

# THE UNRAVELLING OF THE *MATRYOSHKA* DOLL – IMPACT OF THE C.T.A. ON ENTITIES HAVING NEXUS TO THE U.S.

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## Tags

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## INTRODUCTION

Because most U.S. States do not require information about the beneficial owners of an entity, and with more than two million entities being formed in the U.S. each year, it was about time for Congress to enact a law that mandates disclosure of the identity of the ultimate beneficial owners and the persons who maintain substantial control of private entities.

Aimed at curbing money laundering, terrorism financing, serious tax fraud, human and drug trafficking, counterfeiting, piracy, securities fraud, financial fraud, and similar activities, Congress enacted the Corporate Transparency Act (“C.T.A.”) on January 1, 2021. The D.T.A. became fully effective from January 1, 2024. It requires certain domestic and foreign entities to disclose to the Financial Crimes Enforcement Network (“FinCEN”), a division of the U.S. Treasury Department, the identity of their beneficial owners and control persons. A failure to do so can attract heavy penalties.

The targets of the C.T.A. are much like *Matryoshka* dolls, having many layers between what appears on the surface and what exists at the heart. Congress intended to unravel the identity of the ultimate beneficial owners by peeling one layer at a time, thereby requiring the lowest tier entity to disclose the identity of the individuals that control the company.

This article serves as a primer to the C.T.A., asking questions and providing answers.

## WHO IS REQUIRED TO REPORT UNDER THE C.T.A.?

Briefly, any entity that is either organized in the U.S. or a foreign entity that is registered to conduct business in the U.S. is required to report certain specific information about its (a) individual ultimate beneficial owners and (b) individuals who assisted either in the formation of the entity or obtaining the registration to conduct business in the U.S.

### **General Definition**

A Reporting Company has been broadly defined to mean the either of the following:<sup>1</sup>

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<sup>1</sup> 31 U.S. Code § 5336(a)(11)(A); 31 CFR 1010.380(c)(1).

1. A domestic Reporting Company. This is defined to mean any of the following entities:
  - a. A corporation
  - b. A limited liability company
  - c. An entity that is created by the filing of a document with a secretary of state of one of the states or any similar office under the law of a State or Indian tribe
2. A foreign Reporting Company. This is defined to mean a company that meets the following criteria:
  - a. It is a corporation, limited liability company, or other entity.
  - b. It is formed under the law of a foreign country.
  - c. It is registered to do business in any U.S. State or tribal jurisdiction by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe.

### **Exemption for Heavily Regulated Entities**

Companies that are subject to substantial reporting requirements under another Federal statute are exempt from the reporting under the C.T.A. Examples include the following:<sup>2</sup>

1. Entities registered with the Securities Exchange Commission. Examples include the following:
  - a. Publicly traded companies (registered securities issuers)
  - b. Brokers or dealers in securities
  - c. Securities exchanges or clearing companies; money services businesses
  - d. Other Exchange Act registered entities
  - e. Investment companies or investment advisers
  - f. Venture capital fund advisers
  - g. Commodity Exchange Act registered entities
2. Entities in the Financial and Insurance sector that are regulated businesses. Examples include the following:
  - a. Banks
  - b. Credit unions
  - c. Depository institution holding companies
  - d. Insurance companies

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<sup>2</sup> 31 U.S. Code § 5336(a)(11)(B).

- e. State-licensed insurance producers
  - f. Pooled investment vehicles
  - g. Financial market utilities
3. Governmental authorities and political subdivisions
  4. Inactive Entities<sup>3</sup>
  5. Large Operating Entities<sup>4</sup>
  6. Public accounting firms registered under the Sarbanes-Oxley Act
  7. A public utility that provides telecommunications services, electrical power, natural gas, or water and sewer services within the U.S.
  8. Any entity that is controlled or wholly owned, directly or indirectly, by one or more entities that are otherwise exempt in the above categories.

