically resist accepting investment responsibility for those trusts due to the specialised skills required and the potential liability associated with managing a closely held business and holding concentrated positions. Notably, trust "advisors" or "directors" are usually deemed to have the same fiduciary duties to the trust beneficiaries and exposure to liability for their actions or inactions as similarly situated trustees.

II. <u>Beneficial Owner - Responses to NPRM Questions 15, 16, & 17</u>

Question 15: Proposed 31 CFR 1010.380(d) interprets the CTA as providing for a relatively broad approach to the definition of beneficial ownership. How burdensome will this approach be for reporting companies? In addition to responding generally to this question, please provide specific considerations and data related to costs and burdens.

As applied to situations in which a trust holds an ownership interest in a reporting company, the Proposed Regulations do not (and likely cannot) adequately address all situations in which an individual has a direct ownership or control interest, as explained in more depth in the response to Question 17(ii), below. The difficulty in complying with the Proposed Regulations when a reporting company is owned by an irrevocable discretionary trust is a function of the unique and multi-faceted nature of irrevocable discretionary trusts in the American legal system, beginning with the traditional bifurcation of beneficial enjoyment (which can take a variety of forms and structures) and control rights over trust property (which can further be divided among various parties to the trust including individual and corporate trustees, trust protectors, distribution advisors, and investment advisors, as set forth in our opening comments.

Given the lack of a clear, objective rule applicable to irrevocable discretionary trusts, and the fact that reporting companies are potentially subject to sanctions, it is likely that a reporting company will assume a very significant burden to "over-comply" with the Proposed Regulations by gathering more information than is necessary or useful with regard to trusts which have an ownership interest in a reporting company. If there were more certainty that reporting companies are required to identify only those entities and individuals listed in Prop. Reg. § 1010.380(d)(3)(ii)(C), then the potential burden on reporting companies would be mitigated. In addition, as explained in more depth below, the potential for penalties for not reporting changes in the identities of beneficial owners within the relatively short timeframes adds to the burden on reporting companies.

Question 16: One component of the proposed definition of beneficial owner is an individual who "exercises substantial control over the reporting company." Is the definition of "substantial control" sufficiently clear for reporting companies to be able to understand and use it?

> ***Sub-question 16i: Are there any indicators that are not sufficiently clear?***
>
> ***Sub-question 16ii: Does the catch-all provision ("any other form of substantial control over the reporting company") enable a reporting company to identify the individual(s) in substantial control of the reporting company?***
>
> ***Sub-question 16iii: Are there any additional indicators of substantial control that FinCEN should consider expressly including in the regulatory definition?***

Any individual who directly or indirectly through any contract, arrangement, understanding or relationship exercises substantial control over a reporting company or owns or controls at least 25% of the reporting company will be found to have beneficial ownership under the CTA and Proposed Regulations. As such, there are two prongs on which to focus: (i) control and (ii) ownership.

As to the control prong, the Proposed Regulations provide a definition and examples for when an individual will be found to directly have substantial control. However, there is no similar definition or example, as to how an individual can indirectly have substantial control. As such, FinCEN should provide similar guidance as to when an individual will be deemed to have substantial control indirectly.

The Proposed Regulations should also clearly address when an agency relationship results in substantial control over a reporting company. Prop. Reg. §§ 1010.380(d)(1)(iii) and (d)(2) provide that substantial control over a reporting company includes substantial influence over important matters affecting the reporting company and that an individual may exercise substantial control over a reporting company through any arrangement or relationship. Prop. Reg. § 1010.380(d)(3)(ii)(B) also provides that an individual may directly or indirectly own or control an ownership interest of a reporting company through control of such ownership interest owned by another individual.

