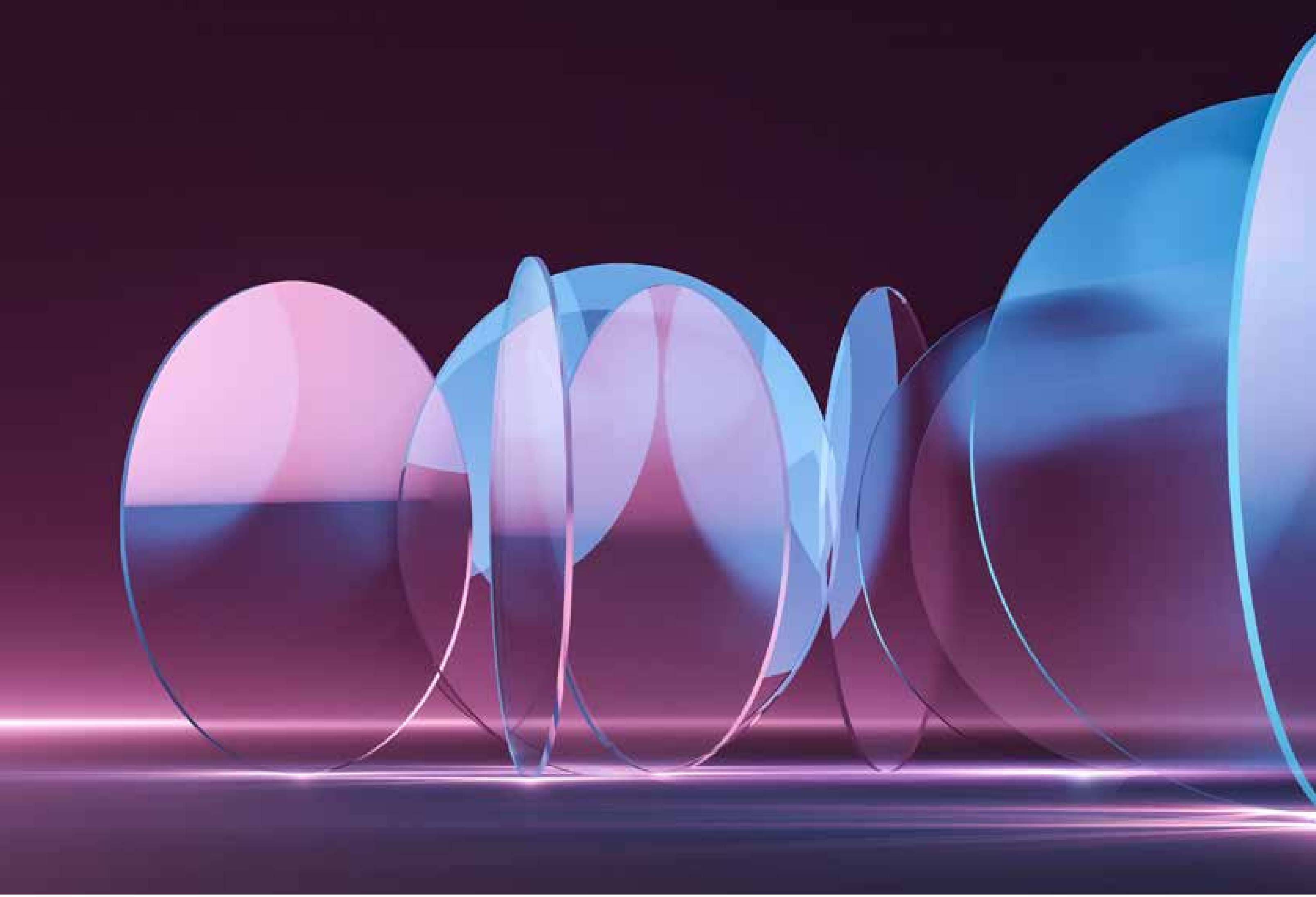