## WHAT IS A REPORTING COMPANY REQUIRED TO REPORT UNDER THE C.T.A.?

An entity meeting the definition of a Reporting Company is required to file a beneficial Ownership Interest report (“B.O.I. Report”) to report certain information about itself, its Beneficial Owners, and Company Applicants.<sup>5</sup>

### **Information About the Reporting Company**

The report must include the following:

1. The Reporting Company’s full legal name
2. Any trade names it uses
3. Its business address
4. Its I.R.S. tax identification number

<sup>3</sup> 31 CFR 1010.380(c)(2)(xxiii). An inactive entity is any entity that (a) was in existence prior to January 1, 2020, (b) is not engaged in an active business, (c) is not owned by a foreign person (directly or indirectly, in whole or in part), (d) has had no changes in ownership during prior 12 months, (e) has not sent or received funds greater than \$1,000 in the prior 12 months, and (f) does not hold any assets in the U.S. or otherwise, including any ownership interests in other entities.

<sup>4</sup> 31 CFR 1010.380(c)(2)(xxi). A Large Operating Entity is any entity that (a) has an operating presence at a physical location in the U.S.; (b) employs more than 20 full-time employees; and (c) has filed a federal tax return for the previous year showing more than \$5,000,000 of gross receipts.

<sup>5</sup> The terms “Beneficial Owner” and “Company Applicant” have been defined below in detail.

*“An entity meeting the definition of a Reporting Company is required to file a beneficial Ownership Interest report (“B.O.I. Report”) to report certain information about itself, its Beneficial Owners, and Company Applicants.”*

## **Information About Each of the Reporting Company's Beneficial Owners and Company Applicants**

The report must include the following:

1. Full name
2. Date of birth
3. Residential address
4. A unique identifying number and the issuing jurisdiction for that number. The number must be derived from the individual's
  - a. U.S. passport;
  - b. state-issued driver's license;
  - c. identification document issued by a state, local government, or tribe; or
  - d. foreign passport if none of the above documents are available.
5. An image of the above-mentioned document from which the identifying number is reported. Any change in any of the above information must be reported to FinCEN within 30 calendar days of such change.

## **WHO IS A BENEFICIAL OWNER OF THE REPORTING COMPANY?**

A "Beneficial Owner," with respect to a Reporting Company, is either of the following individual or individuals:

1. An individual who directly or indirectly exercises substantial control over a Reporting Company
2. An individual who owns or controls at least 25% of the ownership interests in a Reporting Company

An individual might be a beneficial owner through substantial control, ownership interests, or both. A Reporting Company is not required to report the reason that an individual is a beneficial owner.

## **WHEN IS AN INDIVIDUAL SAID TO EXERCISE SUBSTANTIAL CONTROL OVER A COMPANY?<sup>6</sup>**

An individual is said to exercise substantial control over a Reporting Company in any of the following circumstances:

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<sup>6</sup> Small Entity Compliance Guide published 9/18/23.

1. The individual serves as a senior officer<sup>7</sup> of the Reporting Company.
2. The individual has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body).
3. The individual directs, determines, or has substantial influence over important decisions made by the Reporting Company. Important decisions include decisions regarding the following items:
  - a. 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.
  - b. The reorganization, dissolution, or merger of the Reporting Company.
  - c. Major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the Reporting Company.
  - d. The selection or termination of business lines or ventures, or geographic focus, of the Reporting Company.
  - e. Compensation schemes and incentive programs for senior officers.
  - f. The entry into or termination, or the fulfillment or non-fulfillment, of significant contracts.
  - g. 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.
4. The individual has any other form of substantial control over the Reporting Company.

An individual may, directly or indirectly, exercise substantial control over a Reporting Company in any of the following ways:

1. Through board representation
2. Through ownership or control of a majority of the voting rights of the company.
3. Through rights associated with any financing arrangement or interest in a company
4. Through control over one or more intermediary entities that separately or collectively exercise substantial control over a Reporting Company
5. Through financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees
6. Through any other contract, arrangement, understanding, relationship, or otherwise

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<sup>7</sup> “The term “senior officer” means 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.” 31 CFR § 1010.380(f)(8).



