

The Corporate Transparency Act – A Big Deal for Small Entities

Corporate Transparency Act - Background

The recent enactment of the Corporate Transparency Act (CTA) is a significant addition to the U.S. anti-money laundering laws. The principal objective of the (CTA) is to create a national database of information regarding the individuals who, directly or indirectly, own a substantial interest in, or hold substantial control over (referred to in the CTA as “beneficial owners”), certain types of domestic and foreign legal entities (referred to in the CTA as “reporting companies”). The CTA requires “reporting companies” to e-file a report with the Treasury Department’s Financial Crimes Enforcement Network (FinCEN), containing personal identifying information about the company, its “beneficial owners” and “company applicants.” FinCEN estimates that the CTA will initially affect over 32.6 million entities and 5 million each year thereafter, imposing significant compliance burdens on smaller, otherwise unregulated, entities.

The CTA was enacted on January 1, 2021, as part of the National Defense Authorization Act. Final regulations were issued September 29, 2022.¹ It is designed to prevent evasion of anti-money laundering rules and protect the U.S. financial system from illicit use. It establishes a central registry of individuals who are beneficial owners of legal entities, aiming to provide transparency with a repository of data on those who control smaller businesses. To collect this data, it imposes a reporting requirement on entities subject to the Act.

Under the CTA, corporations, limited liability companies (LLCs) and limited partnerships (LPs) (reporting companies) must disclose information on the company itself and its “beneficial owners” to FinCEN. Reporting companies are generally created by filing a document with the secretary of state or similar office. Entities which are already heavily regulated, such as banks and charities, may qualify for exemptions. Since the formation of a trust does not require filing any document with the secretary of state or similar office,

a trust is generally not subject to the Act. However, certain situations (discussed below) may cause trusts to be subject to the CTA’s reporting requirements.

Who is Subject to Reporting Requirements?

In general, a domestic or foreign “reporting company” is subject to the Act. A “reporting company” is defined as any entity whose creation requires a filing with a secretary of state or other governmental authority unless an exemption applies. Thus, corporations, LLCs and LPs are subject to the Act.² In addition, the CTA also applies to foreign legal entities that register to do business in the U.S. by filing registration documents with a governmental authority (in CTA parlance, an “applicable agency”).

The CTA specifically excludes twenty-three different types of entities from the definition of a “reporting company”, because they are already subject to substantial federal or state regulation. The most notable exception is for “large operating companies”, defined as companies with a physical presence in

¹The CTA is codified at 31 CFR §5336 and the final regulations are located in the Code of Federal Regulations at 31 CFR 1010.380. The final regulations are 330 pages long, only 32 pages of which contain the text of the final regulations – the remaining pages contain background on the development of the CTA. The preamble to the final regulations includes a substantial narrative that explains the final regulations and the basis for the rules. FinCEN expects to issue further clarification and guidance, including FAQs and help lines, to assist in understanding and implementing the CTA.

²General partnerships, sole proprietorships and trusts, whose formation is not dependent upon a filing with a secretary of state or other governmental authority, are not “Reporting Companies” under the CTA. However, reporting may be required if it is a Beneficial Owner of, or a Company Applicant with regards to, a Reporting Company, as discussed later.

the United States, more than \$5 million of U.S.-sourced gross receipts or sales on the previous year's tax return, and more than 20 full-time employees in the U.S.³ Legal entities that are wholly owned or controlled⁴ by one or more large operating companies (or any of the entities listed below, which are exempt from the CTA reporting requirements) are also exempt from the CTA under the so-called Subsidiary Exemption.⁵ The beneficial ownership information (BOI) in such situations need only include the name of the exempt entity in lieu of the other information required of the beneficial owners.

Is a “Family Office” a Reporting Company under the CTA?

Most U.S. “family offices” are organized as corporations, LLCs or LPs, whose creation depends on filing documents with the secretary of state or other governmental authority. Thus, a “family office” meets the definition of a domestic reporting company subject to the reporting requirements of the CTA.

However, a large “family office” may fall under the large operating company exemption (described above) if it has (1) a physical presence in the United States, (2) more than \$5 million of U.S.-sourced gross receipts or sales⁶ on the previous year's tax return, and (3) more than 20 full-time employees in the U.S.