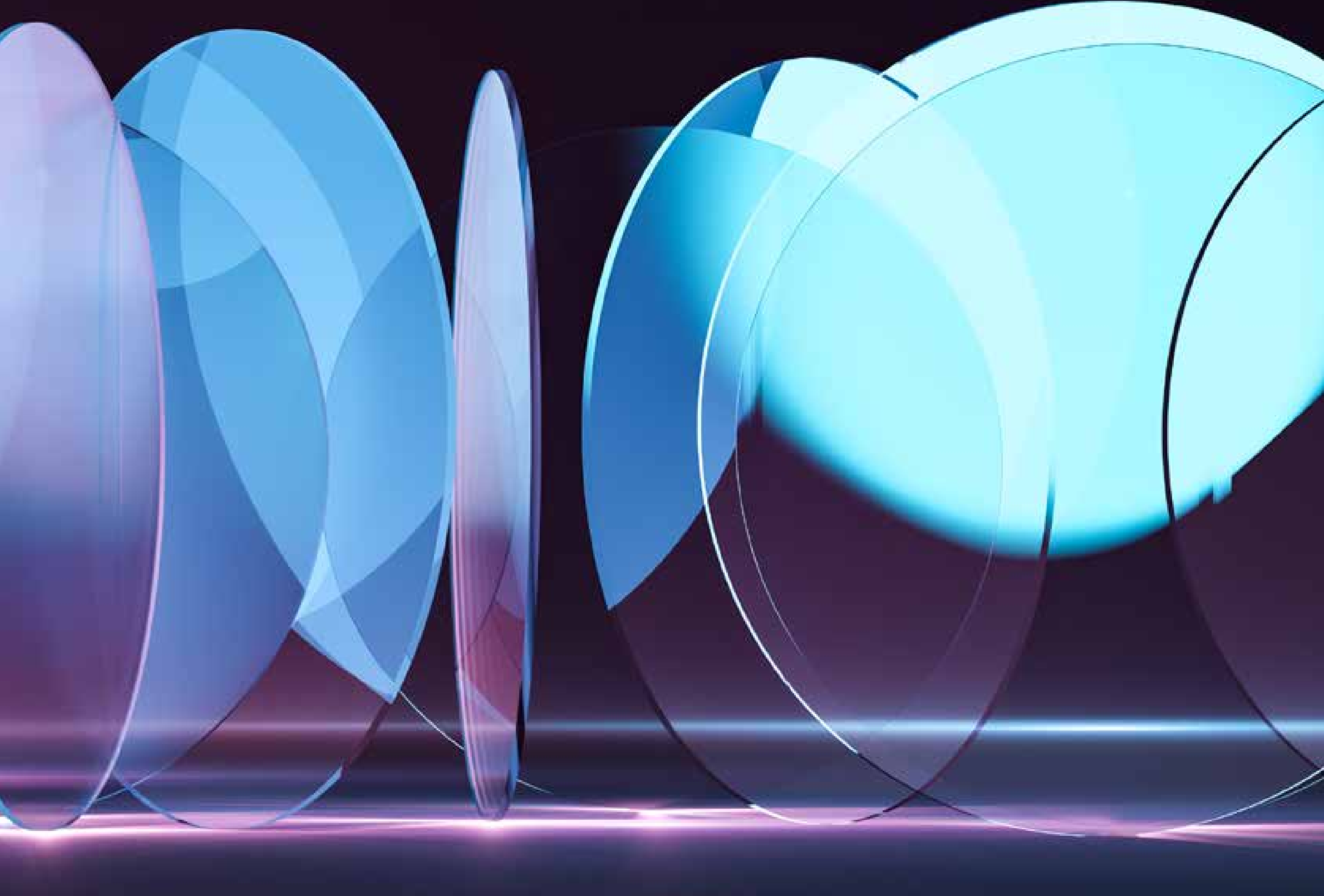