## WHEN IS AN INDIVIDUAL SAID TO OWN OR CONTROL AN OWNERSHIP INTEREST OF A REPORTING COMPANY?<sup>8</sup>

An individual is considered to be a beneficial owner if he or she owns or controls at least 25% of the ownership interest in a Reporting Company. An individual is said to have an ownership interest in a company in any of the following ways:

1. The individual owns equity, stock, or similar instrument.
2. The individual owns capital or profit interest in an entity.
3. The individual owns a convertible instrument (with or without consideration).
4. The individual owns options or other non-binding privileges (including any put, call, straddle) to buy or sell any of the foregoing instruments.

The fact that any of the above instruments is characterized as debt is irrelevant.

Ownership or control of the ownership interest may be held in any of the following ways:

1. It may be held jointly.
2. It may be held directly.
3. It may be held indirectly through any contract, arrangement, understanding, or relationship.
4. It may be held through a nominee, intermediary, custodian, or agent.

In the case of a trust, ownership or control of a Reporting Company may be held by any of the following persons involved with the trust:

1. Ownership or control of a Reporting Company may be owned by a trustee having the authority to dispose of trust assets.
2. Ownership or control of a Reporting Company may be owned by a beneficiary who is the sole permissible recipient of income and principal from a trust.
3. Ownership or control of a Reporting Company may be owned by a beneficiary who has the right to demand a distribution of the assets from the trust.
4. Ownership or control of a Reporting Company may be owned by a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust.

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<sup>8</sup> Small Entity Compliance Guide published 9/18/23.

## HOW IS THE OWNERSHIP PERCENTAGE OF AN INDIVIDUAL IN A COMPANY CALCULATED WHEN DETERMINING THE 25% THRESHOLD?

In determining whether an individual owns or controls at least 25% of the ownership interests of a Reporting Company, the total ownership interests that an individual owns or controls, directly or indirectly, shall be calculated as a percentage of the total outstanding ownership interests of the Reporting Company as follows:

1. Any options or similar interests of the individual shall be treated as exercised.
2. For Reporting Companies that issue capital or profit interests (including entities treated as partnerships for federal income tax purposes), the 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.
3. For corporations, entities treated as corporations for U.S. Federal income tax purposes, and other reporting companies that issue shares of stock, the applicable percentage shall be the greater of
  - a. the total combined voting power of all classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote, and
  - b. the total combined value of the ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests.

## DOES THE C.T.A. CARVE OUT ANY EXCEPTIONS FROM THE DEFINITION OF A “BENEFICIAL OWNER?”

Yes, the C.T.A. exempts the following from the definition of a Beneficial Owner:

1. A minor child, as defined under the local law of the State in which a domestic Reporting Company is organized or a foreign Reporting Company is registered.<sup>9</sup>
2. An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual.
3. An employee of a Reporting Company, acting solely as an employee, 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.

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<sup>9</sup> The reporting company is required to report the requisite information of a parent or legal guardian of the minor child.



*“A company applicant is an individual who directly files the document that either creates a domestic Reporting Company or first registers a foreign Reporting Company.”*

4. An individual whose only interest in a Reporting Company is a future interest through a right of inheritance.
5. A creditor of a Reporting Company.

## WHO IS A COMPANY APPLICANT REQUIRED TO REPORT?

A company applicant is an individual who directly files the document that either creates a domestic Reporting Company or first registers a foreign Reporting Company. If more than one individual is involved in the filing process, a company applicant is the individual who is primarily responsible for directing or controlling such filing. For example, the attorney responsible to the client is the company applicant even though the filing may be done by a paralegal or intern.

Reporting Companies in existence prior to January 1, 2024, are not required to include any information for a Company Applicant.

## DOES THE C.T.A. OFFER RELIEF FOR BENEFICIAL OWNERS AND COMPANY APPLICANTS WHO DO NOT WISH TO DISCLOSE SENSITIVE PERSONAL?

Yes. A beneficial owner or a company applicant may obtain a FinCEN Identifier from FinCEN which may be reported by the Reporting Company in the B.O.I. Report in lieu of the personal information required to be disclosed in the report. A FinCEN identifier is a 12-digit unique identifying number which, in the case of individuals, starts with the numeral 3. For entities, a FinCEN Identifier starts with the numeral 2.<sup>10</sup>

1. A FinCEN Identifier is obtained by providing the required Personal Information (that must be reported in a B.O.I. Report) directly to FinCEN.<sup>11</sup>
2. A FinCEN Identifier is an option made available to individuals who do not wish to disclose their Personal Information to the Reporting Company.
3. Reporting Companies may prefer to receive FinCEN Identifiers from their beneficial owners and company applicants in order to avoid the hassle of implementing security protocols otherwise required to protect the Personal Information from unauthorized disclosure and liability in the event of a breach.

