Sherman Atlas Sylvester & Stamelman

CORPORATE ALERT

March 2023

Private Company Ownership Disclosure is Coming

What is the Corporate Transparency Act?

The Corporate Transparency Act (together with its implementing regulations, the "Act") was enacted in 2021 as part of the Anti-Money Laundering Act of 2020 in the National Defense Authorization Act to deter illicit actors from using corporate structures to hide their identities and launder money through the United States financial systems. The Financial Crimes Enforcement Network of the Department of Treasury ("FinCEN") released final regulations (the "Final Rule") of the Act on September 29, 2022. The Act requires all reporting companies to file a report with FinCEN disclosing certain identifying information about (i) the reporting company and (ii) ***each*** of its beneficial owners and (iii) company applicants (together with information about the beneficial owners, "Beneficial Ownership Information") and becomes effective on ***January 1, 2024*** (the "Effective Date").

What is a Reporting Company?

A reporting company is any:

1. Domestic entity ***created*** by the filing of a document with a Secretary of State or similar office of any State; or
2. Entity formed under the law of a foreign country that is ***registered to do business*** in any State by the filing of a document with the Secretary of State or similar office of that State.

When must a reporting company file an initial report with FinCEN?

- Reporting companies created (or which became a foreign reporting company) on or after the Effective Date must file an initial report within ***30 days*** after receiving evidence of formation (or registration to do business).
- Reporting companies created (or which became a foreign reporting company) before the Effective Date must file an initial report before ***January 1, 2025***. This one-year compliance period gives reporting companies ***over two years*** from the publication of the Final Rule to comply with their reporting obligations.

In This Issue

Office Locations

New Jersey
210 Park Avenue
2nd Floor
Florham Park NJ 07932
973.302.9700

New York
1185 Avenue of the Americas
3rd Floor
New York NY 10036
212.763.6464

Follow Sherman Atlas on Linkedin

What information must be included on the initial report with FinCen?

1. Information for the Reporting Company

   a. Full legal name;

   b. Trade names or DBAs;

   c. The address of the principal place of business or primary location in the United States;

   d. State or foreign jurisdiction of formation;

   e. For foreign reporting companies, the state where it first registered to do business; and

   f. Taxpayer Identification Number (TIN) or for foreign companies not issued a TIN, a tax identification number issued by a foreign jurisdiction and the name of the jurisdiction. Reporting companies that do not have a TIN or a tax identification number from a foreign country, must obtain one before filing.

2. Information for every Individual who is a beneficial owner and/or a company applicant

   a. Full legal name;

   b. Date of birth;

   c. Company applicants***** who registered the entity in the course of their business, must provide the address of their business and all others must provide the individual's residential street address. This does not have to be an address in the United States; and

   d. Copy of a government issued photo ID, such as a non-expired passport or driver's license.

*******Reporting companies created or registered before the Effective Date are not required to report information about any company applicant.*

What type of entities are exempt from the Act's requirements?

Below is a list of 23 entities, most which are already regulated by the state or federal government, that are not considered reporting companies, and therefore do not need to file a report so long as they remain exempt.

Securities Reporting Issuer	Other Exchange Act Registered Entity	Financial Market Utility
Governmental Authority	Investment Company or Investment Adviser	Pooled Investment Vehicle
Bank	Venture Capital Fund Adviser	Tax-Exempt Entity
Credit Union	Insurance Company	Entity Assisting a Tax-Exempt Entity
Depository Institution Holding Company	State-Licensed Insurance Producer	Large Operating Company
Money Services Business	Commodity Exchange Act Registered Entity	Subsidiary of Certain Exempt Entities
Broker or Dealer in Securities	Accounting Firm	Inactive Entity
Securities Exchange or Clearing Agency	Public Utility	

What is considered a large operating company under the Act?

To qualify as a large operating company under the Act, a company must:

1. Employ more than 20 full time employees in the United States;
2. Have an operating presence at a physical office within the United States; ***and***
3. Have filed a Federal income tax or information return in the United States for the previous year demonstrating more than ***$5,000,000*** in gross receipts or sales. This excludes gross receipts or sales from sources outside the United States. If the entity is part of an affiliated group of corporations that filed a consolidated return, this amount is what was reported on the consolidated return.

