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## FinCEN Reporting for LLCs Owned by Foreign Charities

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### FINAL REGULATIONS IMPLEMENTING CORPORATE TRANSPARENCY ACT

On September 29, 2022, the Financial Crimes Enforcement Network (“FinCEN”), a bureau of the U.S. Department of the Treasury (“Treasury”), issued final regulations<sup>1</sup> (“final CTA regulations”) implementing section 6403 of the Corporate Transparency Act (CTA),<sup>2</sup> enacted as part of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021.<sup>3</sup> Beneficial ownership reporting requirements under the final CTA regulations are effective beginning January 1, 2024, and on January 13, 2023, FinCEN issued notices and requests for comment on the respective electronic forms of beneficial ownership reports and FinCEN identifier application.<sup>4</sup> The final rules CTA regulations provide significant

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<sup>1</sup> F.R. Doc. 2022-21020 (Sept. 29, 2022), available at <https://public-inspection.federalregister.gov/2022-21020.pdf?1664455519>; 87 Fed. Reg. 59,498 (Sept. 30, 2022).

<sup>2</sup> H.R. 6395, tit. LXIV, §6403 (2020).

<sup>3</sup> Pub. L. No. 116-283, 134 Stat. 4604 (2021) (“NDAA”).

<sup>4</sup> 31 C.F.R. §1010.380(a)(1) (2022). The “Chapter X” regulations are hereafter referenced as BSA regulations. See BSA §5336(b)(1)(G); text at nn. 6 and 7, below. See also BSA §5336(b)(2) (beneficial ownership information reporting requirements), §5336(b)(3) (FinCEN identifier requirements); F.R. Doc. 2023-00703 (Jan. 13, 2023), available at 88 Fed. Reg. 2760 (Jan.

beneficial ownership reporting exceptions for affiliates of foreign not-for-profit organizations, organized or registered to conduct business in the United States.<sup>5</sup>

The organizational structure and U.S. tax treatment of both a foreign charitable organization and a U.S. affiliate organized as an LLC may determine whether ultimate beneficial owners (UBOs) of the LLC will be subject to FinCEN reporting under the CTA with respect to their direct or indirect ownership of LLC membership interests, or governance rights. This article discusses how an LLC owned or controlled by a foreign not-for-profit organization may be subject to, or exempt from CTA compliance, based on the corporate and governance structure and U.S. tax treatment of the foreign nonprofit parent and the LLC. Treasury and FinCEN may find it advisable to issue additional guidance on CTA compliance and on tax status of LLCs owned by foreign charities with regard to CTA exemptions for tax-exempts, as discussed in this article.

### BACKGROUND OF THE CTA

Treasury and FinCEN amended Part 1010 of Chapter X, Title 31 of the Code of Federal Regulations by adding new §1010.380.<sup>6</sup> The “Chapter X” regulations implement provisions of the Bank Secrecy Act (BSA),<sup>7</sup> which the CTA amended for the first time since 2001.<sup>8</sup> Generally, the BSA requires financial institutions to keep certain records and make certain re-

17, 2023) (Beneficial Ownership Information (BOI) Report Summary of Data Fields, beneficial ownership reports to be filed electronically); F.R. Doc. 2023-00708 (Jan. 13, 2023), available at 88 Fed. Reg. 2764 (Jan. 17, 2023) (FinCEN Identifier Application Summary of Data Fields, form to be filed electronically by applicants).

<sup>5</sup> BSA Reg. §1010.380(b)(2)(i) (special reporting rule), §1010.380(c)(2)(xix) (exemption for certain tax-exempt entities), §1010.380(c)(2)(xx) (exemption for certain non-exempt entities assisting a tax-exempt entity), §1010.380(c)(2)(xxii) (exemption for subsidiaries of certain tax-exempt entities).

<sup>6</sup> 31 C.F.R. §1010.380(a)(1) (2022). The final CTA regulations are the first of three sets of rule-making under the CTA. See BSA §5336(b)(1)(F), §5336(b)(4), §5336(d)(3).