If the family office is registered as an investment advisor under the Investment Advisors Act of 1940, which is often the case for “multi-family offices”, or is a “venture capital fund advisor” under the Investment Company Act of 1940, the family office would qualify for an exemption from the definition of a reporting company (mentioned below). The family office may also be exempt from the definition of a reporting company if it is a “commodity pool operator”, “commodity trading advisor”, or other entity registered with the U.S. Commodity Futures Trading Commission (mentioned below).

A registered private trust company (PTC) may be exempt from the CTA as a “bank” under the Investment Company Act of 1940 if it is state supervised and examined.⁷

Entities controlled by or wholly owned by an exempt family office entity should also be exempt from the CTA reporting requirements under the “Subsidiary Exemption” described above.

Companies Exempt from the CTA Reporting Requirements

The principal targets of the CTA are shell companies used for money laundering and other illegal purposes. Thus, the CTA contains twenty-three exemptions to the reporting requirements for various entities that do not pose a money laundering threat. It authorizes FinCEN to add to the list of entities exempt from the CTA, although FinCEN is not recommending any additional exemptions at the present time. The following entities, which each have detailed definitions, are currently exempt from the CTA's reporting requirements:⁸

- Securities Reporting Issuer
- Domestic Governmental Authorities
- Banks
- Domestic Credit Unions
- Bank Holding Companies and Saving and Loan Holding Companies
- Registered Money Transmitting Businesses
- Broker-Dealers in Securities
- Securities Exchange or Clearing Agents
- Other Exchange Act Registered Entities
- Registered Investment Companies and Advisors
- Venture Capital Fund Advisor
- State-Regulated Insurance Companies
- State-Licensed Insurance Producers

³ A newly formed entity will never meet this exception.

⁴ The CTA final regulations do not provide clarity on the definition of “control.”

⁵ CTA §5336(a)(11)(B)(xxii); 31 CFR §1010.380(c)(2)(xxii). This exemption does not extend to subsidiaries of money services business, pooled investment vehicles, or entities assisting a tax-exempt entity. According to FinCEN, this exemption is limited to wholly-owned subsidiaries to prevent “entities that are only partially owned by exempt entities from shielding all of their beneficial owners.” The “wholly-owned” requirement eliminates companies who have issued restricted stock or profit interests to service providers from qualifying for the “subsidiary exemption.”

⁶ \$5 million in gross receipts or sales in the aggregate, including the receipts or sales of other entities owned by the family office and through which the family office operates.

⁷ See also the exception in 31 C.F.R. §1010.380(b)(2)(i) which may apply to private trust companies.

⁸ See 31 U.S.C. §5336(a)(11)(B)(i)-(xxiii) for a detailed list and description of the 23 entities exempt from the CTA reporting requirements.

- Commodity Exchange Act Registered Entities
- Public Accounting Firms
- Public Utilities
- Financial Market Utilities
- Pooled Investment Vehicles
- Tax-Exempt Entities including a §527 political organization
- Entities Assisting Tax-Exempt Entities
- Large Operating Companies
- Subsidiaries of Exempt Entities
- Inactive Entities⁹

Unfortunately, there is no procedure for an entity exempt from the CTA reporting requirements to secure a “certification” of its CTA exemption.

An entity that was exempt from the CTA reporting requirements that no longer meets the criteria for any exemption must file a BOI report within 30 calendar days after the date that it no longer meets the criteria for any exemption.

If a reporting company meets the criteria for any exemption subsequent to filing an initial report, that change is deemed to be a change with respect to information previously submitted to FinCEN, and the entity must file an updated report within 30 days. That updated report must indicate that the filing entity is no longer a reporting company.

Who is a “Beneficial Owner” or “Company Applicant?”

The CTA requires reporting companies to report certain identifying information for both a “beneficial owner” and a “company applicant” to FinCEN. A “beneficial owner” is defined as an individual who (1) directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, owns or

controls¹⁰ at least 25% of the “ownership interests” of a reporting company, or (2) exercises “substantial control” over a reporting company (e.g., senior officers of a company defined as, among others, a CEO, CFO, COO, general counsel, or anyone with similar duties regardless of title).¹¹

The CTA takes an expansive view of the term “ownership interest.” It includes both equity in the reporting company and other forms of interests, including capital or profit interest; instruments convertible into equity, including warrants, rights and options; and other interests convertible into equity in the company.¹² In calculating the 25% ownership threshold, options or other contingent interests in the reporting company are treated as exercised without regard to any discount for the present value of the contingent interest. The term “ownership interest” also includes indirect ownership (e.g., acting as an intermediary, custodian or agent for another, or otherwise having an ownership interest by another person that an individual has the right to control).