The above characterizations of substantial control of a reporting company or control of an ownership interest could encompass an agency relationship, such as that of an agent under a power of attorney or a court appointed guardian, and result in the agent being considered a beneficial owner. With that said, it is quite common for tax and legal professionals to be designated as an agent of an entity on an IRS Form 2848, Power of Attorney. The agent in this case can exercise substantial influence over IRS tax matters that affect the entity. We recommend that such an agent be excluded from the definition of "beneficial owner" due to the professional nature of the relationship and because the Department of Treasury should already have any essential information with respect to a person designated as an agent on a Form 2848. We also recommend that the Proposed Regulations clearly state that an agent under a non-IRS power of attorney, or court appointed guardian, should be considered a beneficial owner only if such person has authority to act on behalf of a reporting company or the power to control the ownership interests of a beneficial owner of a reporting company.

Question 17: The statutory definition of beneficial owner also includes an individual "owns or controls at least 25 percent of the ownership interests." Is the approach to first define "ownership interests" useful?

> ***Sub-question 17i: Is the proposed definition of "ownership interests" sufficiently clear for reporting companies to be able to understand and use it?***

We do not have any comment with respect to the definition of "ownership interests" in Prop. Reg. § 1010.380(d)(3)(i).

> ***Sub-question 17ii: Are there any aspects of the proposed rule on the determination of whether an individual owns or controls 25 percent of the ownership interests of a reporting company that are not sufficiently clear? What additional clarification could make it easier to calculate whether one owns or controls 25 percent of the ownership interests? Please propose explanatory regulatory language.***

We believe that Prop. Reg. § 1010.380(d)(3)(ii)(C) may lead to complications and confusion when a common law trust holds an ownership interest in a reporting company.

Prop. Reg. § 1010.380(d)(3)(ii)(C)(*1*) would include as a beneficial owner "a trustee of the trust or other individual (if any) with the authority to dispose of trust assets". In many cases, the application of this provision would be straight forward, such as when one or more individuals is serving as trustee, and even in the less common situation in which an individual not serving as trustee has the authority to dispose of trust assets, such as, for example, a trust in which a beneficiary has an inter vivos power of appointment to direct the distribution of trust assets to or for a class of potential appointees. But how is this provision to be applied when an entity is serving as trustee? Would the reporting company be required to determine what individuals (such as employees) within that entity might fit within this provision? If so, what if no single individual has the authority to act on behalf of the entity serving as trustee (such as when, as an example, material distributions are only made by a committee)? How is this provision to be applied in a situation in which the ordinary roles of a trustee are divided among multiple parties, who may or may not be called "trustees," such as distribution advisors, investment direction advisors, trust protectors, etc.? In those circumstances, what does it mean to "otherwise dispose of trust assets?"

The greater potential for complexity is due to Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*), but before addressing that complexity, we want to point out the practical limits of the provision. Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*) provides two clear provisions for determining which, if any, beneficiary would be considered to own or control an ownership interest of a reporting company.

- Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*)(*i*) would include as a beneficial owner "a beneficiary who … [i]s the sole permissible recipient of income and principal from the trust…." As written, this provision would be easily interpreted – but we believe that the number of common law trusts that have only one beneficiary who is the sole permissible recipient of income and principal is limited. As described below, common law trusts are more likely to include multiple beneficiaries.
- Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*)(*ii*) would include as a beneficial owner "a beneficiary who … [h]as the right to demand a distribution of or withdraw substantially all of the assets from the trust…." We think there are two complications with this provision.
    - First, it is not clear what "substantially all" means. Would this be based upon a percentage of the assets, and if so, would a beneficiary's rights to withdraw assets over a period of years be considered on a cumulative basis?
    - Second, and similar to the prior point, we believe that there are not many common law trusts that would fall into this category, other than revocable trusts and irrevocable trusts which grant a beneficiary the right to withdraw trust assets upon the occurrence of certain events, such as the beneficiary reaching a designated age, after achieving some external life milestone or after the death of other beneficiaries or individuals (which would probably be within the definition of Prop. Reg. § 1010.380(d)(3)(ii)(C)(*3*)(*ii*)).

