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# Corporate Transparency Act: identifying individuals who own or control ownership interests of reporting companies

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### Introduction

Following the enactment of the Corporate Transparency Act 2021 (CTA), the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) explained that:

*Collecting this information and providing access to law enforcement, the intelligence community, regulators, and financial institutions will diminish the ability of illicit actors to obfuscate their activities through the use of anonymous shell and front companies.*

This article sets out the current understanding of the definition of "beneficial owner" and the requirement to report individuals who own or control 25% or more of the ownership interests of a reporting company, including indirectly or through intermediary entities. Final regulations and FinCEN supplementary information provide significant details. As FinCEN releases further guidance and frequently asked questions (FAQs), this understanding may change.

### CTA

Beginning in 2024, US corporations, limited liability companies and statutory partnerships must file a beneficial owner information (BOI) report with FinCEN, unless an exemption applies (for further details please see "[Using 2023 to get ready to comply with new US FinCEN beneficial owner register](#)").

### Definition of "beneficial owner"

The CTA provides that a beneficial owner of a reporting company is any individual who, directly or indirectly, either:

- exercises substantial control over a reporting company (the "substantial control" prong); or
- owns or controls at least 25% of the ownership interests of a reporting company (the "ownership interest" prong).

The final regulations provide details regarding "direct or indirect exercise of substantial control" and "ownership or control of ownership interest." Both lists of details are expansive. In addition to specifics, both lists include a catch-all provision that scoops in any contract, arrangement, understanding or otherwise. This article focuses on the "ownership interest" prong of the beneficial owner definition (for details on the "substantial control" prong please see "[Corporate Transparency Act: identification of individuals who exercise substantial control over reporting companies](#)").

### Exceptions to definition of beneficial owner

The CTA includes five exceptions to the definition of beneficial owner. These are:

- a minor child, provided that a parent or guardian's information is reported, and the reporting company submits an updated BOI report when the minor reaches the age of majority (as defined under the law of the state where the company was created);
- an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual, so that the reporting company is reporting real parties in interest not those who merely act on another individual's behalf;
- an individual acting solely as an employee of a reporting company, provided that such individual is not a senior officer;
- an individual whose only interest in a reporting company is a future interest through a right of inheritance (but once the interest comes to be owed by the individual an updated BOI report is submitted); and
- a creditor of the reporting company, provided that is the individual's sole interest in the reporting company.

Commenters to the proposed regulations requested adding trust beneficiaries, particularly those that might be unaware of their beneficiary status, to the list of excepted individuals. FinCEN noted that the CTA does not provide for the addition of other exceptions to the definition of "beneficial owner," and so FinCEN's final regulations did not extend the list.

### **Definition of "ownership interest"**

The term "ownership interest" means:

- any of the following:
  - equity, stock, or similar instrument;
  - preorganisation certificate or subscription; or
  - transferable share of, or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust – in each such case, without regard to whether any such instrument is transferable, classified as stock or anything similar, or confers voting power or voting rights;
- any capital or profit interest in an entity;
- any instrument convertible, with or without consideration, into any share or instrument described above, any future on any such instrument, or any warrant or right to purchase, sell, or subscribe to a share or interest described above, regardless of whether characterised as debt;
- any put, call, straddle, or other option or privilege of buying or selling any of the items described above without being bound to do so, except to the extent that such option or privilege is created and held by a third party or third parties without the knowledge or involvement of the reporting company; or
- any other instrument, contract, arrangement, understanding, relationship or mechanism used to establish ownership.

The definition of ownership interest focuses solely on types of arrangements that convey ownership interests (eg, equity, convertible instruments and stocks), rather than referencing legal entities in which ownership interests are held. FinCEN believes this reflects the wide variety of potential reporting company structures and the potential for evasion inherent in specifying detailed rules for each structure.

The final regulations added a catch-all provision designed to ensure that any individual or entity that establishes an ownership interest in a reporting company not described in the other subparagraphs of the definition is subject to the beneficial owner reporting requirements.