<sup>7</sup> 31 U.S.C. §§5311 *et seq.*

<sup>8</sup> CTA §6403(a) (adding new BSA §5336 under subch. II of ch.

ports that have been determined to be useful in criminal, tax, or regulatory investigations or proceedings, and for intelligence or counter intelligence activities to protect against international terrorism.<sup>9</sup>

The CTA furthers international regulatory compliance and law enforcement objectives of the BSA by requiring domestic or foreign “reporting companies” to disclose their beneficial owner upon formation or registration to do business under the laws of a U.S. State or Indian Tribe.<sup>10</sup> A reporting company is a corporation, LLC or similar entity that files an organizational document or registers to do business with a secretary of state or similar office of a State or Tribal jurisdiction.<sup>11</sup> The company applicant<sup>12</sup> or another agent of a reporting company must file a report and annual updates with FinCEN identifying the reporting company, any beneficial owner of the entity and an applicant who is not a beneficial owner.<sup>13</sup> Failure to report beneficial ownership information may result in penalties up to \$10,000 and certain additional penalties, subject to IRS reasonable cause waiver. The penalties, which could be either civil or criminal, may be imposed on any person, including any individual, reporting company, or other entity.<sup>14</sup>

Generally, a beneficial owner is an individual who, directly or indirectly, exercises substantial control over, owns 25 or more percent equity interests of, or receives substantial economic benefits from the assets

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53, 31 U.S.C.).

<sup>9</sup> See 74 Fed. Reg. 10,148, 10,149 (Mar. 9, 2009) (proposed amendments to BSA regulations regarding confidentiality of a report of suspicious activity (“SAR”), in part to implement changes made by the Uniting and Strengthening America by Providing the Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA PATRIOT Act”), Pub. L. No. 107-56, tit. III, §351, 115 Stat. 272, 321 (2001)).

<sup>10</sup> See CTA §6402; BSA §5336(b).

<sup>11</sup> BSA §5336(a)(11); BSA Reg. §1010.380(c)(1).

<sup>12</sup> BSA §5336(a)(2) (definition of the term “applicant”); BSA Reg. §1010.380(e).

<sup>13</sup> See generally BSA §5336(b); BSA Reg. §1010.380(a), §1010.380(b). The company applicant information reporting requirement does not apply to reporting companies existing prior to effective date of the final CTA regulations. See BSA Reg. §1010.380(b)(2)(iv). Company applicant information also is not required to be disclosed in any updated reports. §1010.380(b)(3).

<sup>14</sup> See generally BSA §5336(h); BSA Reg. §1010.380(g). See also §1010.380(f)(8) (defining a “senior officer” of a reporting company, who could be liable for reporting failures under CTA, see BSA Reg. §1010.380(g)(4)(iii)). On January 18, FinCEN issued a final rule updating certain penalties applicable under the BSA. However, the penalties that apply under BSA section 5321 are not applicable to CTA violations. See BSA §5321(a)(1), §5321(a)(6), §5336(h)(3)(A); NDAA §6403(b) (certain conforming amendments to other BSA sections); F.R. Doc. 2023-00943 (Jan. 18, 2023), available at 88 Fed. Reg. 3311 (Jan. 19, 2023).

of a reporting company.<sup>15</sup> CTA applies broadly to U.S.-based entities and to foreign-formed companies that submitted a successful registration filing under the law of a State or Indian Tribe to conduct business in the United States.<sup>16</sup> Congress exempted from CTA a business concern that employs more than 20 full-time employees in the United States, filed a U.S. income tax or information return for the previous year reporting more than \$5,000,000 in U.S.-source gross receipts or sales, on a consolidated basis if applicable, and has an operating presence at a physical office within the United States. Another broad exemption applies to “pooled investment vehicles” that generally are operated or advised by a bank, credit union, broker-dealer, investment company, investment adviser or venture capital fund investment adviser, as defined in the final CTA regulations.<sup>17</sup> Overall, final CTA regulations exempt 23 types of entities from the definition of a “reporting company.” Other enterprises exempt from CTA include a §501(c) exempt entity, a domestic entity assisting financially a tax-exempt entity, and a subsidiary of a tax-exempt entity.<sup>18</sup>

