

Bankruptcy Trustees Need More FinCEN Guidance

By **Brian Shaw and David Doyle** (August 9, 2024)

Congress enacted the Corporate Transparency Act in 2021 to require reporting of information about entities and their beneficial owners to combat money laundering, tax fraud and other financial crimes.[1]

The CTA generally requires reporting companies to identify their beneficial owners through a filing with the U.S. Department of the Treasury's criminal enforcement bureau, the Financial Crimes Enforcement Network.[2] Failure to timely file CTA reports can result in civil and criminal fines and penalties against the failing entity and its senior officers.[3]

The initial deadline to report for companies formed before Jan. 1, 2024, is Jan. 1, 2025.[4] Companies formed between Jan. 1, 2024, and Dec. 31, 2024, must complete their first reporting within 90 days of formation, and those formed Jan. 1, 2025, or later, must do so within 30 days of formation.[5]

Reporting companies must also file updated reports upon a change in the required information filed with respect to the reporting company and its beneficial owners. [6]

Since its enactment, insolvency professionals have questioned whether Chapter 7 and 11 trustees and other insolvency-related fiduciaries are subject to the CTA's reporting obligations and penalties.

This is so, in no small part, because although the CTA has over 20 exceptions to the definition of a "reporting company," being a debtor in bankruptcy, or a receiver or assignee, is not one of them.[7] As of yet, FinCEN has not issued formal guidance for any type of bankruptcy fiduciary, but it has not been silent either.

Last month, FinCEN entered into consent orders in two North Carolina bankruptcy cases reflecting a rather limited position that, absent rare and unusual circumstances, a Chapter 7 trustee is not a senior officer of a reporting company and thus will not incur liability under the CTA.[8] And while this instruction makes practical sense in the context of Chapter 7 cases in which they were entered, it is not clear the same is true for other types of fiduciaries.

For example, a trustee of an operating company, whether in Chapter 11 or the unusual operating Chapter 7 case,[9] or an assignee or receiver that has control over an operating entity, all could be argued to be acting as a senior officer of the operating entity.

Similarly, a trustee of an estate, or estates, that includes a subsidiary and its member-managed parent may also have requirements simply because of the company structure of certain assets belonging to the estate.

Accordingly, and as addressed below, additional guidance is necessary for most types of fiduciaries overseeing bankruptcy estates or other insolvency vehicles.



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The Corporate Transparency Act

The CTA requires a reporting company to disclose information about each of its "beneficial owners," as defined in the CTA.[10]

The CTA has numerous exceptions from the definition of "reporting company," including any company that has an operating presence at a physical office in the U.S., 20 or more full-time U. S. employees, and reported U. S. receipts or sales for the previous year exceeding \$5 million.[11]

There are other exceptions for companies subject to disclosures under other laws, such as insurance companies, public accounting firms and banks.[12] As noted above, debtors and bankruptcy trustees are not part of the exclusions.[13]

Under the CTA, the term "beneficial owner" means "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (i) exercises substantial control over the entity; or (ii) owns or controls not less than 25 percent of the ownership interests in the company." [14]

For each beneficial owner, the reporting company must disclose the owner's full legal name; date of birth; residential street address; an identifying number from a nonexpired passport, driver's license or similar document; and an image of the document.[15]

Any person who "willfully fail[s] to report complete or updated beneficial ownership information to FinCEN" is in violation of the act and subject to criminal and civil penalties.[16] A person has "failed to report" if the person "causes the failure, or is a senior officer of the [reporting company] at the time of the failure." [17]

The term "senior officer" is defined as "any individual holding the position" or "exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function." [18]

YLG Partners and BOA Nutrition

In June, the bankruptcy administrators, or BAs, in YLG Partners Inc. in the U.S. Bankruptcy Court for the Middle District of North Carolina [19] and BOA Nutrition Inc. in the U.S. Bankruptcy Court for the Eastern District of North Carolina [20] filed largely identical motions requesting that the bankruptcy court confirm that Chapter 7 trustees are not subject to the CTA. [21]

In both cases, the debtor was a North Carolina corporation and otherwise qualified as a reporting company under the CTA. [22]

The BAs argued that, as a matter of law, the Chapter 7 trustee was not required to report on behalf of the debtor. In the motions, the BAs noted that the debtor is a separate and distinct legal entity from the bankruptcy estate, which is created by statute upon the filing of a bankruptcy petition.

The BAs further argued that the Chapter 7 trustee is an agent of the bankruptcy estate, not of the debtor, and the Chapter 7 trustee's duties ordinarily do not require performing a responsibility of the debtor unless expressly required to do so by statute. [23]

The BAs also noted that a Chapter 7 trustee is an independent third party with no firsthand knowledge about a debtor's beneficial ownership. The BAs correctly pointed out that, if subject to the act, a trustee would often have to resort to taking discovery from shareholders, officers and directors to obtain the required information — with no corresponding benefit to the bankruptcy estate, and often with no funds to compensate the trustee for his or her efforts.

In both cases, FinCEN filed substantially similar response briefs.[24] FinCEN focused on the definition of "senior officer" of a reporting company to determine whether a trustee risked sanctions under the CTA.[25] According to FinCEN, serving as a Chapter 7 trustee of the bankruptcy estate of a reporting company does not make the trustee a "senior officer" of the debtor.[26]

A senior officer is an individual who "hold[s] the position or exercis[es] the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function," according to the CTA.[27] Because a trustee does not exercise that type of authority over the Chapter 7 debtor, FinCEN contended, a trustee would not be required to report for the debtor.[28]

So, while FinCEN agreed with the BAs' conclusion, it got there by different means. That is notable, because FinCEN did not state that Chapter 7 trustees have a blanket exclusion from the CTA and its civil and criminal penalties.[29]

Rather, FinCEN cautioned that a Chapter 7 trustee may be liable for a Chapter 7 debtor's failure to report under the CTA in "unusual circumstances." [30] FinCEN gave two unusual, nonexclusive examples: a trustee who willfully prevented the debtor from reporting, and one who falsely informed the debtor that the trustee would report for the debtor.