### **Directly or indirectly owning or controlling an ownership interest**

An individual may directly or indirectly own or control an ownership interest of a reporting company through any contract, arrangement, understanding, relationship or otherwise, including:

- joint ownership with one or more other persons of an undivided interest in such ownership interest;
- through another individual acting as a nominee, intermediary, custodian or agent on behalf of such individual;
- with regard to a trust or similar arrangement that holds such ownership interest:
  - as a trustee of the trust or other individual (if any) with the authority to dispose of trust assets;
  - as a beneficiary who is the sole permissible recipient of income and principal from the trust, or a beneficiary who has the right to demand a distribution of or withdraw substantially all the assets from the trust; or
  - as a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust; or
- through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the reporting company.

Particular attention should be paid to the last paragraph above which clarifies that ownership or control of intermediary entities that own or control a reporting company is a specific means through which an individual may directly or indirectly own or control an ownership interest of a reporting company. Family succession planning structures often utilise numerous companies and advisers must consider each of those entities to determine the individuals to be included on the BOI report of each reporting company in the structure.

### **Use of FinCEN identifier**

BOI reports for companies in a chain of ownership may wish take advantage of the shorthand option of reporting ownership through another entity. In a recently released final rule, FinCEN provides that a reporting company may report another entity's FinCEN identifier and full legal name in lieu of the information required with respect to the individual beneficial owners of the reporting company only if:

- the other entity has obtained a FinCEN identifier and provided that FinCEN identifier to the reporting company;
- an individual is or may be a beneficial owner of the reporting company by virtue of an interest in the reporting company that the individual holds through an ownership interest in the other entity; and
- the beneficial owners of the other entity and of the reporting company are the same individuals.

If at any time the reportable beneficial owners of either the reporting company or the entity whose FinCEN identifier was reported changes such that the two are no longer identical, then the reporting company must file an update with FinCEN and can no longer report the relevant entity's FinCEN identifier.

### **Voting powers or rights**

It is important to note that the listed forms of ownership (eg, equity or stocks) are independent of voting power or voting rights.

Although often associated with ownership, voting rights are not necessary to ownership. Likewise, the description of specific types of relationships through which ownership of ownership interests can occur (eg, joint ownership or through an intermediary entity) does not reference voting.

Nevertheless, the ownership or control of a majority of the voting power or voting rights of the reporting company is specifically included under the "substantial control" prong of the beneficial owner definition (for further details please see "[Corporate Transparency Act: identification of individuals who exercise substantial control over reporting companies](#)"). As a result, individuals with voting powers or rights must always be analysed to see whether they are to be included on a reporting company's BOI report.

### **Ownership interests held in trust**

FinCEN understands that assets, such as the ownership interests of a reporting company, can be held in trust. The final regulations identify the trustee as an individual who will be deemed to control trust assets for the purpose of determining which individuals own or control 25 percent or more of the ownership interests of the reporting company. In supplementary information, FinCEN specifically notes that, "In addition to trustees, the final rule specifies that other individuals with authority to control or dispose of trust assets are considered to own or control the ownership interests in a reporting company that are held in trust."

The final regulations identify circumstances in which ownership interests held in trust will be considered as owned or controlled by a beneficiary or a settlor. FinCEN's supplementary information notes that one consequence of the further specificity is to confirm the reading that, depending on the specifics of the trust arrangement, the ownership interests held in trust could be considered simultaneously as owned or controlled by multiple parties in a trust arrangement.

FinCEN also makes clear that the final regulations are specific examples of the more general principle that an individual "may directly or indirectly own or control an ownership interest of a reporting company through any contract, arrangement, understanding, relationship, or otherwise." The examples in the final regulations do not address all applications of the general principle.

FinCEN supplementary information confirms that the final regulations regarding ownership through a trust are different, less specific, and less prescriptive than the attribution of stock owned by a trust to its beneficiaries under section 318(a)(2)(B) of the Internal Revenue Code and FinCEN believes that its language is more closely tailored to the purpose and language of the CTA than rules governing income tax liability.