## NOTICE 2021-56

The IRS issued guidance in 2021 setting forth provisions in organizational documents for LLCs that wish to apply for a stand-alone tax exemption under §501(c)(3).<sup>19</sup> An LLC wholly owned by a charity automatically would be treated as a corporation for tax purposes, and would have to comply individually with exemption requirements, rather than being treated as a branch of the member.<sup>20</sup> LLCs previously could apply for a §501(c)(3) exemption. Prior to issuance of IRS Notice 2021-56, the 2021 Form 990 instructions had provided that, whether the filing entity was an LLC, was one type of organizational structure to be disclosed in the heading of the informational return.<sup>21</sup>

Notice 2021-56 made the availability of exemption for LLCs explicit, subject to certain requirements. Or-

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<sup>15</sup> BSA §5336(a)(3); BSA Reg. §1010.380(d).

<sup>16</sup> BSA §5336(a)(11)(A)(ii); BSA Reg. §1010.380(c)(1)(ii) (“foreign reporting company”).

<sup>17</sup> BSA §5336(a)(10) (“pooled investment vehicle” definition), §5336(a)(11)(B)(xviii)–(xxi); BSA Reg. §1010.380(c)(2)(xviii)–(xxi). “Pooled investment vehicles” organized as LLCs, with foreign charities as investors, generally would be exempt from CTA, but this exemption is outside the focus of the article.

<sup>18</sup> BSA Reg. §1010.380(c)(2)(xix) (tax-exempt entity), §1010.380(xx) (entity assisting financially or holding governance rights over a tax-exempt entity), §1010.380(xxii) (subsidiary of tax-exempt entity).

<sup>19</sup> IRS Notice 2021-56.

<sup>20</sup> See Treas. Reg. §301.7701-3(c)(1)(v)(A) (as amended in 2020); IRS Notice 2021-56.

<sup>21</sup> See 2021 Instructions for Form 990 Return of Organization

ganizational documents of an LLC, including the certificate of formation and operating agreement, must contain certain provisions regarding corporate governance and distribution of assets otherwise reserved for not-for-profit corporations. Notice 2021-56 sets forth additional requirements for an LLC to apply for an exemption as a §501(c)(3) organization.

Guidance on obtaining a stand-alone exemption for an LLC may be developed further, in part due to varying state limited liability company laws. On March 10, 2022, the New York State Office of Attorney General commented in response to Notice 2021-56, that the IRS should not recognize §501(c)(3) status for LLCs domiciled in New York, because New York Limited Liability Company Law does not recognize LLCs organized exclusively for charitable purposes.<sup>22</sup> In contrast, Delaware Limited Liability Company Act does not contain a profit-making requirement. Thus, LLCs may be formed for any lawful purpose, including a charitable purpose.<sup>23</sup>

## LLC OWNED BY FOREIGN CHARITY

Despite uncertainty in Internal Revenue Code requirements, foreign charities that wish to expand their charitable operations, fundraising or grantmaking in the United States may find a benefit in forming a U.S. LLC as a wholly owned subsidiary of the foreign parent charity. Depending on the laws of the jurisdiction in which the foreign exempt member was formed or to which it is subject, the LLC member may be deemed to be owned or controlled by individuals or entities which may be UBOs with respect to a subsidiary LLC.<sup>24</sup>

## LLC EXEMPT UNDER §501(c)(3)

A foreign charity may form the LLC initially as a for-profit subsidiary or exclusively for charitable purposes, depending on the requirements of applicable state LLC statute, and subject to limitations on the foreign organization imposed by applicable foreign nonprofit law. The foreign parent may decide at the time of formation or at a later date to obtain exempt status for the LLC. For example, if the activities and finances of the LLC would qualify it as a public charity under §170(b)(1)(A), the nonprofit member of the

LLC may wish to file exemption application on IRS Form 1023. Alternatively, if the purposes comport with the charitable purposes and operational objectives of the foreign charity, the parent charity may wish to file IRS Form 1024 seeking an exemption for the LLC as a lobbying organization under §501(c)(4) or another applicable type of organization exempt under §501(c)..