Our greatest concern with Prop. Reg. § 1010.380(d)(3)(ii) is due to the fact that the enumerations within Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*) appear to be only illustrative. Prop. Reg. § 1010.380(d)(3)(ii) provides that "[a]n individual may directly or indirectly own or control an ownership interest of a reporting company through a variety of means, *including but not limited to:….*" (emphasis added). We believe that the "including but not limited to" language may lead to confusion, which is best demonstrated by examples.

Hypothetical 1. Assume that a corporation was originally owned by one individual. Over time the ownership was transferred so that the shares are now owned outright and in both *inter vivos* and testamentary trusts for many members of multiple generations descended from the original shareholder. In this hypothetical, assume that no individual or trustee shareholder owns more than five percent of the ownership interests, and that the corporation is a reporting company.

Hypothetical 2. Assume that an individual creates an irrevocable trust for the benefit of her children, grandchildren and great grandchildren, and that she relinquishes any and all rights with respect to the assets contributed to the trust, including any rights to withdraw assets or to revoke the trust. The terms of the trust name the grantor's friend as the sole trustee, and the trustee has the sole and absolute discretion to make any, or no, distributions to the grantor's descendants, the number of which is increasing each year. Years after the trust was created, the individual trustee invests in an entity that is a reporting company.

How would a reporting company handle these hypotheticals?

- It is likely that none of the beneficiaries in these hypotheticals would be described either in Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*)(*i*) (because there are multiple beneficiaries), or in Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*)(*ii*) (because none of them have a right to demand a distribution of or to withdraw *any* of the assets from the trusts).

- It is unlikely that the grantors and settlors of any of the trusts would be included in Prop. Reg. § 1010.380(d)(3)(ii)(C)(*3*) because the grantors and settlors are all deceased, or they have no rights to revoke or withdraw assets from the trust (directly or indirectly) because the trusts are irrevocable.
- Finally, we do not understand how to interpret Prop. Reg. § 1010.380(d)(3)(iii), specifically the language "and the percentage of such ownership interests that an individual owns or controls shall be determined by aggregating all of the individual's ownership in comparison to the undiluted ownership interests of the company."
    - Assume that a reporting company is a corporation, that each of four siblings own 20% of the shares and the remaining 20% of the shares are owned by a trust. If one of the siblings is the sole beneficiary of income and principal of the trust, or has the right to demand a distribution of or withdraw substantially all of the assets from the trust, then it would make sense to aggregate her outright ownership of 20% with the additional 20% owned in the trust. But what if all four siblings are beneficiaries of the trust and none of them have the right to demand any distribution of or withdraw any assets from the trust? Is any portion of the trust ownership aggregated with the any of the siblings' shares? Are the siblings' shares owned outright aggregated under a family attribution rule, without even considering the ownership held in the trust?
    - Finally, what does the "undiluted ownership interests" mean?

Our concern is that a reporting company in any of the hypotheticals above may take an extremely conservative approach and require that *all* the beneficiaries of the trusts be considered as owning or controlling an ownership interest in the reporting company.

Finally, we believe the penalties associated with the failure to report complete or updated beneficial ownership information should be revised as it pertains to information a reporting company receives from a trustee. Without the trustee providing the reporting company information, the reporting company will unlikely be able to fulfill its reporting obligations. This is similar to how a CPA receives information from a taxpayer to prepare income tax returns. For example, even if the reporting company has a copy of the trust agreement, it is often the case that beneficiaries are referred to not by name, but as a class, e.g., the "settlor's descendants," to address the settlor's desire to include as beneficiaries descendants born after settlement of the trust. The reporting company will not necessarily know this information. If a reporting company receives information from a trustee as to who the beneficial owners are, and the reporting company reasonably relies on that information and submits the report based on that information that later turns out to be inaccurate or incomplete, the reporting company should not be liable or penalized as it relied on the information provided to it. Moreover, if a reporting company does not include ownership information in an initial or updated report due to its inability to obtain the necessary information from the trustee or other owners after reasonable efforts to do so, it should not be liable or penalized. The regulations should clearly state that no penalties, not even penalties for non-wilful situations, should apply in such situations. In particular, unless final regulations provide clear guidance on who must be included in the CTA report, particularly as to who is deemed to own 25% of the ownership interests in a reporting company held by a trust with multiple beneficiaries and under which the trustee has full discretion to distribute (or not) net income and principal, no penalties should be assessed, provided the reporting company acts in good faith and takes all reasonable steps to identify trust individuals who must be reported.