Those who are not included in the definition of a beneficial owner include the following: (1) minor children¹³ (however, the company must provide information of a parent or legal guardian required by the CTA), (2) individuals acting as nominees on behalf of another individual, (3) employees who are strictly employees and not senior officers, (4) individuals whose only interest in a reporting company is a future inheritance right, (5) creditors of a reporting company, and (6) individuals who provide ordinary, arms-length advisory or other third-party professional services to a reporting company.

A “company applicant” is defined as a person who actually files the document to create the company with the secretary of state or other governmental authority, or who first registers a foreign reporting company with

⁹ The final regulations define an “inactive entity” as one that (1) was in existence on or before January 1, 2020, (2) is not engaged in active business, (3) is not owned by a foreign person, (4) has not experienced any change in ownership in the preceding 12-month period; (5) has not sent or received funds in an amount greater than \$1,000 through a financial account in the preceding 12-month period; and (6) does not hold any assets.

¹⁰ Note the two components of this test: (1) an individual who owns at least 25% of the ownership interests of a Reporting Company or (2) an individual who controls at least 25% of the ownership interests of a Reporting Company.

¹¹ “Substantial control” (as is “ownership”) is broadly defined. “Substantial control” does not require ownership in an entity but relates to authority and decision making. In addition to being a senior officer of the company, an individual can exercise “substantial control” over a company if (1) they have authority over the appointment or removal of senior officers or majority of the board of directors, (2) have “substantial influence over important decisions” of the reporting company, or (3) (catch-all provision) have any other form of substantial control over a Reporting Company.

¹² If there is more than one class of equity interests outstanding, the 25% threshold is determined as a percentage of all outstanding interests, if possible. Failing that, at least 25% of any class of equity interests triggers the reporting requirement.

¹³ The Reporting Company must submit an updated BOI within 30 days of when the minor child reaches the age of majority.

a governmental authority, or directs/controls the filing of such a document by another. The final regulations specify that the term company applicant is limited to two people at most: the first being the individual who directly files the document, and the second being the individual who is primarily responsible for directing or controlling such a filing if more than one individual is involved. Reporting companies created or registered before January 1, 2024, are exempt from providing company applicant information. The reporting by a company applicant applies only to reporting companies formed on or after January 1, 2024. In addition, a reporting company does not have to provide updates on the company applicants after including such information in its initial report to FinCEN, but it must correct any inaccurate information previously reported about their company applicants.

CTA – Information Required to be Reported

Information required of reporting companies:

- (1) Full legal name of the reporting company, as well as any other trade name or “d.b.a.” used by the reporting company;
- (2) The street address of the reporting company’s principal place of business (if located in the U.S.) – a post office box or the address of a third party (such as a formation agent) does not satisfy this requirement;
- (3) The state, territory, possession or tribal jurisdiction of a domestic reporting company’s formation or a foreign reporting company’s first U.S. registration;
- (4) The taxpayer identification number (TIN) or employer identification number (EIN) for all domestic reporting companies and foreign reporting companies possessing a TIN or EIN, otherwise a foreign reporting company’s taxpayer identification number issued by a foreign jurisdiction and the name of that jurisdiction.

Information required of those individuals who are a “beneficial owner” or “company applicant”:

- (1) Full legal name;
- (2) Date of birth;
- (3) Current residential or business street address;
- (4) A unique identifying number from an acceptable, non-expired identification document (e.g., U.S. passport number, driver’s license used by a state, or identification card issued by a state or local government of Indian tribe). Only if none of the foregoing documentation is available may a non-expired foreign passport be used; and
- (5) An image of a government issued photo ID, like a driver’s license or passport, is required from which the unique identifying number was obtained.

Individual “beneficial owners” and “company applicants” who do not act as formation agents must report their residential address for tax residency purposes. “Company applicants” who provide a business service as a corporate or formation agent must report their business address.