<sup>10</sup> A Reporting Company may apply for a FinCEN identifier by checking a box on the B.O.I. report at the time of submitting the report. The FinCEN Identifier is issued instantly upon submission.

<sup>11</sup> To request a FinCEN identifier, an individual is required to first obtain a login.gov account. After signing in to login.gov, a FinCEN Identifier can be obtained by completing the FinCEN ID application at [here](#). It requires the same information which an individual who is a beneficial owner or a company applicant is otherwise required to furnish to a Reporting Company to complete a B.O.I. Report.



4. Use of a FinCEN Identifier prevents an individual who may be a beneficial owner of more than one Reportable Company from repetitiously furnishing the same information to multiple filers.
5. The individual is responsible for updating any changes to his or her personal information which dispenses the need for Reporting Companies to file updated BOI Reports each time the personal information of a beneficial owner changes.

## WHAT IS THE DUE DATE FOR FILING A B.O.I. REPORT UNDER THE C.T.A.?

The due date for filing a B.O.I. depends on the date of the formation of the entity.<sup>12</sup>

1. A domestic Reporting Company formed on or after January 1, 2024, and before January 1, 2025, must file a report within 90 calendar days of the earlier of the date of receipt of notice of its creation and the date on which a secretary of state or similar office first provides public notice (such as through a publicly accessible registry) that the domestic Reporting Company has been created.
2. The time period for filing a report is reduced to 30 days for any domestic Reporting Company created on or after January 1, 2025.
3. A domestic Reporting Company created before January 1, 2024, and any entity that became a foreign Reporting Company before January 1, 2024 are required to file a report not later than January 1, 2025.
4. An entity that no longer meets the definition of an exempt company is required to file a report within 30 calendar days after the date that it no longer meets the criteria for any exemption.
5. Any change or inaccuracy in the reported information must be reported or corrected to FinCEN within 30 calendar days of the change or when the inaccuracy comes to the knowledge of the Reporting Company.<sup>13</sup>
6. The C.T.A. does not specify the point in time the substantial control or ownership interest must be measured.

## DOES THE C.T.A. IMPOSE PENALTIES FOR A WILLFUL FAILURE TO COMPLY WITH ITS PROVISIONS?<sup>14</sup>

Yes, a penalty may be imposed for willfully providing false or fraudulent beneficial ownership information, including a false or fraudulent identifying photograph or document, or willfully failing to report a completed or updated B.O.I. Report. A person found liable may be subject to a penalty of up to \$500 for each day a violation

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<sup>12</sup> 31 CFR 1010.380(a)(1).

<sup>13</sup> 31 CFR 1010.380(a)(2) and (3).

<sup>14</sup> 31 U.S. Code § 5336(h).

continues and has not been remedied, a fine of up to \$10,000 and prison time of up to two years, or both.

Also, any person who knowingly disclose or use the beneficial ownership information obtained by him or her for purposes of completing a B.O.I. Report may be subject to a penalty of up to \$500 for each day a violation continues and has not been remedied, and a fine of up to \$250,000 and prison time of up to five years, or both. No penalty is imposed if the person corrects the inaccurate or incomplete information within 90 days of the original filing. The exception, however, does not apply if the person has actual knowledge of the inaccuracy or incompleteness at the time of original filing.

## CONCLUSION

The C.T.A. is a game-changer in so far as it attempts to unravel the *Matryoshka* dolls to identify the real economic owners hiding behind corporate structures. FinCEN will soon develop a vast C.T.A. repository of information. Only time will tell if it can muster enough resources to dig out meaningful information necessary to combat illicit activities it intended to curb in the first place. The resources of artificial intelligence companies clearly will be required by FinCEN if it wishes to extract information promptly and in meaningful form.

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