The Proposed Regulations also include penalties for the failure to provide an updated beneficial ownership report to FinCEN within 30 days of learning of the change. In the context of a trust, this timeframe is too short to identify and report on a change at the trust level by a reporting company that may have no visibility on what is happening, at least with respect to the beneficiaries.[1] There are numerous situations that may give rise to a change in beneficial ownership, i.e., a minor turns 18, a beneficiary who was a beneficial owner dies, a power under the trust is exercised to add or remove a beneficiary, etc. If any type of change must be reported within 30 days, the reporting company would need to follow up with the trustee at least every few weeks to determine if there had been any changes. In the notice of proposed rulemaking, there is a comment that to allow the reporting companies to report on an annual basis could cause significant degradation and accuracy and usefulness of the beneficial ownership information. However, if the requirement to provide updated information within 30 days is limited to changes in the trustee, FinCEN will always have a means to collect additional information on the trust beneficiaries by simply contacting the trustee if questions arise prior to the annual report being filed. Perhaps with the exception of changes to the trustee, the reporting company should be required to report any changes through an annual filing, which would only be required if changes occurred during the prior year.

We therefore suggest four modifications to the Proposed Regulations. First, if a trust owns an ownership interest in a reporting company, we believe the reporting company should be permitted to list (i) the trustee and other individual(s), if any, described in Prop. Reg. § 1010.380(d)(3)(ii)(C)(*1*)) as the only individual(s) who might exercise direct or indirect substantial control, (ii) beneficiaries described in Prop. Reg. § 1010.380(d)(3)(ii)(C)(*2*), and (iii) a grantor or settlor described in of Prop. Reg. §1010.380(d)(3)(ii)(C)(*3*). In other words, the regulation should be clarified to state that the individuals identified in subparagraph (C) are exhaustive.

Second, we suggest that a reporting company that reasonably relies on information provided by a trustee as to whether any beneficiary or other individual should be included in the report shall not be subject to penalties if that information is later determined to be inaccurate or incomplete.

Third, we suggest that FinCEN lengthen the timeframe for a reporting company to report on beneficial ownership changes with respect to beneficiaries of trusts from the 30 days as currently proposed to one year for changes other than a change to the trustee.

Fourth, we suggest that if a bank or trust company is serving as trustee of a trust and has the authority to dispose of trust assets, the trustee itself and not any of its employees should be reported by the reporting company as a beneficial owner.

III. Company Applicant - Response to NPRM Question 20

Question 20: Is the proposed definition of company applicant sufficiently clear in light of current law and current company filing and registration practices, or should FinCEN expand on this definition? If so how?

Prop. Reg. §1010.380(e), which defines the term "company applicant," is quite broad. The definition of company applicant includes not only the individual who files the document that creates the domestic reporting company or that first registers the foreign reporting company, it also includes any other individual who directs or controls the filing of either such document by such individual. In effect the definition of company applicant captures the individual who actually files the document, such as an associate or paralegal at a law firm, an employee of the corporate service provider, or an employee of the reporting company, as well as the law firm partner, employer, principal, supervisor, business colleague, etc. who directs them to do so.

[1] We do not dispute that a change of trustee should be reported within 30 days.