Information must be reported to the company, and the company must furnish the information to FinCEN. The information must be kept current.

FinCEN will maintain the BOI in a secure national database known as Beneficial Ownership Secure System (BOSS). Information contained in BOSS will only be accessible by certain law enforcement agencies, taxing authorities and a limited number of other potential users for specified purposes upon request.¹⁴

Failure to report can result in both civil and criminal penalties. The civil penalty is up to \$500/day. In addition, a violation is subject to a penalty not to exceed \$10,000 and/or up to two years in prison.¹⁵ A safe harbor is available for persons who submit incorrect information on a BOI report if the correction is made within 90 days of the original incorrect filing.

¹⁴ For specifics on who may obtain information contained in the BOSS database, see generally, CTA §5336(c)(2)(B). On December 15, 2022, FinCEN issued proposed regulations governing the disclosure of beneficial ownership information to authorized recipients. Those recipients will be required to establish and maintain secure systems to protect the information. Federal agencies will need to provide FinCEN with a brief justification for their request, while state, local and Tribal agencies will need to provide a court document authorizing the agency to access the BOI from FinCEN’s database. Reports filed under the CTA are not available to the public and are exempt from search and disclosure under the Freedom of Information Act (“FOIA”). Foreign authorities can only obtain access to BOI reports via a request to a U.S. federal agency. Sometime in the future FinCEN will issue regulations revising customer due diligence (CDD) rules which mainly affect financial institutions.

¹⁵ 31 U.S.C. §5336(h)(3)(A).

Beneficial Owner Reporting Requirements – Effective January 1, 2024

The “beneficial owner” reporting requirements are effective January 1, 2024. Domestic reporting companies in existence before January 1, 2024, and foreign reporting companies first registering in the U.S. before January 1, 2024, must report no later than January 1, 2025.

Domestic reporting companies formed on or after January 1, 2024, and foreign reporting companies first registered in the U.S. on or after January 1, 2024, must file initial reports within 30 calendar days of formation or registration. A change in beneficial owners must be reported within 30 days of the change. For example, if a beneficial owner moves and changes his or her address, that change must be reported to FinCEN.

CTA-exempt entities must file their initial BOI report within 30 calendar days of the first date that the entity no longer qualifies for any exemption from the CTA.

“Company applicants” are subject to the reporting requirements for entities formed after January 1, 2024. This would include a paralegal who forms the LLC and the supervising attorney.

Neither the CTA nor the CTA final regulations provide for an extension of time to file a BOI report.

The reporting company is responsible for filing the BOI. All BOI reports and all applications for FinCEN Identifiers (discussed below) must be certified by the reporting entity that the information provided therein is “true, correct and complete.” FinCEN deliberately placed the responsibility on the reporting entity (and its senior officers) for certifying that the information reported on the BOI is “true, correct and complete.”¹⁶

If any information in a BOI report filed with FinCEN, or application for a FinCEN Identifier, is incorrect or inaccurate, the reporting company has 30 calendar days from when it first becomes aware, or has reason to know, of the mistake or inaccuracy to file a correct BOI report.

It is the reporting company’s responsibility to keep its BOI report current with FinCEN. The people responsible are (1) the specific person who caused the failure and (2) any senior officer. There is no “good faith” or “substantial compliance” exception to the reporting company’s obligation to accurately report.

An updated BOI is not required upon the dissolution or termination of a reporting company. A change in beneficial owner due to death is deemed to occur not upon death but on the date the estate is settled, at which time the BOI report must be updated.

Changes to the image of the identifying documents submitted to FinCEN for a beneficial owner require an update only if the change relates to the beneficial owner’s name, date of birth, residential address or unique identifying number. Other changes to the identifying documents, such as the individual’s personal characteristics or expiration date, do not require an updated BOI.¹⁷ Thus, a new picture on a driver’s license, U.S. passport or other governmental ID does not need to be reported on an updated BOI report.

How it Applies to Trusts or Similar Arrangements

Currently, private trusts are not included among the entities that must report, and charitable organizations, including private foundations, are specifically exempt from the reporting requirements. While trusts initially appear to be exempt, that could change in the future. The CTA calls for future study of partnerships, trusts and other legal entities.