Novel Fiduciary Liability Risks Under the Corporate Transparency Act

By Steven H. Holinstat and Jacob E. Wonn



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As of January 1, 2024, the newly implemented Corporate Transparency Act (CTA) mandates that most corporations, limited liability companies (LLCs), limited partnerships (LPs), and similar business entities formed or registered to do business in the United States file reports with FinCEN identifying, among other things, such entity's "beneficial owners" and "company applicants." So-called reporting companies that fail to comply with these new requirements are subject to fines of up to $500 per violation per day, and individuals responsible for any willful noncompliance may be sentenced to imprisonment for up to two years. Although trusts themselves are not reporting companies under the CTA, many trusts own interests in reporting companies, thereby mandating the disclosure of the trustees and other fiduciaries of such trusts as beneficial owners of these reporting companies in FinCEN filings. Accordingly, the fiduciaries of trusts that own interests in reporting companies understandably may have concerns regarding the extent to which they are responsible for compliance with filing requirements under the CTA and could be held personally liable for noncompliance. This article explores potential fiduciary liability risks under the CTA and suggests practices to potentially mitigate or limit those liability risks.

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Background

Although a full description of the CTA's specific filing requirements and deadlines is beyond the scope of this article, a short summary of these requirements is warranted to set the stage for the discussion that follows. In general, the CTA requires any corporation, LLC, LP, or similar business entity (with some very limited exceptions) formed before 2024 to (a) file initial beneficial ownership information (BOI) reports with FinCEN on or before January 1, 2025, and (b) provide certain information regarding the reporting company's company applicants and beneficial owners. 31 C.F.R. § 1010.380(a)(1)(iii). With respect to any reporting company formed during or after 2024, the initial BOI report must be filed within 90 days of receiving evidence of formation of the company. *Id*. § 1010.380(a)(1)(i)(A). Additionally, any change to the information included in an initial BOI report must be reported to FinCEN within 30 days of the change. *Id*. § 1010.380(a)(2)(i).

