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Reporting beneficial owners of certain US companies: proposed regulations on what constitutes beneficial ownership

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- › Introduction
- › Background
- › Beneficial owner – two-prong test
- › Ownership or control of reporting company through a trust
- › Exceptions to beneficial owner
- › Company applicant
- › Comment

Introduction

On 7 December 2021, the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued proposed regulations with details to begin compiling a beneficial owner register for US companies under the Corporate Transparency Act (CTA). This article is the second in a series reviewing those details in the context of family succession planning, continuing with what constitutes beneficial ownership.⁽¹⁾

Background

Enacted 1 January 2021, the CTA establishes a beneficial owner reporting regime for US companies, pursuant to which reporting companies must submit a report containing "beneficial owner" and "company applicant" information (together, "beneficial ownership information" (BOI)). For further details please see ["Reporting beneficial owners of certain US companies – details of new Corporate Transparency Act"](#).

The proposed regulations are intended to clarify the various BOI requirements of the CTA, including:

- who must file a BOI report;
- what constitutes beneficial ownership;
- what information must be disclosed in a BOI report; and
- when the information must be reported.

This article summarises the proposed regulations regarding what constitutes beneficial ownership.

Once a company is determined to be a reporting company (for further details please see ["Reporting beneficial owners of certain US companies: proposed regulations on who must file a beneficial owner report"](#)), its "beneficial owner" and "company applicant" must be identified.

Beneficial owner – two-prong test

The CTA defines a "beneficial owner" as any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise:

- exercises substantial control over the entity; or
- owns or controls not less than 25% of the ownership interests of the entity.

The proposed regulations clarify the definition of "beneficial owner" by giving further guidance as to the terms "substantial control" and "ownership interests", as well as how such substantial control or ownership interests are "indirectly" exercised or owned.

Substantial control over entity

The proposed regulations provide three non-exclusive indicators of "substantial control":

- service as a senior officer of a reporting company, which for this purpose means "any individual holding the position or exercising the authority of a president, secretary, treasurer, chief financial officer, general counsel, chief executive officer, or any other officer, regardless of official title, who performs a similar function";
- authority over the appointment or removal of any senior officer or a majority or dominant minority of the board of directors (or similar body) of a reporting company; and
- direction, determination or decision of, or substantial influence over, important matters affecting the reporting company, including but not limited to:
 - the nature, scope and attributes of the business of the reporting company, including the sale, lease, mortgage or other transfer of any principal assets of the reporting company;
 - the reorganisation, dissolution or merger of the reporting company;
 - major expenditures or investments, issuances of any equity, incurrence of any significant debt or approval of the operating budget of the reporting company;



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- the selection or termination of business lines or ventures, or geographic focus, of the reporting company;
- compensation schemes and incentive programmes for senior officers;
- the entry into or termination, or the fulfilment or non-fulfilment of, significant contracts; and
- amendments of any substantial governance documents of the reporting company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures.

Substantial control also includes "any other form of substantial control over the reporting company", which is a catch-all provision designed to cover additional powers not specifically discussed above. The Society of Trusts and Estate Practitioners, New York Branch (STEP NY) has suggested that the catch-all provision be removed as it is overly broad when applied in the trust context. It further suggested that, instead, FinCEN should clarify whether individuals serving in administrative roles such as trust protector, distribution committee or investment director should be considered to exercise substantial control over a reporting company owned by the trust.

The proposed regulations specify that an individual may "directly or indirectly" exercise substantial control over a reporting company through a variety of means, including through:

- board representation;
- ownership or control of a majority or dominant minority of the voting shares of the reporting company;
- rights associated with any financing arrangement or interest in a company;
- control over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company;
- arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- any other contract, arrangement, understanding, relationship or otherwise.

An individual who has the right or ability to exercise substantial control shall be deemed to exercise such substantial control.

Based on the breadth of the definition of "substantial control", FinCEN expects that a reporting company will identify "at least" one beneficial owner under the substantial control prong, regardless of whether that individual also satisfies the "ownership" prong. Furthermore, all individuals who meet the definition of "substantial control" must be identified and disclosed. This is a notable deviation from the beneficial ownership disclosure requirement under the existing customer due diligence (CDD) for financial institutions, where new legal entity customers need only identify one individual who exercises a "significant degree of control over the entity".