However, trusts that own or control at least 25% of a reporting entity or trustees who exercise substantial control over a reporting company will have to report. Think about a trust owning at least a 25% interest in a family limited partnership, an interest in a closely held business or even a vacation home held in an LLC. All those entities and their beneficial owners are subject to the CTA reporting.

¹⁶ The Reporting Entity is ultimately responsible for the information reported on the BOI. The Reporting Entity’s agent submitting the BOI on behalf of the Reporting Company is not responsible for the information reported. The Beneficial Owner has a responsibility to provide accurate information to the Reporting Entity. It is unlawful for an individual to provide false or fraudulent ownership information or to willfully fail to report complete or updated beneficial ownership information.

¹⁷ 31 CFR §1010.380(2)(2)

All of the individual's ownership interests in a reporting company are required to be taken into consideration to determine if the individual meets the 25% threshold.

Thus, a trust's holdings will be aggregated with ownership interests the individual holds outside the trust to determine if the trust owns or controls at least 25% of the reporting entity. For example, if the sole beneficiary of a trust individually owns 12% of a reporting company and the trust owns 13% of the reporting company, the 25% threshold is met by aggregating the individual's and the trust's beneficial interests in the reporting company.

A reporting company will be required to provide information about the trustee and other individuals with authority to control or dispose of trust assets.

A trustee or other individual¹⁸ (if any) with the authority to dispose of trust assets is considered a "beneficial owner" subject to the CTA's reporting requirements. So is a beneficiary who (1) is the sole permissible recipient of income and principal (e.g., a surviving spouse of a marital deduction trust); or (2) has the right to demand a distribution of, or withdraw, substantially all the assets. The same holds true for a grantor who has the right to revoke the trust or otherwise withdraw the assets. The final regulations confirm that multiple parties may be beneficial owners of a trust. Thus, a trust could have more than one beneficial owner subject to a reporting requirement (i.e., a trustee, a beneficiary and/or the grantor).

Trustees must review existing trusts to determine if the trust is (or later becomes) a beneficial owner; and if so, they must bring the trust into compliance with the reporting requirements of the CTA.

If a reporting company is held in trust and the reporting company meets the definition of a beneficial owner, the reporting company will have a reporting requirement if, among other things: (1) there is a

change of situs of the trust that causes a change of address of the trustee; (2) a beneficiary's change of address; (3) a minor beneficiary reaches the age of majority and thereafter holds a power to control or dispose of trust assets; (4) a trustee, advisor or protector resigns, is removed or newly appointed; (5) the death of a beneficiary or grantor who was beneficial owner; (6) the termination of the "silent period" of a silent trust when the beneficiary no longer has a representative; or (7) other events necessitating a change in the reporting information.

There are a number of issues involving trusts that the final regulations do not directly address. For example, who is beneficial owner of a directed trust: is it the directed trustee, the person who directs the trustee or both? Is a "substitution" power considered the ability to exercise "substantial control" over the trust? What if the "substitution power" allows the withdrawal or contribution of at least a 25% interest in a reporting company? Is the power to fill a trustee vacancy considered exercising "substantial control" over the trust? Does coordinating a nonjudicial modification or nonjudicial settlement agreement qualify as exercising "substantial control" over the trust? Does a power of appointment held by someone other than a beneficiary constitute exercising "substantial control" over a reporting company held in a trust? How do beneficiaries of a "silent trust" know of their potential reporting obligations? How does the silent trust beneficiary's representative obtain the necessary information from the beneficiary without alerting the latter to the existence of the trust? What if there are multiple beneficiaries, as opposed to a sole beneficiary, of a trust? Is their interest just a "mere expectancy", which does not rise to the level of beneficial ownership under the CTA? These and other issues await clarification.

¹⁸ An "other individual" may include an individual serving in a fiduciary position such as investment directors, advisors or committee members, or even non-fiduciary positions, such as trust protectors or persons holding veto powers over certain actions of the trustee depending on the relevant circumstances.

Obtaining a FinCEN Identification Number

Beneficial owners and company applicants required to report their information can obtain a unique identification number from FinCEN called a FinCEN Identifier.