A foreign charity may have §501(c)(3) status, although contributions to such foreign organization would not be deductible by U.S. taxpayers under the Code.<sup>25</sup> In addition, under certain bilateral tax treaties, the IRS automatically may recognize tax-exempt status of a foreign charitable organization for federal income tax purposes. The contributions to such charity would be deductible under §170(b), albeit only up to the amount of income sourced in the treaty country.<sup>26</sup> Moreover, a grantor or the grantee foreign charity would need to confirm that the donation made to a disregarded LLC of a foreign organization with a treaty-based U.S. tax exemption and equivalent to a public charity, would be treated as a donation subject to deductibility limits under §170(b)(1)(A).<sup>27</sup> Thus, the deductibility of charitable contributions by a U.S. taxpayer directly to a foreign nonprofit exempt under a treaty would be subject to a stricter percentage income limitation than a similar gift to an affiliated LLC, which is a public charity under §170(b)(1)(A)(vi) and §501(c)(3).<sup>28</sup> Accordingly, foreign charities with a §501(c)(3) treaty-based exemption may benefit from forming an LLC to conduct charitable activities in the United States and applying for an exemption for the LLC as a public charity. In each case, foreign organizations should be aware of

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<sup>25</sup> See I.R.C. §170(c)(2)(A), §501(c)(3). Unless otherwise provided or context otherwise requires, all section (“§”) references are to the Internal Revenue Code of 1986, as amended, 26 U.S.C. §§1 *et seq* (“Code”).

<sup>26</sup> See, e.g., U.S.-Canada Income Tax Treaty, art. XXI; IRS Notice 99-47; 2001 EO CPE Text, *Exemption of Canadian Charities Under the United States-Canada Income Tax Treaty*, <https://www.irs.gov/pub/irs-tege/eotopic01.pdf>.

<sup>27</sup> See generally Vishnepolskaya, *Deductibility of Charitable Contributions to Single-Member LLCs Organized in a U.S. and a Foreign Jurisdiction Under IRS Notice 2012-52*, 73 Exempt Org. Tax. Rev. 127, 136–140 (2014).

<sup>28</sup> See I.R.C. §170(b)(1)(A)(vi), §170(b)(1)(B), §170(c)(2), §501(c)(3). Here, deductibility of contributions to a disregarded LLC of a foreign charity is distinguished from deductibility of contributions made directly to a foreign charity, which is exempt under §501(c)(3) pursuant to a bilateral tax treaty provision. In the latter case, depending on applicable treaty provisions, a foreign charity may rebut a presumption that contributions made to it are subject to the lower contribution ceiling applicable to gifts to private foundations. See, e.g., U.S.-Canada Income Tax Treaty, art. XXI; IRS Notice 99-47; 2001 EO CPE Text, *Exemption of Canadian Charities Under the United States-Canada Income Tax Treaty*, <https://www.irs.gov/pub/irs-tege/eotopic01.pdf>.

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*Exempt from Income Tax* (referring to LLCs as “other entities” to be disclosed as a form of organization in Item K).

<sup>22</sup> Office of N.Y.S. Atty Gen., *Letter Re: Notice 2021-56 Comments from the Office of New York Attorney General Letitia James* (Mar. 10, 2022), available at <https://aboutbtax.com/148>.

<sup>23</sup> 6 Del. C. §18-106(a).

<sup>24</sup> See, e.g., Canadian Not-for-Profit Corporations Act (S.C. 2009, c. 23), §§2, 9, 10.



CTA exemptions available to their U.S. subsidiaries, discussed below.

## THREE CTA EXEMPTIONS FOR LLCs OWNED BY FOREIGN CHARITIES

### LLCs as Subsidiaries of §501(c)(3) Foreign Organizations

A U.S. LLC that is owned by a foreign not-for-profit organization exempt under §501(c)(3), is exempt from CTA.<sup>29</sup> Therefore, an organization formed in a foreign jurisdiction, which is exempt under §501(c)(3),<sup>30</sup> may form a CTA-exempt LLC to have operational presence in the United States, to accept donations, which may be tax-deductible to U.S. taxpayers, or for other lawful purposes. In some instances, the LLC would not apply for a stand-alone exemption under §501(c)(3).<sup>31</sup> Instead, the LLC would be tax-transparent and, among other things, facilitate receipt of charitable funds or investment activity in the United States.<sup>32</sup> The disregarded LLC, all of the equity interests of which would be owned by the foreign charity, would be exempt from CTA compliance whether or not contributions to the foreign member are deductible under the Code.<sup>33</sup>

However, if persons other than certain CTA-exempt entities<sup>34</sup> own equity in or control the LLC, in addition to the foreign nonprofit, the LLC would be a reporting company. Thus, final CTA regulations would require compliance with reporting requirements for each LLC UBO.