For purposes of preparing a reporting company's initial BOI report, the

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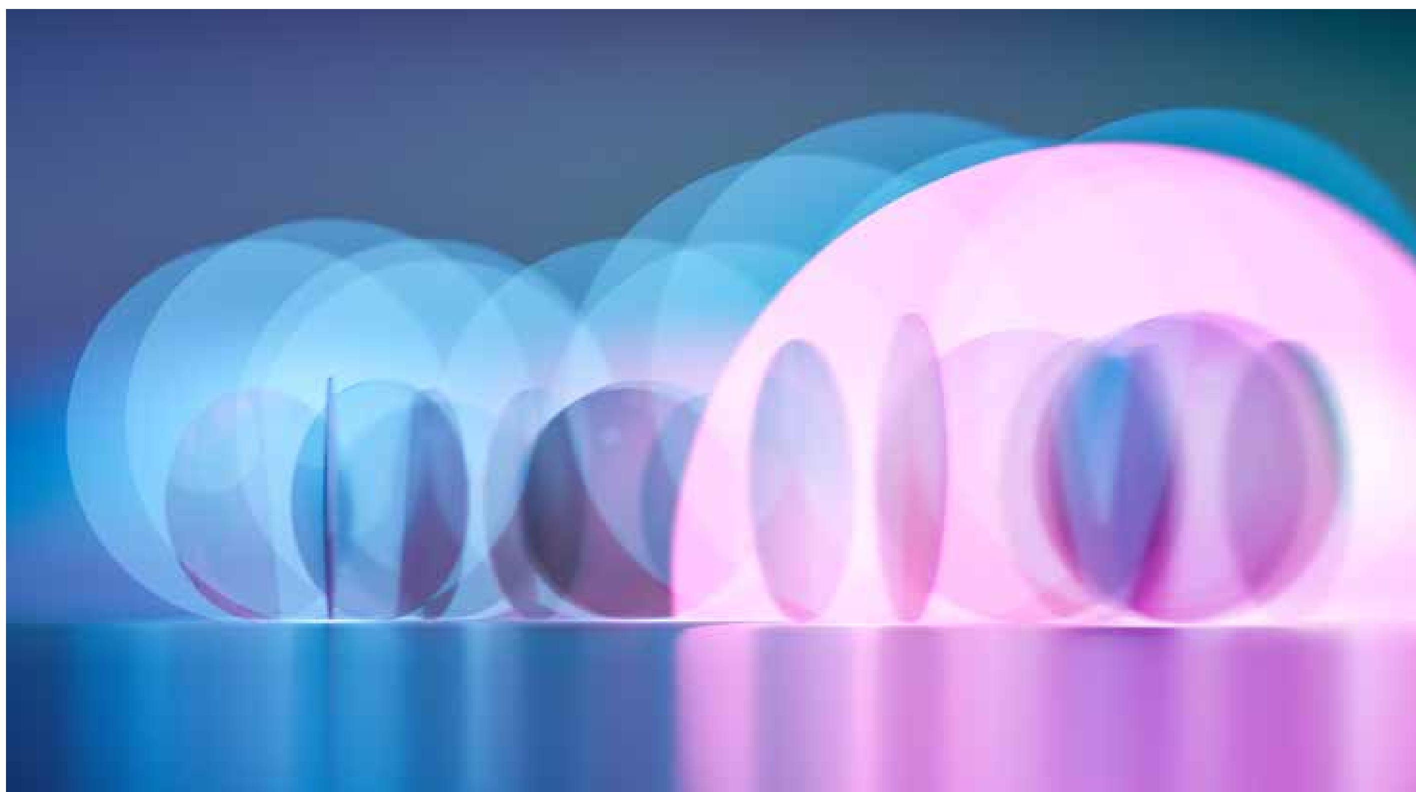
company applicants are defined as (a) the individual who actually files the documents forming the company with the relevant state agency and (b) the individual with primary responsibility for directing the filing. *Id*. § 1010.380(e). More importantly, for purposes of this article, a beneficial owner of a reporting company is defined as "any *individual* who, directly or indirectly, either [1] exercises substantial control over such reporting company or [2] owns or [3] controls at least 25 percent of the ownership interests of such reporting company." *Id*. § 1010.380(d) (emphasis added). This definition of beneficial owners generally includes directors and officers of a corporation and managers of an LLC, and in the context of a trust that holds at least 25 percent of the ownership interests in a reporting company and/or exercises substantial control over such company (such as, for example, the power to remove and replace directors, officers, or managers of the company), it also encompasses the trustees and other fiduciaries of the trust, and perhaps even the individuals with the power to remove and replace the trustees and other fiduciaries.

As previously noted, the CTA provides that any person who willfully fails to file required BOI reports or furnishes false information in those reports may be subject to fines of up to $500 per violation per day (not to exceed $10,000 per violation) and/or imprisonment for up to two years. 31 U.S.C. §§ 5336(h), 1010.380(g). In the context of a willful failure to file required BOI reports for a reporting company, these penalties may be imposed on any individual who "either causes the failure, or is a senior officer of the entity at the time of the failure." 31 C.F.R. § 1010.380(g)(4)(iii).

Risks of Fiduciary Liability Under the CTA

Given the financial penalties associated with a reporting company's noncompliance with the CTA's reporting requirements, it is foreseeable that trustees and other fiduciaries of trusts owning interests in reporting companies may have concerns regarding the extent to which they may become liable for any such noncompliance. The applicable regulation indicates that a reporting company's compliance with the CTA's reporting requirements is an obligation of the company itself, *id*. § 1010.380(a), which implies that the senior officers or managers of the company would bear direct responsibility for compliance. This, however, does not resolve the question of whether trustees and other fiduciaries of trusts with interests in reporting companies also might become liable for noncompliance with such requirements. As noted above, a person's liability for penalties under the CTA is predicated on that person willfully causing a failure to file required BOI reports or furnishing inaccurate information in those reports. Based on this standard, it seems plausible that the trustee of a trust with an interest in a reporting company could be exposed to liability under the CTA if that trustee neglects to provide the company's senior management with beneficial ownership information related to the trust's interest or willfully furnishes inaccurate information for the company's use in preparing a BOI report. Similarly, it is conceivable that such a trustee may potentially be held liable under the CTA if that trustee is in a position to exercise oversight with respect to the reporting company's senior management—such as through a power to remove and replace officers or managers of the company—and fails to take reasonable steps to ensure that any required BOI report is filed within the prescribed deadline. Furthermore, even if the parties with direct liability for penalties under the CTA in such circumstances would be the reporting company itself or members of its senior management, rather than the trustee, there is a risk that the parties with direct liability may, in turn, sue the trustee for their fault in causing the liability.