To obtain a FinCEN Identifier, the individual must furnish FinCEN with their full legal name, proof of identification and their residential address (i.e., the same information otherwise required to be furnished in the absence of obtaining a FinCEN Identifier). In return FinCEN will furnish a unique identifying number, a FinCEN Identifier, to the applicant, which can be furnished to the reporting company for use in satisfying the FinCEN reporting requirements. If the “beneficial owner” obtains a FinCEN Identifier, the beneficial owner may provide it to the reporting company and the reporting company only needs to furnish the FinCEN Identifier to FinCEN in lieu of the information otherwise required. However, FinCEN must be informed of any subsequent changes to the beneficial owner’s information within 30 calendar days of the change. It is the beneficial owner’s responsibility (rather than the reporting company) to keep the information current, to keep the image of the identifying document current and to correct any inaccuracies in the information provided within 30 calendar days after the date when the individual or reporting company becomes aware, or has reason to know, of the inaccuracy. A reporting company may also obtain its own FinCEN Identifier by following the same procedure.

Takeaways

Those subject to the CTA may want to consider the following:

1. Consider shutting down dormant LLCs in 2023 to avoid reporting requirements that will take effect on January 1, 2024. Also, consider setting up LLCs or other entities in 2023 to avoid the “company applicant” reporting requirement, which takes effect on January 1, 2024.
2. Apply for a FinCEN Identifier as soon as possible.
3. Determine if an entity is a reporting company or qualifies for one of the twenty-three exemptions from the CTA reporting requirements.
4. Familiarize yourself with the BOI reporting requirements, especially the requirement to update information furnished to FinCEN.
5. Designate a person or group to monitor CTA compliance. This will involve developing internal policies and procedures to assess reporting obligations, identifying beneficial owners and company applicants, and monitoring changes that need to be updated and reported to FinCEN.
6. Monitor smaller large operating companies. A reduction in revenue or the number of employees could result in the termination of CTA-exempt status.
7. Include BOI reports as part of a checklist to consider during the entity formation process or onboarding of a trust relationship. Companies acquiring a target company will want to ensure that the target company has met their reporting obligations.
8. Be cautious of fraudulent third-party facilitators claiming to be in the business of performing and monitoring CTA compliance. It could lead to an inadvertent distribution of confidential personal information.

Conclusion

The CTA requires extensive reporting by companies, beneficial owners and company applicants.¹⁹ While trusts are excluded as a reporting entity, they could become a reporting entity if they directly or indirectly own or control over 25% of a reporting entity. Companies, individuals and trustees must familiarize themselves with these rules to avoid potential civil and criminal penalties. More details will be forthcoming, pending issuance of further guidance interpreting the CTA. In the meantime, companies, individuals and trustees must understand the current CTA reporting requirements and prepare for potential reporting requirements to come.

¹⁹ The final regulations include a detailed set of cost estimates for CTA compliance. For companies with simple management and ownership structure – which FinCEN estimates to be about 59% of Reporting Companies – the estimated cost will be approximately \$85.14 per report; for intermediate structures, the cost is estimated at \$1,350 per report; and for complex structures the cost is estimated to be \$2,614.87 per report.

Situations Where a Trust, Beneficiary and/or Grantor Is a Beneficial Owner

Capacity	Authority
Trustee, advisor, protector, representative or person acting on behalf of any of above individuals, whether or not a fiduciary under state law	<ul style="list-style-type: none"> • Power to dispose of trust assets if the trust and such person (collectively) owns at least 25% interest in the reporting company • Owns a majority of the voting power or voting rights in the reporting company • Controls a majority of the voting power or voting rights in the reporting company • Directs, determines or has substantial influence over important decisions made by the reporting company • Right to remove and replace senior officers of the reporting company • Right to remove and replace a majority of the board of directors of the reporting company
Grantor	<ul style="list-style-type: none"> • Right to revoke the trust when the trust and grantor (collectively) own at least 25% interest in the reporting company • Right to withdraw assets of the trust when the trust and grantor (collectively) own at least 25% interest in the reporting company
Beneficiary	<ul style="list-style-type: none"> • As sole recipient of income and principal of the trust when the trust and beneficiary (collectively) own at least 25% interest in the reporting company • Right to demand distribution or withdrawal of substantially all of the trust assets when the trust and beneficiary (collectively) own at least 25% interest in the reporting company


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