

Delaware Corporate Trust Law Update

Thursday, February 23, 2023

The Corporate Transparency Act – An Overview for Our Corporate Trust Clients

On September 30, 2022, the Financial Crimes Enforcement Network (“FinCEN”) published the final rule concerning beneficial ownership reporting under the Corporate Transparency Act, for codification at 31 C.F.R. 1010.380 (the “Rule”). The first round of regulations implemented by the Rule will be effective January 1, 2024, and will have an immediate impact on trustees, corporate service providers, and other actors engaged in the formation and administration of legal entities.

Summary of the Rule

The Rule requires certain entities formed by a filing with the Secretary of State or any similar office under the laws of a state or Indian tribe (“Reporting Companies”) to file a report with FinCEN within 30 days of their formation (a “Report”). Reporting Companies existing before January 1, 2024 will have until January 1, 2025 to file a similar report. The Report must identify the Reporting Company and disclose certain personal identifying information on beneficial owners (“Beneficial Owners”) of and applicants (“Applicants”) for the Reporting Company. There are two categories of Beneficial Owners under the Rule. First, an individual is a Beneficial Owner of a Reporting Company if that individual owns or controls at least 25 percent of the ownership interests in the Reporting Company. Second, an individual is a Beneficial Owner if that individual exercises “substantial control” over the Reporting Company. There are also two categories of Applicants. First, the individual who files the document that forms the Reporting Company is an Applicant. Second, the individual who is primarily responsible for directing or controlling such filing is also an Applicant.

Absent an exception, the definition of Reporting Company will encompass almost all Delaware-created business entities. Similar to Delaware corporations, limited partnerships and limited liability companies, formation of Delaware statutory trusts (a “Statutory Trust” or “Statutory Trusts”) requires a filing with the Delaware Secretary of State. Such filing makes a Statutory Trust a Reporting Company under the Rule, unless an exception applies. Conversely, because the creation of Delaware common law trusts does not involve a state filing, they are not Reporting Companies under the Rule. There are 23 exceptions to the definition of Reporting Company. For so long as an entity that would be a Reporting Company falls into one of the exempted categories, it will not need to file a Report with FinCEN. Many Statutory Trusts will likely fall into one or more of the exempted categories, usually under the purview of the subsidiary exception codified at 31 CFR 1010.380(c)(2)(xxii), which provides that an entity that would be a Reporting Company will be exempt if it is a wholly-owned subsidiary of certain types of exempt entities. Through the subsidiary exemption, many Statutory Trusts may get the benefit of exemptions applicable to SEC Reporting Issuers, Depository Institution Holding Companies, and Large Operating Companies. Statutory Trusts may also be eligible for a number of other exceptions.

Corporate trustees and other corporate service providers should understand the Rule, the information to be reported, and the responsibilities to make filings under the Rule. Richards, Layton &



Finger, P.A. attorneys have been monitoring the Corporate Transparency Act since its initial proposal and have been closely analyzing its implementing regulations since the advance notice of proposed rulemaking was published in April 2021. We welcome our clients to reach out with questions and concerns and look forward to helping navigate the emerging regulatory landscape.

Considerations for Trustees

A. Filing Responsibility

The responsibility to file the Report with FinCEN belongs to the Reporting Company under the Rule. If a Statutory Trust is properly structured and the governing instrument is properly drafted, in many circumstances corporate trustees will not have an obligation to file Reports with FinCEN. Nonetheless, by virtue of serving as the trustee of a Trust, corporate trustees are indelibly associated with that Statutory Trust, and regulators may engage trustees in an enforcement action against a Statutory Trust. Even if a Statutory Trust is exempt from the Rule at the time of formation, exemption at formation does not shield the Statutory Trust from responsibility to make an updated filing later if the exception ceases to apply. If the composition of beneficial ownership of the trust changes, it may trigger a new filing obligation as well.

The parties to a trust agreement should agree in writing on whose responsibility it is to cause the Statutory Trust to file and continue to make filings to comply with the Rule. Additionally, for new transactions, corporate trustees should consider obtaining representations and warranties that the Statutory Trust qualifies for an exception under the Rule and covenants that, in the absence of an exception, the appropriate person at the trustor, sponsor, administrator, or other appropriate party will cause the Statutory Trust to comply with the Rule. Such representations, warranties, and covenants are not dissimilar from the market suite of representations, warranties and covenants that corporate trustees obtain regarding regulatory and licensing obligations that may attach to a Statutory Trust by virtue of its business or assets.

Corporate trustees and their clients may also need to adjust business practices in consideration of the Rule. For example, it is common practice to form a Delaware statutory trust under a short-form trust agreement months, or even years, in advance of a contemplated transaction. This practice is done for convenience and to allow the Statutory Trust time to obtain licenses, bank accounts, and tax IDs in advance of a given transaction. Because reporting obligations under the Rule generally trigger within 30 days of formation, the obligation to report could impose an additional responsibility during the time between formation and consummation of a transaction. That responsibility will increase if reportable information changes at the time a transaction closes, which could trigger a second reporting obligation. The Delaware Statutory Trust Act is flexible and offers multiple options for adapting to these circumstances. Richards, Layton & Finger welcomes discussions with its clients to address how to best construct a governing instrument to clarify these responsibilities.