The definition of company applicant in the CTA itself, which is found at 31 U.S.C. § 5036, is actually narrower than that in the Proposed Regulations in that it only provides that this term include an individual who files the application to form the reporting company or files the application to register the foreign reporting company to do business in the United States. However, the regulatory authority of Treasury throughout the CTA is quite broad, so there does appear to be support for the Proposed Regulations' expanded definition of company applicant. Chief among such support is CTA § 6402 which, when setting forth Congress's justification for enacting the CTA, notes the following:

> malign actors seek to conceal their ownership of corporations, limited liability companies, or other similar entities in the United States to facilitate illicit activity, including money laundering, the financing of terrorism, proliferation financing, serious tax fraud, human and drug trafficking, counterfeiting, piracy, securities fraud, financial fraud, and acts of foreign corruption, harming the national security interests of the United States and allies of the United States[.]

It would certainly be helpful to those in law enforcement to not only have information regarding the agent, employee, associate, vendor, etc. who filed the company formation or registration document, but also that of the person who directed them to do so. It is more likely that the person who directed the filing will have information on the beneficial owners of the reporting company should there be any questions with respect to the information reported to FinCEN pursuant to the CTA.

Nevertheless, there are practical issues with the Proposed Regulations' definition of company applicant that FinCEN should consider. Under Prop. Reg. §1010.380(b) the reporting company will be required to report with respect to the Company Applicant his or her name, date of birth, complete business address, and unique identifying number and provide a copy of the document that includes this number. With respect to the initial CTA report, we believe that it will be difficult for the reporting company to know in all cases who the company applicant is or the person who directed the company applicant, particularly if the filing or registration is carried out through a service provider utilized by the lawyer who advised the company at the time of formation. Even if the reporting company does secure this information for its initial CTA report, if any of this information is inaccurate or there is a change with respect to any such information, an updated or corrected report is to be filed with FinCEN by the reporting company under Prop. Reg. §1010.380(b). We believe that it will be the rare occasion that a reporting company would be aware of any changes to much of this information or have access to all the sources that could provide such information, particularly after many years have passed.

In order to avoid a concern on the part of a reporting company that it will be unable to access such information, we recommend that Prop. Reg. §1010.380(b) require the company applicant to provide the required information about themselves, and any changes in this information, to the reporting company. This Proposed Regulation could further provide that if the reporting company makes a reasonable and good faith effort to obtain this information from the company applicant for the initial and updated reports and provides proof of such efforts, the reporting company will be deemed to have fully complied with the CTA and shall not be subject to penalties if that information is later determined to be inaccurate or incomplete. Alternatively, this Proposed Regulation could mandate that a company applicant obtain a FinCEN identifier and provide this to the reporting company, in which case there should be no need for the reporting company to update the company applicant's information.

It is also quite possible that while the person who directed the company applicant to do the filing will remain in touch with the reporting company, that this person will eventually no longer have any contact or knowledge of the whereabouts of the person who was directed to do the filing. Prop. Reg. §1010.380(b) should therefore be revised to provide that if the person directing the company applicant provides to the reporting company its updated information, there is no need to provide information about the person who was directed to make the filing.

IV. Reporting Company - Response to NPRM Question 21

Question 21: Is the proposed definition of "reporting company" sufficiently clear to avoid confusion about whether an entity does or does not meet this requirement? If not, what additional clarifications could make it easier to determine whether this requirement applies to a particular entity?

A. Domestic Reporting Company Generally

As applied to domestic reporting companies, we are of the opinion that the definition is clear and leaves little room for ambiguity. We believe that under Prop. Reg. § 1010.380(c)(1)(i), the term "reporting company" includes a corporation, limited liability company, or other entity, created by the filing of an organizational document with the Secretary of State or similar office under the law of a state or Indian Tribe. While the statutory term "other entity" was initially unclear, it is clear from the Proposed Regulations that the term is not designed to encompass entities beyond those that require the filing of organizational documents with the applicable state or Indian Tribe, as these types of entities are not intended to be targeted under the Act. Further, it is clear from the Proposed Regulations that FinCEN desires to focus on an organizational filing requirement as the common and consistent qualifying factor to be a domestic reporting company, which makes sense and provides a clear regulatory requirement.