Unusual circumstances not mentioned by FinCEN, but which should give Chapter 7 trustees pause, include those in which a trustee has been authorized to operate the Chapter 7 debtor's business under Section 721 of the U.S. Bankruptcy Code,[31] or has been appointed over affiliated parent and subsidiary debtors, where the subsidiary is a reporting company, and the parent is its managing member — a position to which the trustee, on behalf of the estate, may succeed.

Both situations, it could be argued, put the trustee in a position more easily equatable to a senior officer.

FinCEN may have agreed to the entry of consent orders in North Carolina to avoid a decision by the bankruptcy court that found broader protection for bankruptcy trustees than that which FinCEN was willing to agree.[32]

Consistent with a desire to preserve its ability to craft its policy without the help of bankruptcy courts, FinCEN's responses in the North Carolina cases also noted that it anticipates "issuing official guidance consistent with this response to provide clarity for Chapter 7 trustees more generally." [33]

More Guidance Necessary From FinCEN

Under the CTA's regulations, the definition of a senior officer includes not only those who "hold the position" of an officer, but also those who "exercise the authority" of one.[34]

As noted above, even after the entry of the consent orders in BOA Nutrition and YLG Partners, whether an operating bankruptcy trustee, assignee or receiver can be held liable under the CTA is unclear.

A Chapter 11 trustee who oversees the management of an operating entity would seem to fall closer to the definition of "senior officer" or otherwise have substantial control. The same can be said of some federal and state court receivers or assignees, who in their respective processes may also be operating a business.

Each of these fiduciaries could be defended by many or all the arguments set forth by the BA if faced with alleged CTA liability.

On the other hand, each of these fiduciaries could also be argued by FinCEN to be much more akin to a senior officer than a Chapter 7 trustee. Such a conflict should make any trustee or other bankruptcy fiduciary nervous absent guidance from FinCEN or the courts.

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[1] 31 U.S.C. § 5336.

[2] *Id.* § 5336(b)(1).

[3] *Id.* § 5336(h)(3).

[4] 31 C.F.R. 1010.380(a)(1)(iii).

[5] 31 C.F.R. 1010.380(a)(1)(ii)(A), (B).

[6] 31 U.S.C. § 5336(b)(1)(D); 31 C.F.R. 1010.380(a)(1)(i)(A).

[7] See *id.* § 5336(a)(11)(B)(i) – (xxi); see also, e.g., Bethany D. Simmons and Noah Weingarten, *FinCEN Provides Corporate Transparency Act Reporting Guidelines for Bankruptcy but Uncertainty Remains*, Reuters (June 18, 2024) (<https://www.reuters.com/legal/litigation/fincen-provides-corporate-transparency-act-reporting-guidelines-bankruptcy-2024-06-18/>).

[8] *In re YLG Partners, Inc.*, Case No. 23-10709 (Bankr. M.D.N.C.); *In re BOA Nutrition, Inc.*, Case No. 23-03665 (Bankr. E.D.N.C.).

[9] See 11 U.S.C. § 721.

[10] 31 U.S.C. § 5336(b)(1), (2).

[11] 31 U.S.C.A. § 5336(a)(11)(B).

[12] *Id.*

[13] See *id.*

[14] *Id.* § 5336(a)(3).

[15] *Id.* § 5336(b)(2).

[16] *Id.* § 5336(h)(1)(B), (h)(3).

[17] 31 C.F.R. § 1010.380(g).

[18] 31 C.F.R. § 1010.380(f)(8).

[19] YLG Partners, Case No. 23-10709.

[20] BOA Nutrition, Case. No. 23-03665.

[21] YLG Partners, Case No. 23-10709 (Bankr. M.D.N.C.) [Dkt. No. 16]; BOA Nutrition, 23-03665 (Bankr. E.D.N.C.) [Dkt. No. 25].

[22] *Id.*

[23] *Id.*; see, e.g., 11 U.S.C. § 704(a)(11) (requiring trustee to perform debtor's obligations under employee benefit plan); 26 U.S.C. § 6012(b)(3) (requiring trustee to file tax returns on behalf of debtor).

[24] YLG Partners, Case No. 23-10709 (Bankr. M.D.N.C.) [Dkt. No. 62]; BOA Nutrition, 23-03665 (Bankr. E.D.N.C.) [Dkt. No. 46].

[25] *Id.*

[26] *Id.*

[27] 31 C.F.R. § 1010.380(f)(8).

[28] YLG Partners, Case No. 23-10709 (Bankr. M.D.N.C.) [Dkt. No. 62]; BOA Nutrition, 23-03665 (Bankr. E.D.N.C.) [Dkt. No. 46].

[29] *Id.*

[30] *Id.*

[31] 11 U.S.C. § 721.

[32] YLG Partners, Case No. 23-10709 (Bankr. M.D.N.C.) [Dkt. No. 63]; BOA Nutrition, 23-03665 (Bankr. E.D.N.C.) [Dkt. No. 48].

[33] YLG Partners, Case No. 23-10709 (Bankr. M.D.N.C.) [Dkt. No. 62]; BOA Nutrition, 23-03665 (Bankr. E.D.N.C.) [Dkt. No. 46].

[34] 31 C.F.R. § 1010.380(f)(8).