B. Identity of Applicants

For many Reporting Companies, the two categories of Applicants will be the same person, but that will rarely be the case for Statutory Trusts. Corporate trustees typically execute Certificates of Trust at the direction of an individual at the corporate trustee's client who wishes to form the Statutory Trust and file the Certificate of Trust with the assistance of a third party. Going forward, to satisfy the

Applicant reporting requirement, Reporting Companies will need to confirm the identity of the individual who files the Certificate of Trust and the individual primarily responsible for directing the filing of the Certificate of Trust at the time the Statutory Trust is formed. If the corporate trustee elects to have its employee file Certificates of Trust, the filing employee's information will be reportable.

C. Backward-Looking Reporting Requirement

The Rule is both forward and backward-looking. Any Statutory Trust formed prior to January 1, 2024, will need to consider whether it qualifies for an exception from the Rule, and if it does not, file a Report no later than January 1, 2025. While, in most cases, the responsibility to file will not sit directly with the trustee, corporate trustees may wish to reach out to their existing clients to ensure that they are aware of the Rule and that they undertake to cause the Statutory Trust's compliance with it. Transaction parties may also wish to cancel dormant Statutory Trusts before January 1, 2025.

Considerations for Corporate Service Providers

Corporate service providers, such as registered agents, company formation agents and independent director service providers (collectively "Corporate Service Providers") will also see an immediate impact from the Rule. Corporate Service Providers regularly file instruments with Secretaries of State or similar offices that cause a Reporting Company to be formed.

A. Applicant Information Reporting

Each employee of a Corporate Service Provider who files a document causing the formation of a Reporting Company will be an Applicant. Corporate Service Providers will need to keep track of which employees make such filings, even if the Reporting Company qualifies for an exception at the time of formation. The information to be reported on an Applicant includes sensitive personal identifying information, such as name, date of birth, and a unique identifying number from certain acceptable classes of identification. As an alternative to providing or reporting such information directly, individuals may obtain a "FinCEN Identifier." A FinCEN Identifier is a unique identifying number assigned directly by FinCEN. Any person who obtains a FinCEN Identifier has an obligation to keep the information associated with it current with FinCEN. Once obtained, it may be provided in lieu of the sensitive information above. The process by which individuals can apply for a FinCEN Identifier is not yet set by the Rule and will be the subject of future rulemaking. Richards, Layton & Finger is closely monitoring future rulemaking on the procedure for obtaining a FinCEN Identifier to advise its clients on the process should they wish to pursue them for their employees.

B. Providing Guidance on Reporting

Due to the 30-day window between formation of a Reporting Company and the reporting deadline, Corporate Service Providers or their clients may begin working on their Report contemporaneously with formation of an entity, or shortly thereafter. It is likely that formation and reporting under the Rule may dovetail into one cohesive exercise and Corporate Service Providers may face questions from their clients about how to file or how to correctly report information. Corporate Service Providers should consider what advice they are willing to give and establish standards and protocols for doing so.

C. Independent Directors and Managers

Provisions relating to the authority of independent directors and managers, depending on their scope, may cause an independent director or manager to be classified as a Beneficial Owner. The Rule requires a Reporting Company to report any individuals with “substantial control” over it. Substantial control includes the ability to direct, determine, or exercise substantial influence over, among other things, the *dissolution* of a Reporting Company. Because Independent directors and managers frequently control a Reporting Company’s ability to dissolve, their information may be reportable, depending on the scope of that authority. Richards, Layton & Finger is available to discuss the boundaries of independent director and manager authority and their effect on the application of the Rule.

Considerations for other Entities

All existing entities should consider whether they are or will be categorized as Reporting Companies under the Rule and, if so categorized, determine whether they will qualify for an exemption from the Rule as of January 1, 2025. If no exception applies, such entity should be prepared to make a full and complete filing as early as January 1, 2024, and no later than January 1, 2025. Individuals and businesses who regularly form new entities should consider what additional procedures and protocols need to be put in place to carry on their business efficiently considering the Rule’s requirements. Such actions may include terminating unused shelf entities or restructuring existing portfolio companies to better facilitate compliance with the Rule. Failure to comply with reporting and filing obligations may result in enforcement of penalties that include fines of up to \$10,000 and imprisonment for not more than two years.

Conclusion

Trustees, Corporate Service Providers, and other actors engaged in the formation and administration of legal entities can take actions prior to the Rule’s effective date to smooth its implementation. Richards, Layton & Finger continues to monitor interpretation of and creation of rules under the Corporate Transparency Act. We welcome our clients to reach out with questions and look forward to helping navigate the emerging regulatory landscape.