With this intention, "other entity" would appear to exclude a structure like a trust, which is created by an agreement between the settlor and trustee and not by the filing of an organizational document with a state or territory. This should be acceptable given FinCEN's intentions on scope of a reporting company. It is noteworthy that although a few states in the U.S. require or permit the trustee of a trust to file a trust registration with a government authority, in no state is such a registration required in order to create the trust.

If this interpretation is accurate, then we believe that in prescribing final regulations under the Act, FinCEN should affirm that that there should be no further regulatory expansion of the "reporting company" definition that attempts to identify additional organizational forms as being included under the Act.

B. Foreign Reporting Company Generally

As applied to foreign reporting companies, we are of the opinion that the definition "registered to do business" may be overly broad and leave room for ambiguity and cause disparate treatment among various states. This is because of the variation among state laws on what activity gives rise to the level of doing business. What may rise to the level of doing business in one state may not in another state. Consequently, we would propose additional considerations and broad line tests to make it easier to determine whether this requirement applies to a particular entity.

Additional clarification is needed with respect to foreign companies that may need to register in local U.S. jurisdictions for reasons <u>other</u> than conducting business. These situations arise when foreign companies have needs that may not rise to the level of "doing business" within a state, but nevertheless, are required under state law to seek clearance or registration of some sort to perform a certain task or activity. Examples may include the following types of activities that would require registration:

- Maintaining, defending, or settling a lawsuit or proceeding
- resurrecting and addressing a state tax clearance for a prior tax year

- dealing with internal LLC affairs such as holding member or manager meetings
- maintaining a bank account in the state
- having an office, agency, or persons in the state for handling securities custody
- soliciting or obtaining orders where the orders require acceptance outside the state before they become contracts
- selling, by contract created in a foreign jurisdiction and agreeing, by the contract, to deliver into a U.S. state that requires the supervision and/or inspection of technical or skilled trades that are generally not available in the foreign jurisdiction
- creating, as borrower or lender, or acquiring indebtedness with or without a mortgage or other security interest in property
- collecting debts or foreclosing mortgages or other security interests in property
- conducting an isolated transaction that is not one in the course of similar transactions. See Title 6, Section 18-912 of the Delaware Code and Florida Statutes 605.0905 Florida LLC Act for further example.

On the other hand, there may be instances where the "registered to do business" definition may not apply altogether because no registration is required under applicable state law; however, the foreign company is one that fits within the scope of entities that FinCEN wants to monitor and include as a "reporting company" under the CTA. Examples may include a foreign company formed to own certain personal real estate holdings in a U.S. jurisdiction or to maintain a bank account. Some states do not require registration in this instance as the activity does not rise to the level of transacting business. Illustrative examples of this can be found in Florida Statutes § 605.0905(m), and 68 Del. Laws c 18-912(3).

Finally, there may be instances where the "registered to do business" definition of a foreign corporation becomes moot or generally inapplicable because the foreign corporation no longer does business in the U.S., but the corporation needs to pursue a claim or tax assessment from a prior year. In that case, the corporation will need to pursue a certificate of authority to commence business. Further examples can be found in both Michigan Comp. Laws, § 450.2051 and in the Revised Model Business Corporation Act, § 15.02 (c). While likely unintended in scope, such a certification of authority would draw the foreign corporation back into the definition of a reporting company.

C. Exceptions to Reporting Companies—Large Operating Company

Prop. Reg. § 1010.380(c)(3) generally exempts 23 types of entities from the definition of "reporting company." Key exemptions include those for large operating companies, securities issuers, banks, insurance companies and producers, brokers or dealers in securities, registered investment companies and advisers, venture capital fund advisers, accounting firms, tax exempt entities (or those assisting tax exempt entities) and special pooled investment funds. We recognize that these entities are exempt because they are already subject to federal or state regulation, so their beneficial owners are typically known to regulators. We also recognize that FinCEN chose not to propose any new exemptions, despite its authority under the Act to do so.