In any event, assuming a trustee of a trust with an interest in a reporting company may be held liable for penalties under the CTA in the types of circumstances described above, an important threshold question is whether that liability would be imposed on the trustee in their *fiduciary* capacity (in which case, any fines would be paid from trust property) or *personal* capacity (in which case, any fines would be paid from the trustee's own pocket). If a trustee were held liable under the CTA in a fiduciary capacity, the key legal issue to consider is whether beneficiaries of the trust could then sue the trustee in a surcharge action for losses incurred by the trust. In contrast, if the trustee were held liable under the CTA in a personal capacity, the key issue to consider is whether the trustee would be permitted reimbursement from trust property. The distinction between these two issues may have important ramifications when analyzed with respect to the terms of the trust's governing instrument, particularly any provisions thereof related to the exculpation or



indemnification of trustees.

Unsurprisingly, the CTA and its implementing regulations do not answer these questions, and no judicial opinions, administrative rulings, or expert commentaries have yet been published to address potential risks of fiduciary liability under the CTA. However, it is clear that trustees generally have a fiduciary duty to exercise reasonable care, diligence, and prudence in the administration of the trust estate, including with respect to the avoidance of unnecessary expenditures. Indeed, legal precedents in analogous contexts illustrate that trustees may be held liable for losses resulting from the failure to comply with other types of governmental filing requirements (such as tax returns). *See, e.g.*, *Est. of Gerber*, 73 Cal. App. 3d 96, 115 (1977) (holding trustee liable for failure to make timely claim for refund of taxes due); *People ex rel. Madigan v. Manor*, 2013 IL App. (1st) 113132-U, at P2 (holding trustee of charitable trust liable for failure to comply with state attorney general's reporting and registration requirements).

To illustrate how the aforementioned principles and issues might play out in practice, consider the following hypothetical scenarios:

Scenario 1. *A trust is the sole member of an LLC that is a reporting company, and the trustee of the trust is the manager of the LLC.*

In this scenario, given that the trust is the sole owner of the LLC and the trustee (either as trustee or as manager of the LLC) is the only person able to exercise substantial control over the LLC, it is likely that such trustee would bear direct and exclusive responsibility for filing the LLC's BOI reports and, as a result, could potentially be held liable for any penalties imposed under the CTA if they either fail to file said reports or willfully file reports containing false information. Furthermore, if any associated penalties were charged against the trust property—including against the LLC's assets, which are, in turn, indirectly owned by the trust—the trust beneficiaries may claim that such actions by the trustee (either as a fiduciary of the trust or manager of the LLC) constitute a breach of the trustee's fiduciary duty and seek to surcharge the trustee for the losses resulting from said breach.

Scenario 2. *A trust owns a 24 percent membership interest in an LLC that is a reporting company, the trustee also happens to be the manager of the LLC, and the remaining membership interests are owned by unrelated third parties.*

The trustee, in their capacity as manager of the LLC, would be responsible for filing the LLC's BOI reports. If any associated penalties were charged against the reporting company for failing to timely file an accurate BOI for the reporting company, the trust's beneficiaries could seek to surcharge the trustee for any indirect loss sustained by the trust due to its 24 percent interest in the reporting company. But, if the liability arises from the failure or refusal by the 76 percent owners to provide the requisite information, the trustee may seek to raise this fact as a defense to a claim by the trust's beneficiaries (assuming, of course, that the trustee engaged in appropriate due diligence). It is also possible that the trust's beneficiaries could nonetheless seek to hold the trustee liable unless the trustee (as manager of the LLC) were to take all appropriate steps to recover

any losses from the other owners who failed or refused to provide the requisite information.

