

You Filed Your Beneficial Ownership Information Report, But Is it Right? An Analysis of Substantial Control

Corporate News: A Legal Update

By Karen Tobin on September 23, 2024

You are likely now aware of the Financial Crimes Enforcement Network's (FINCEN) new Corporate Transparency Act in effect as of January 1, 2024, that requires domestic entities (and foreign entities qualified to do business in the United States) to file a Beneficial Ownership Information Report (BOI) with FINCEN.

In addition, you are also likely aware of your deadlines for filing these reports and FINCEN's potential fines and possible imprisonment for willfully failing to file or update a BOI. Civil penalty amounts are adjusted for inflation and currently the civil fines are \$591 per day. A person who willfully violates the BOI requirements may also be subject to criminal penalties of up to two years imprisonment and a fine of up to \$10,000.

How Do You Know You Reported All the Information and Beneficial Owners Correctly?

As the rules provide, it is not just the individuals who directly or indirectly own 25 percent or more of the entity that must file, but those who have "substantial control" under FINCEN's rules.

An individual can exercise substantial control over a reporting company in four ways:

- The individual is a senior officer (president, CFO, general counsel, CEO, COO, or any other officer who performs a similar function). Note: FINCEN states that a secretary or treasurer title alone does not rise to the level of exercising substantial control;
- The individual has the authority to appoint or remove certain officers or a majority of the board of directors (or similar body) of the reporting company;
- The individual is an important decision maker, defined by FINCEN as an individual able to direct, determine, or who has substantial influence over

important decisions of the reporting company. This includes actions such as determining scope of business, ability to enter into or terminate important contracts, approving major financial decisions, or influence over the organization's structure; or

- The individual has **any other** form of substantial control over the reporting company.

This last category only serves to cloud the issue. However, FINCEN indicates that it is intended to cover control exercised in new and unique ways that could still be considered substantial in that flexible corporate structures may have different indicators of control than what is listed in the other categories listed by FINCEN.

In addition, it is important to remember that ownership in a company comes in many forms, not just shares represented by a stock certificate or membership interest. Profit interest, convertible instruments, or options or privileges are all forms of ownership and must be reported. FINCEN states that if your company has options, privileges or convertible instruments, you are to assume that they have been converted when calculating percentages.

What if the Beneficial Owners Refuse to Comply With Reporting Requirements?

The bottom line is that it is up to the company **and** the individual beneficial owners to report – each can be held liable for the failure to report. FINCEN recommends that a reporting company should advise their beneficial owners of this requirement, obtain their information, and consider putting in place mechanisms to ensure that beneficial owners will keep them apprised of changes in reported information if necessary. The reporting company should make these individuals aware that they could face civil and criminal penalties if they do not provide their information. Moving forward, companies should consider amending their shareholder or operating agreements as well as employment agreements with those holding substantial control to ensure they include provisions requiring compliance with the BOI.

Does an Entity Dissolved in 2024 Have to File a BOI?

FINCEN published guidance on this as well, stating that if an entity was in existence on January 1, 2024, it still needs to file the BOI. After filing, it can then return to the form and update the report by checking the "Newly Exempt Entity" box.

We have yet to hear of any actual reports of penalties being assessed by FINCEN. Time will tell how they roll out enforcement of the civil and criminal penalties.

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