The main expansion in the Proposed Regulations is clarification of the "large operating company" exemption, defining it in Prop. Reg. § 1010.380(c)(3)(xxi) to mean a company that: employs more than 20 employees on a full-time basis in the United States, filed Federal income tax returns in the prior year demonstrating more than $5,000,000 in gross receipts or sales in the aggregate, including receipts or sales from entities owned by the entity and through which the entity operates; and has an operating presence at a physical office within the United States.

While the clarification of a larger operating company exception is welcome, in some contexts, its requirements may swallow the rule. Below are some examples where a company may not benefit from the large operating company exception under a literal reading of the rule, even though intended.

A common organizational technique for larger companies is to own entities underneath for purposes of separating business lines and asset classes, minimizing liability exposure, engaging in tax planning, estate planning, and other business and planning purposes. In these instances, it is possible that the application of requirements under this exemption may not be met until a certain period of time has passed or might never be met because each new company would be a reporting company until it has had time to build a track record of gross receipts and employment. In some instances, the holding company might never meet the large company exception because its sole function is organizational and it does not operate a business. Perhaps in this instance a holding company can be exempted from the reporting requirements either by virtue of being an "alter ego" of the operating business, or by an expansion of the definition and requirements of the inactive entity exception under Prop. Reg. § 1010.380(c)(3)(xxiii), given its 100% ownership in the operating business. We believe that comparison can be drawn to the Proposed Regulations allowance for the $5,000,000 filing threshold to be met for affiliated groups of corporations within the meaning of 26 U.S.C. § 1504 and provided for specifically under Prop. Reg. § 1010.380(c)(3)(xxi)(C).

With the revolving door of company staffing, it is not uncommon these days for employees to shift employment, sometimes even after a short period of time. While the employee requirements of the exemption are helpful, we propose some markers on when the 20 full-time employees are measured so there is no confusion as to whether a company qualifies. For example, we propose the employee requirement included under Prop. Reg. § 1010.380(c)(3)(xxi)(A) be a measurement at "any point in the year", which will prevent disqualification of a company if at the end of the company's applicable tax year, some employees have left the organization and the 20 employee threshold is no longer met. Another option would be to apply an average number of employees over the company's applicable taxable year.

While the greater than $5,000,000 gross receipts requirement is a clear marker, its application to companies with foreign operations may present some inequities. Currently as the proposed rules are written, gross receipts from foreign operations are not included in this calculation. If it is FinCEN's intention to exclude foreign source earnings from being counted, then more specificity is needed in Prop. Reg. § 1010.380(c)(3)(C) to assess how to perform this analysis. In this day of the remote and virtual workforce, tracking domestic vs. foreign sales can be difficult without clear guidelines. For example, if a sale is consummated in a virtual meeting between parties located in the U.S. and in a foreign country, where is the revenue from the sale sourced? What if the sale was consummated physically in the U.S. but to a foreign customer? And even if clear guidelines are provided, how will the accounting for the U.S. vs. foreign revenue be handled? If a company is not setup with foreign operations, it could be an enormous administrative burden to require accounting systems and methodologies to accurately bifurcate domestic vs. foreign revenue for this purpose.

It is possible, especially in today's rapidly changing business environment, that a company which has previously qualified for the large operating company exception may become required to file under circumstances not intended to fall within the scope and purpose of the Act. Such instances might include the continuation of operating activities in furtherance of a plan to wind up the affairs of a company or a declaration of bankruptcy where partial year sales may not meet the $5,000,000 requirement. Often times these events span over one or more tax years. We would propose an additional exception for such circumstances where formal action has been taken pursuant to the governing documents of an entity to begin the discontinuation of operating activities.

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ACTEC appreciates that the task of preparing these Proposed Regulations is complex. We would very much appreciate the opportunity to participate in an open and on-going dialogue with FinCEN on a regular basis to assist in the process of formulating the new rules, particularly as they may relate to trusts that hold interests in reporting companies.

ACTEC's Executive Director, Deborah McKinnon and/or the Co-Chairs of the ACTEC FATF Task Force, Carolyn A. Reers, Lyat Eyal, and Glenn G. Fox, are available and may be contacted for this purpose:

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