



SHORING UP THE FINANCIAL CRIME MONITORING ECOSYSTEM: HOW THE CORPORATE TRANSPARENCY ACT AFFECTS OWNERSHIP DISCLOSURE FOR DOMESTIC AND INTERNATIONAL COMPANIES



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OVERVIEW

The Corporate Transparency Act (the “CTA”) went into effect on January 1, 2024, and requires “reporting companies” in the United States to disclose certain types of information about their “beneficial owners” (“BOI Report(s)”) to the Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”).

Who are “beneficial owners”? Beneficial owners are the individuals who ultimately *own* or *control* a company. We will examine what this legal concept means in greater detail below. For now, be aware that compliance with the CTA is tricky in large part because it is not always easy to determine who is, and who isn’t, a beneficial owner.

REPORTING COMPANIES

Reporting companies include both domestic and foreign entities. Domestic reporting companies include corporations, LLPs, or any other similar entities that are created by the filing of a document with a secretary of state or any similar office under the law of a state. Foreign reporting companies include privately formed entities and any other similar entities formed under the law of a foreign country that are registered to do business in the United States.

The CTA identifies certain exempted entities that are not considered reporting companies. Examples of exempted entities include banks, credit unions, SEC-reporting companies, insurance companies and public accounting firms.

There are two key exemptions (out of 23) that are particularly relevant:

- 1. Large Operating Company Exemption:** A specific exemption exists for an entity that (i) employs more than 20 employees on a full-time basis in the United States; (ii) filed in the previous year Federal income tax returns in the United States demonstrating more than \$5 million in gross receipts or sales; and (iii) operates and has a presence at a physical office within the United States.
- 2. Subsidiary Exemption:** This exemption applies to any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by specified exempt entities (including large



operating companies).

WHO IS A BENEFICIAL OWNER?

Reporting A beneficial owner is 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 at least 25% of the equity interests¹ of the entity.

“*Substantial control*” encompasses individuals who (i) serve as a **senior officer** of the reporting company, (ii) have **appointment or removal authority** over the senior officers and board of directors, (iii) **can direct, determine, or have substantial influence** over important decisions within the company, and (iv) **have any other type of substantial control** over the company.

There is no maximum number of beneficial owners who must be reported, but beneficial owners **do not** include the following five types of people:

- A minor child if the information of a parent or legal guardian is reported pursuant to the CTA.
- An individual acting as a *nominee, intermediary, custodian* or *agent* on behalf of another individual.
- An employee of the reporting company (i) who is not a senior officer and (ii) whose control over or economic benefits from the company is derived **solely from** the employment status of the person.
- An inheritor whose only interest in a reporting company is a future interest through a right of inheritance².
- A creditor of the reporting company **unless** the creditor exercises substantial control over the entity or owns or controls at least 25% of the equity interests of the company.

¹ While many commentators on the CTA have noted that the substantial control prong is potentially tricky from a compliance perspective, the second “equity control” prong is also not always easy to apply to a particular company’s situation. For example, many early-stage startups have “major investors” (a defined concept in the model NVCA financing instruments) who hold multiple types of equity and other rights to purchase or receive future equity. It is common in such scenarios for major investors to have preferred shares in a target company as well as convertible notes, warrants, and similar rights to receive additional issuances of preferred equity in the future. In these situations, it is important to consider the current preferred ownership of the target (reporting) company, along with rights to future equity that have a non-trivial likelihood of being activated by the investor.

² While it may not be a common scenario, it is possible for a preferred investor in a reporting company to transfer a substantial ownership interest (e.g., preferred equity) in such company to a trust that is set up to comply with the general transfer restrictions applicable to such ownership interests. In this type of situation, the original preferred investor is the beneficial owner, not the beneficiary or beneficiaries set forth in the trust.



WHAT NEEDS TO BE IN A CTA REPORT?

Reporting companies subject to the CTA are required to provide the following information regarding the entity: (i) full legal name; (ii) trade names or d/b/a names; (iii) address of the entity; (iv) the jurisdiction of formation or registration; and (5) the federal taxpayer identification number.

For **each** beneficial owner, the reporting company must provide the following:

- i. full legal name;
- ii. birthdate;
- iii. home address;
- iv. an identifying number from a driver's license, passport, or other approved documents; and
- v. an image of the approved document that contains the identifying number.

In lieu of (iv) and (v), an individual may apply for a FinCEN identifier number, after which the individual is permitted to use the identifier number on subsequent filings.

If the reporting company is formed on or after January 1, 2024, information related to the **company applicant** must also be filed. A company applicant is both (i) the individual who directly files the document that creates or registers the company, and (ii) the individual who is primarily responsible for directing or controlling the filing of the relevant document by another. If both (i) and (ii) are the same individual, that person is solely the company applicant. **All company applicants must provide the same information to FinCEN that is required of beneficial owners.**

The following facts relating to company applicants are worth noting:

1. Under the relevant FinCEN rules, company applicants are those individuals who "directly file the document" that creates or registers the reporting company. Such company applicants do not include third-party couriers or delivery service employees.
2. An automated incorporation or filing service/platform is generally not considered a company applicant. According to FinCEN:

"If a business formation service only provides software, online tools, or generally applicable written guidance that are used to file a creation or registration document for a reporting company, and employees of the business service are not directly involved in the filing of the document, the employees of such services are not company applicants. For example, an individual may prepare and self-file documents to create the individual's own reporting company through an automated incorporation service. In this case, this reporting company reports only that individual as a company applicant."

3. Once a company applicant is associated with a BOI Report, a company applicant may **not** be removed from such BOI Report (even if such company applicant no longer has a relationship with the reporting company).

WHEN MUST COMPANIES FILE CTA REPORTS?

Existing reporting companies that were formed before January 1, 2024, must file their initial reports no later than January 1, 2025. Newly-formed reporting companies created after January 1, 2024, must file their initial reports 90 days after receiving notice of their creation or registration.

Once the initial filing is submitted, there is no annual or quarterly filing requirement. However, reporting companies have **30 days to amend** their report to include updated information. Additionally, reporting companies **must** correct inaccurate information previously filed within 30 days of discovering the error.

CTA reporting is done electronically through a secure electronic filing system available via FinCEN's website: <https://boiefiling.fincen.gov/>.

THERE ARE SIGNIFICANT PENALTIES FOR COMPLIANCE FAILURES

Any person who provides false information or fails to comply with the CTA's reporting requirements is liable for civil penalties of no more than \$500 for each day that the violation continues. Violators are also subject to criminal penalties including (a) fines of up to \$10,000 and (b) imprisonment of up to two years.

As the Corporate Transparency Act (CTA) reshapes the landscape of ownership disclosure for both domestic and international companies, navigating its requirements is more crucial than ever. The stakes for compliance are high, and the intricacies of determining beneficial ownership and reporting company status demand meticulous attention and expertise.

BurgherGray LLP is at the forefront of guiding companies through the evolving legal and regulatory environment surrounding the CTA. Don't navigate these complex waters alone. Contact BurgherGray LLP today to discuss how the Corporate Transparency Act impacts your business and how we can help you comply effectively and efficiently.

Contact Gopal Burgher (gburgher@burghergray.com) or John Eden (jeden@burghergray.com) to discuss how the Corporate Transparency Act impacts your business and how we can help you comply effectively and efficiently.

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