In addition, as a special rule, the beneficial ownership information of the foreign exempt organization, instead of its directors or members, may be provided in the FinCEN report.<sup>35</sup>

Thus, foreign nonprofits exempt under §501(c)(3), and wishing to establish or expand charitable activities or raise funds in the United States, would not be subject to additional costs associated with beneficial ownership reporting under the CTA with respect to a wholly owned LLC. On the other hand, with respect to non-CTA-exempt persons who, in the aggregate hold controlling interests in the U.S. subsidiary, CTA

reporting requirements are balanced in preventing malfeasance and reducing compliance burdens for foreign nonprofits.

### LLCs as Tax-Exempt Entities

If the LLC subsequently obtained individual tax-exempt status under §501(c), the LLC would be exempt from CTA requirements as a tax-exempt entity, and UBO reporting to FinCEN would not be required.<sup>36</sup> Furthermore, once the exemption is granted, tax-exempt status may be effective retroactively to the date the LLC was formed, or to another date, such as the application filing date. Treasury and FinCEN appear to have rejected the interpretation that an entity with a pending exemption application would be CTA-exempt during the review period.<sup>37</sup> Future FinCEN guidance may clarify transition rules for LLCs that apply for, and subsequently obtain exempt status under §501(c). Future regulations expressly may exempt LLCs from reporting requirements retroactively to the effective date of the exemption for any FinCEN reports that may be due as of the date of the determination letter.

### LLCs as Entities Assisting a Tax-Exempt Entity

The IRS has stated the LLC may not be treated as a disregarded entity while the exemption application is pending.<sup>38</sup> Final CTA regulations are silent on treatment of LLCs with pending IRS Form 1023 for FinCEN purposes. In these circumstances, the LLC could be deemed as an entity assisting financially the parent foreign charity, tax-exempt under the laws of the home jurisdiction but not under the Code.<sup>39</sup> Final CTA regulations do not elaborate on scope of financial assistance.<sup>40</sup> Thus, absent clarifying IRS guidance, assisting in fundraising efforts, accepting charitable contributions or even providing financial management support may be deemed as rendering the requisite financial assistance to the parent foreign organization.<sup>41</sup>

<sup>29</sup> BSA Reg. §1010.380(c)(2)(xxii); I.R.C. §501(a), §501(c)(3).

<sup>30</sup> See treaty-based exemption discussion above.

<sup>31</sup> See generally I.R.C. §501(a) (exemption from income tax), §501(c)(3) (exempt organizations generally organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes).

<sup>32</sup> See Treas. Reg. §301.7701-2(c)(2)(i) (as amended in 2019).

<sup>33</sup> See BSA Reg. §1010.380(c)(2)(xxii).

<sup>34</sup> See *id.*

<sup>35</sup> BSA Reg. §1010.380(b)(2)(i).

<sup>36</sup> I.R.C. §501(c)(3); BSA Reg. §1010.380(c)(2)(xix).

<sup>37</sup> See 87 Fed. Reg. 59,498, at 59,541 (Sept. 30, 2022).

<sup>38</sup> See 2022 *Instructions for Form 990, Return of Organization Exempt From Income Tax*, <https://www.irs.gov/pub/irs-pdf/i990.pdf>.

<sup>39</sup> See BSA Reg. §1010.380(c)(2)(xx). Applicability of CTA rules to a U.S. subsidiary of a charity dually chartered under the laws of a foreign jurisdiction and under the laws of a U.S. State is subject to various additional considerations.

<sup>40</sup> See 87 Fed. Reg. 59,498, at 59,542 (Sept. 30, 2022).

<sup>41</sup> See BSA §1010.380(c)(2)(xx)(A).

