

## The Corporate Transparency Act – Who Counts as a Beneficial Owner?

Joseph B. Allen

**The third installment in a multi-part series looking at the new Corporate Transparency Act discusses the Act’s definition of “beneficial owners”, a concept at the heart of the new law.**

The new Corporate Transparency Act and its related regulations (the “CTA”), set to go into effect January 1, 2024, was adopted with a primary motivation of allowing law enforcement and certain government officials and regulators to more easily cut through the several layers of entities and trusts that can be found in many affiliated company groups to determine the individuals who ultimately benefit economically from investments and assets held by those groups. The CTA labels certain of these individuals “beneficial owners”, and identifying, collecting and compiling information from, and reporting on beneficial owners is likely to take up a large portion of the time spent by reporting companies in complying with the CTA.

Because the definition of a beneficial owner is both very broad and central to CTA compliance, it’s prudent to explore who counts as a beneficial owner. This article is the third of a series on the CTA and discusses the expansive definition of beneficial owners under the new law. Further articles will discuss other aspects of the reports that reporting companies must file under the CTA.

### **The definition of “Beneficial Owners”**

The CTA generally defines a “beneficial owner” as an individual who, directly or indirectly, either (1) exercises substantial control over the reporting company, or (2) owns or controls at least 25% of the ownership interests of the reporting company. The control or ownership may be exercised or held indirectly through one or more intermediary entities.

FinCEN noted in guidance that it expects every reporting company will have at least one beneficial owner. Only individuals can be beneficial owners; if an intermediary entity exercises substantial control over the reporting company or owns or controls at least 25% of the ownership interests of the reporting company, the reporting company likely need to look through that intermediary entity and analyze whether any individuals controlling or owning that intermediary entity constitute a beneficial owner of the reporting company.

Beneficial owners fall into two categories – individuals who exercise substantial control over a reporting company, and individuals who own or control at least 25% of the ownership interests of the reporting company.

### **Exercising Substantial Control**

“Exercising substantial control” is broadly defined and includes the following:

- Service as a senior officer of the reporting company;
- 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 the reporting company;
- Direction, determination, or substantial influence over important decisions made by the reporting company; and
- Any other form of substantial control over the reporting company.

The CTA defines a “senior officer” as “any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.”

An individual may exercise substantial control through a variety of means, including through board representation, ownership or control of voting equity, rights associated with financing arrangements, contract rights, or otherwise. The CTA provides a non-exhaustive list of actions that constitute “important decisions” for a reporting company, such as transferring principal assets; reorganizations or mergers; major expenditures, investments, or equity or debt issuances; approval of the operating budget; selection or termination of business lines; compensation and incentive programs for senior officers; entry, termination, or fulfillment of significant contracts; and amendments to significant governance documents.

### **Ownership Interests**

“Ownership interests” are broadly defined and includes any equity, stock, or similar interest or instrument, without regard to whether any such instrument is transferable, is classified as stock or anything similar, or confers voting power or voting rights. “Ownership interests” includes both capital and profits interests, instruments convertible into equity (regardless of whether the instrument is characterized as equity or debt), and puts, calls, options, warrants, and other rights of buying or selling any equity. However, if any such put, call, option, warrant, or similar right is created and held by one or more third parties without the knowledge or involvement of the reporting company, the reporting company is not required to account for such right in determining its beneficial owners.

If an ownership interest is held in a trust, each of the following individuals may be deemed to own or control the ownership interest: (i) the trustee; (ii) an individual with authority to dispose of trust assets; (iii) a beneficiary who is the sole permissible recipient of income and principal from the trust; (iv) a beneficiary who has the right to demand a distribution of or withdraw substantially all of the assets of the trust; or (v) a grantor or settlor with the

right to revoke the trust or withdraw assets from the trust.

### **25% Threshold**

For purposes of determining whether the 25% threshold has been reached, all options and warrants and, likely, all convertible or exchangeable instruments are treated as exercised, converted, and exchanged, as applicable. In addition:

- For entities that issue capital or profits interests, an individual’s ownership interests are the individual’s capital and profit interests in the entity, calculated as a percentage of the total outstanding capital and profit interests of the entity.
- For corporations, entities treated as corporations for tax purposes, or other entities that issue stock, an individual’s percentage ownership interest in the entity will be greater of (i) the total combined voting power of all classes of equity held the individual as a percentage of total outstanding voting power of all classes of equity entitled to vote, or (ii) the total combined value of the equity of the individual as a percentage of the total outstanding value of all classes of equity.
- If the facts and circumstances do not permit the calculations described in either of the above bullets to be performed with reasonable certainty, any individual who owns or controls 25 percent or more of any class or type of ownership interest of a reporting company shall be deemed to own or control 25 percent or more of the ownership interests of the reporting company.

### **Exclusions and Exemptions**

The CTA provides that “beneficial owners” do not include any of the following:

- Minor children. In lieu of a minor child who would otherwise constitute a beneficial owner, the reporting company must provide the required information regarding the child’s parent or guardian.

- An individual acting as a custodian, nominee, or other agent on behalf of another individual. In lieu of such agent, the reporting company must provide the required information regarding other individual/principal.
- An employee of a reporting company whose substantial control over or economic benefits from such entity are derived solely from the employment status of the employee, provided that such person is not a senior officer of the reporting company.
- An individual whose only interest in a reporting company is a future interest through a right of inheritance.
- A creditor of a reporting company who would otherwise be a beneficial owner solely through rights or interests in the reporting company for the payment of a predetermined sum of money. Loan covenants in favor of a creditor do not count as “substantial control” over the reporting company if the covenants are intended to secure the right to receive payment or enhance the likelihood of repayment. However, if lenders receive warrants or similar rights as part of a credit agreement, loan agreement, or other lending facility, those rights should be examined as potentially constituting “ownership interests” that could result in beneficial owner status.

If an ownership interest in a reporting company is owned directly or indirectly by one or more entities that are exempt from the CTA, and an individual is a beneficial owner of that reporting company solely and exclusively by virtue of being a beneficial owner of one or more exempt entities, then the initial report for that reporting company does not need to identify that individual beneficial owner. Instead, the initial report may include the name of the exempt entity or entities in lieu of the information required for the individual beneficial owner.

### **Be ready to roll up your sleeves**

Unfortunately, determining the beneficial owners of your reporting company for CTA purposes won't be as easy as looking at your cap table and eliminating everyone who holds an ownership interest of less than 25%. It will require looking at officers and

others with substantial influence over company decisions, as well as inquiring with entities that are equity owners in the reporting company with respect to their own individual beneficial owners. (If it's not already addressed, it may be worthwhile to explore amending your operating, partnership, or shareholders' agreements or other applicable documents to require equity owners to provide your company with any information and documentation required for your company to comply with the CTA, tax laws, and other reporting requirements.) Therefore, reporting companies will likely need to set aside some time to properly comply with the CTA, and as always, entities should strongly consider contacting their counsel for further guidance.

**Joseph B. Allen**  
Willcox Savage  
1775 Tysons Blvd, 5th floor  
Tysons, VA 22102  
[jallen@wilsav.com](mailto:jallen@wilsav.com)  
(757) 628-5648