### **Special rule – reporting company owned by exempt entity**

The CTA includes a special reporting requirement for exempt entities having an ownership interest in a reporting company (the "special rule"). The final regulations did not modify the 23 types of exempt entities listed in the CTA. These exempt entities include large operating companies, banks as defined in specified sections of the Investment Company Act of 1940 and the Investment Advisers Act of 1940, and entities registered with the Securities and Exchange Commission, among others.

The special rule under the final regulations provides that,

- if one or more exempt entities has or will have a direct or indirect ownership interest in a reporting company, and
- an individual is a beneficial owner of the reporting company exclusively by virtue of the individual's ownership interest in such exempt entities, then
- the reporting company's report may include the names of the exempt entities in lieu of the information required with respect to the beneficial owners of such exempt entity.

The final regulations clarify that this special rule applies only when an individual is a beneficial owner of a reporting company "exclusively" by virtue of the individual's ownership interest in exempt entities. The special reporting rule is optional.

The BOI report filed by such a reporting company may include the name of the exempt entity rather than the information required with respect to individuals who own or control 25% or more of the reporting company through the exempt entity.

### **Practical application**

A reporting company in a family's succession planning structure may be owned by a trust. Careful consideration must be given to the terms of the trust. And drafting attorneys should begin to consider the CTA ramifications when drafting new trusts.

It is common for the terms of a family trust to describe a class of beneficiaries (eg, the settlor's descendants). As a result, there will be no individual who is the sole permissible recipient of income and principal from the trust. It is also common for the trust terms to provide that distributions to those beneficiaries are to be made in the discretion of the trustee and no beneficiary has the right to demand a distribution of or withdraw substantially all of the assets from the trust. In this situation, the reporting company owned by a trust does not include any details for a trust beneficiary on its BOI report.

When the defined class of beneficiaries has only one member, for example, the settlor has only one child and no grandchildren, the trust terms should be reviewed to determine whether that child is, in fact, the sole permissible recipient of income and principal distributions. For example, the trustee may be permitted to make distributions to charity. Absent such terms, it is unclear whether the description of a class of beneficiaries is enough to take the single beneficiary out of the definition of "beneficial owner". It is hoped that guidance from FinCEN will resolve this uncertainty.

Similarly, it will often be clear that the grantor has the right to revoke the trust and so a reporting company owned by the trust will include details for that grantor on its BOI report. But the terms of an irrevocable trust and provisions or documents granting powers of appointment must be carefully reviewed to determine whether the grantor has the power to otherwise withdraw the assets of the trust. A grantor who has retained or been granted a general power of appointment should be included on a reporting company's BOI report. Similarly, when a trust has been designed as a "grantor trust" for income tax purposes because the grantor can substitute assets, that grantor is likely reportable because she or he has the right to withdraw assets, albeit only upon the condition that other assets are substituted. Again, it is hoped that guidance from FinCEN will clarify some of these situations.

Details for individuals serving as trustee of the trust will be included on a reporting company's BOI report when the company is owned by a trust. In supplementary information to the final regulations, FinCEN expressed that it considers a trustee to be a deemed owner under the owns or controls prong of the definition. Consideration must be given to situations where the trustee itself is a company. If the trustee is a regulated trust company that meets the definition of "bank" under the exemption, then the reporting company may use the special rule to report just the name of that trust company.

## Comment

The effective date for CTA implementation is drawing near. While there are still questions surrounding some elements of reporting, families and their advisers can identify the individuals who will be reportable and begin to collect the necessary data. Reportable individuals should be given the option of establishing their own FinCEN identifier account in order to manage their personal data. Engaging the family's legal counsel to advise on the new law may be necessary given the catch all provisions. Because the CTA is not a tax law, accountants may not be able to assist with application of the law and final regulations.

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