In addition, the LLC would have to derive majority of its funding or revenue from one or more individual U.S. contributors.<sup>42</sup> Also, in order to qualify for this CTA exemption, the LLC would have to be beneficially owned or controlled exclusively by one or more U.S. persons.<sup>43</sup> Pending further IRS guidance, this exemption prong may allow for the LLC to be beneficially owned by the foreign charity but controlled exclusively by a board of managers, subject to governing State law, each of whom is a U.S. citizen or permanent resident.

Alternatively, subject to further FinCEN guidance, an intermediate entity may manage and control the LLC. In this manner, the U.S. individuals with exclusive control over the LLC would control the LLC indirectly through the interposed company. However, such control of the U.S. subsidiary potentially may conflict with the applicable nonprofit laws of the foreign jurisdiction, to which the parent charity is subject. The structure also must comply with applicable State law and the Code. Moreover, even with the added liability protection, the U.S. individuals may avoid potential liability arising out of control of an LLC through a manager for the benefit of a foreign charitable organization. In particular, exposure to liability under CTA of a person who “causes the failure” and of a broadly defined “senior officer” of a reporting company provides additional concerns in managing such an LLC. Thus, pending Form 1023 review, the CTA exemption for an entity assisting a tax-exempt entity may have limited benefit for an LLC owned by a foreign charity not exempt under the Code.

## **CTA Compliance for Certain LLCs Without Exemption Ruling**

A subsidiary, subject to applicable State law, could be a religious organization, which is not required to file IRS Form 1023 to apply for a federal income tax exemption under §501(c)(3). The religious organization, to the extent it is beneficially owned by a foreign charity under applicable State and foreign laws, would be exempt from CTA as a tax-exempt entity as of the formation date. Alternatively, an LLC may be organized before January 1, 2024 and may file IRS Form 1023 seeking an exemption as a public charity

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<sup>42</sup> See BSA Reg. §1010.380(c)(2)(xx)(D).

<sup>43</sup> BSA Reg. §1010.380(c)(2)(xx)(C).

or private foundation before or after such date. In this case, pending the IRS exemption determination letter, the LLC may avail of the deferral of FinCEN requirements for existing reporting companies until January 1, 2025, so long as the LLC is granted the exemption by 2024 calendar year end.

Conversely, absent further FinCEN guidance, an LLC formed on or after January 1, 2024 by a foreign organization without a U.S. exemption may need to file an initial report as required by CTA final rules.<sup>44</sup> Subsequently, if the LLC obtains a favorable exemption ruling, the LLC would file an updated report with FinCEN regarding meeting the criteria for a CTA exemption as a tax-exempt entity.<sup>45</sup>

## **CONCLUSION: NAVIGATING THE FINAL CTA REPORTING RULES**

Foreign tax-exempt organizations with U.S. affiliates may be subject to UBO information reporting rules promulgated by U.S. Treasury and FinCEN under the CTA effective January 1, 2024. The final CTA regulations may impact planning of foreign charities with existing or contemplated operations, fundraising, grantmaking or certain investments in the United States. Certain provisions in the final CTA regulations continue to raise tax planning and compliance issues for foreign nonprofits with LLCs in the United States. For example, FinCEN has not clarified how the exemptions may apply to LLCs seeking an individual tax exemption under §501(c)(3), taking into account LLC tax-exemption guidance in IRS Notice 2021-56.

LLCs seeking to be exempt from CTA reporting also would benefit from FinCEN guidance clarifying the meaning of the term “financial assistance” with respect to a CTA exemption for entities assisting tax-exempts. Furthermore, FinCEN may clarify how the ownership and control requirements under the CTA exemption apply to LLCs effectively controlled by U.S. managers but beneficially owned by a foreign charity not exempt under §501(c)(3). In view of remaining uncertainties in final CTA rules, foreign nonprofits seeking exemption from UBO reporting for U.S. affiliates, and in particular, LLCs, should consult U.S. counsel on the appropriate corporate form and management structure as well as U.S. tax treatment of both the LLC and the foreign parent charity.

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<sup>44</sup> BSA Reg. §1010.380(a)(1)(i).

<sup>45</sup> BSA Reg. §1010.380(a)(2)(ii).