Ownership or control of entity's ownership interests

In determining whether an individual owns or controls 25% of the ownership interests of a reporting company, "ownership interests" under the proposed regulations are defined very broadly to include:

- any equity, stock, or similar instrument, certificate of interest or participation in any profit-sharing agreement, preorganisation certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, interest in a joint venture, or certificate of interest in a business trust, without regard to whether any such instrument is transferable, is classified as stock or anything similar, or represents voting or non-voting shares;
- any capital or profit interest in a limited liability company or partnership, including limited and general partnership interests;
- any proprietorship interest;
- any instrument convertible, with or without consideration, into any instrument described in the first three bullet points above, any future on any such instrument, or any warrant or right to purchase, sell or subscribe to a share or interest described in the first three bullet points above, regardless of whether characterised as debt; or
- any put, call, straddle or other option or privilege of buying or selling any of the items described in the first four bullet points above without being bound to do so.

Similar to the substantial control prong, the ownership interest prong also applies to owned or controlled, "directly or indirectly", through a variety of means, including but not limited to:

- joint ownership with one or more other persons of an undivided interest in such ownership interest;
- control of such ownership interest owned by another individual; or
- a trust.

FinCEN requires reporting companies to consider all facts and circumstances when making determinations about who owns or controls ownership interests. Further, ownership for this purpose should include all ownership of any class or type, and the percentage of such ownership should be determined by aggregating all of the individual's ownership interests in comparison to the undiluted ownership interest of the company.

Ownership or control of reporting company through trust

Although particularly relevant for advisers to families with succession planning structures, the statutory language of the CTA is unclear as to how the CTA will treat trust ownership of a reporting company (for further details please see ["Reporting beneficial owners of certain US companies: observations relevant to private client structures"](#)). The proposed regulations provide clarity by specifying that an individual will be considered to have "ownership interests" of a reporting company held in a trust if the individual is:

- a trustee of the trust or other individual (if any) with the authority to dispose of trust assets;
- a beneficiary who:
 - is the sole permissible recipient of income and principal from the trust; or
 - has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or
- a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust through ownership or control of one or more intermediary entities, or any entities that separately or collectively own or control ownership interest of the

reporting company, or through any other contract, arrangement, understanding or relationship.

Notably, the proposed regulations' approach regarding the attribution of ownership held in trust is more expansive than the CDD rules where the assets held in trust are treated to be owned by the trustee. STEP NY has asked FinCEN to include provisions that address both mandatory and discretionary interests in trusts and how beneficial ownership should be determined or whether it should be limited to trust fiduciaries exercising substantial control.

Exceptions to beneficial owner

In keeping with the CTA, the proposed regulations exclude the same categories of individuals from the definition of "beneficial owner" as specified in the statute (for further details please see "[Reporting beneficial owners of certain US companies – details of new Corporate Transparency Act](#)"). However, in excluding a person who has an interest in a reporting company through the right of inheritance, the proposed regulations clarify that this exception only refers to a "future" interest associated with a right of inheritance, not a present interest that a person may acquire as a result of exercising such a right. Further clarification might be helpful as to how this future interest language in the context of the inheritance exception from a reporting company might also be relevant in the context of a future beneficial interest in a reporting company owned by a trust.

Company applicant

In addition to requiring information on beneficial owners, the proposed regulations require reporting companies to submit information on each "company applicant." For domestic reporting companies, a "company applicant" is any individual who files the document that forms the entity. And for foreign reporting companies, the company applicant is any individual who files the document that first registers the entity to do business in the United States.

Importantly, the proposed regulations added that a company applicant includes "anyone who directs or controls the filing of the document by another". Thus, if an associate or paralegal of the law firm files the documents to form an entity, anyone who directs such filing (eg, a partner of the firm) could be a company applicant, as well as the client who initially asked the firm to form the entity. Through this requirement, FinCEN intends to ensure that the reporting company provides information on individuals who are responsible for the decision to form a reporting company and not just the agent, employee or family member who is tasked with filing the document to form the company. Further clarification and examples in the final regulations would be welcome.

Comment

Once a company is determined to be a reporting company, its beneficial owners and company applicants must be identified. The proposed regulations provide some further guidance and clarification, and hopefully final regulations will give further consideration to trusts owning reporting companies. In the meantime, advisers to families who regularly file formation documents and will be considered the company applicant will want to look into applying for a FinCEN identifier.

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Endnotes

(1) For the first article in the series, see "[Reporting beneficial owners of certain US companies: proposed regulations on who must file beneficial owner report](#)".