Scenario 3. *A trust is the sole member of an LLC that is a reporting company, the manager of the LLC is an unrelated third party, and the trustee of the trust has the power to remove and replace the manager of the LLC.*

In this scenario, although the third-party manager of the LLC would be responsible for filing the required BOI reports, the fact that the trust is the sole owner of the LLC ostensibly gives rise to an affirmative fiduciary duty of the trustee to furnish the manager with accurate beneficial ownership information needed to file such reports. In addition, the fact that the trustee has the power to remove and replace the LLC's manager suggests that the trustee's fiduciary duties would entail an obligation to take reasonable steps to ensure that the manager, in fact, files any required BOI reports within the prescribed deadline, and perhaps even to remove and replace the manager if the trustee has reason to believe that the manager will not comply with the filing requirements. Accordingly, it is plausible that the trust's beneficiaries could seek to hold the trustee responsible for any losses resulting from the trustee's failure to provide the manager of the LLC with accurate information needed to prepare BOI reports, or to exercise reasonable oversight of the manager's compliance with CTA filing requirements.

Scenario 4. *A trust owns a 24 percent membership interest in an LLC that is a reporting company, the remaining 76 percent membership interests are owned by unrelated third parties, the manager of the LLC is also an unrelated third party, and the trustee does not have any role within the LLC or any power to remove and replace the manager of the LLC.*

Unlike in the previous three scenarios, the trustee's risk of exposure to liability in this scenario is much lower for any CTA reporting violations, given that (a) the trust's membership interest in the LLC is under the 25 percent threshold required for beneficial ownership information concerning the trust to be included in the LLC's BOI report and (b) the trustee is not a manager of the LLC and lacks any other authority to exercise substantial control over the LLC. Even in this scenario, however, it would be advisable for the trustee to make an effort to communicate with the manager of the LLC regarding compliance with the CTA's reporting requirements, if only to guard against the remote risk that the trust's beneficiaries could later attempt to sue the trustee if the value of the trust's interest in the LLC were to be diminished by penalties associated with any violations of such requirements.

Practical Guidance

In light of the foregoing potential risks of fiduciary liability under the CTA, trustees of trusts with interests in reporting companies should consider the following practices to attempt to potentially mitigate or limit such risks:

- Where the trustee of a trust with an interest in a reporting company also acts in a managerial capacity with respect to the company, the trustee should make reasonable efforts to ensure that any required BOI reports are filed within the prescribed deadlines using accurate information.
- In cases involving multiple unrelated third parties, compliance with the CTA will require clear communication and coordination between the trustees of trusts owning interests in reporting companies and the third-party managers, officers, etc. of those companies in order to assign responsibility for preparing and filing BOI reports, collecting and furnishing info required for BOI reports, and implementing internal procedures and safeguards to ensure compliance.
- Trustees of trusts owning interests in reporting companies should seek advice from appropriate professionals, including attorneys, to better understand their obligations under the CTA and receive assistance with analyzing the beneficial ownership of such companies. The trustees also should consider engaging service providers to assist with monitoring CTA compliance and preparing necessary filings. These types of services are now being offered by vendors such as CT Corporation and Corporation Service Company, among others.
- Attorneys drafting LLC operating agreements and similar governance documents for other types of reporting companies should consider whether to clearly indicate in such documents who shall bear responsibility for filing BOI reports and to consider whether such documents should include provisions to exculpate and/or indemnify non-responsible parties who are assessed with penalties for violations of the CTA's reporting requirements.
- Similarly, attorneys drafting trust agreements for trusts that will own interests in reporting companies should consider whether to include provisions defining the trustee's obligations regarding CTA reporting requirements, and potentially including exculpation and/or indemnification provisions to the extent permissible under applicable law.
- Even in situations where the trustee of a trust with an interest in a reporting company is not directly responsible for preparing and filing BOI reports, that trustee would still be well-advised to proactively furnish the responsible party with beneficial ownership information required for such reports and to follow up with the responsible party before any applicable deadlines to ensure that BOI reports are timely filed. ■