What is considered an inactive entity under the Act?

To qualify as an inactive entity under the Act, a company must ***NOT***:

1. Be formed after January 1, 2020;
2. Be engaged in active business;
3. Be owned, directly or indirectly, in whole or in part, by any foreign person;
4. Have experienced any change in ownership in the preceding 12 months;
5. Have sent or received, directly or through any financial account in which it or any affiliate has an interest, any funds in an amount greater than $1,000 within the preceding 12 months; ***or***
6. Hold any assets, in the United States or abroad, including ownership interest in a company.

Who is considered a company applicant?

1. The individual who directly files the document that creates the reporting company or first registers the foreign reporting company, ***and***
2. The individual primarily responsible for directing or controlling such filing if more than one individual is involved in the filing of the document.

For example, there may be an attorney primarily responsible for overseeing the preparation and filing of incorporation documents and a paralegal who directly files them with a state office to create the reporting company. In this example, the reporting company would report two company applicants – the attorney and the paralegal – but additional individuals who may be indirectly involved in the filing would not need to be reported. Likewise, employees of business formation services, such as CSC, would be considered company applicants if they are personally involved in the filing of a document to form a particular company.

What is a Beneficial Owner?

A beneficial owner means ***all individuals*** who, directly or indirectly, either (i) exercise ***substantial control*** over a reporting company or (ii) own or control at least ***25%*** of the ownership interests of a reporting company.

The following individuals are not considered beneficial owners:

1. Minor children, if the information of their parents or legal guardians is reported;

2. An individual acting as a nominee, intermediary, custodian or agent on behalf of another individual (including attorneys and tax professionals);
3. An employee of a reporting company (who is not a senior officer), acting ***solely*** as an employee or whose substantial control over or economic benefits from the reporting company are derived ***solely*** from their employment status;
4. An individual whose only interest in the reporting company is a future interest through a right of inheritance (ownership interests begins once the inheritance occurs), or
5. An individual whose only interest in the reporting company is that of a creditor.

If an individual is a beneficial owner of a reporting company exclusively by virtue of the individual's ownership interest in an exempt entity that has or will have direct or indirect ownership interest in the reporting company, then with respect to the beneficial owner, the reporting company has the option to include in the report, either (i) the requested Beneficial Ownership Information about that individual or (ii) the name of the exempt entity.

How do I know whether an individual has exercised substantial control over the reporting company?

The Act's reporting requirements account for a wide array of avenues of control. An individual will be deemed to exercise substantial control over a reporting company if the person meets any one of the following indicators:

1. Is a ***senior officer***, who performs functions that inherently involve substantial control (this does not include the corporate secretary or treasurer, but does include the role of general counsel);
2. Has authority to appoint or remove senior officers or a majority of the Board;
3. Directs, determines or has substantial influence over important decisions made by the reporting company; or
4. Has any other form of substantial control over the reporting company.

Further, an individual, such as a trustee, may, directly or indirectly, exercise substantial control over a reporting company through any one of the following means:

1. Board representation;
2. Ownership or control of a majority of the voting power or voting rights;
3. Rights associated with any financing arrangement or interest in a company;
4. Control over one or more intermediary entities that separately or collectively exercise substantial control over the reporting company;
5. Arrangements or financial or business relationships with other individuals or entities acting as nominees; or
6. Any other contract, arrangement, understanding, relationship or otherwise.

What are considered ownership interests in a reporting company?

1. Equity or stock;
2. Capital or profit interests;
3. Convertible interests;
4. Options or other privileges, but only to the extent of the reporting company's knowledge; and
5. Any other instruments, arrangements or mechanisms used to establish ownership.

What are some arrangements in which an individual will be considered to directly or indirectly own or control an ownership interest in the company?

1. Through joint ownership of an undivided interest;
2. An individual acting through a nominee, intermediary, custodian or agent;
3. With regard to a trust, a (i) trustee, (ii) beneficiary of a trust who is the sole permissible recipient of income and principal from the trust or has a right to demand a distribution of or withdraw substantially all of the assets from the trust, or (iii) grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust; or
4. Through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of such entities, that separately or collectively own or control ownership interests of the reporting company.

How is the 25% ownership interest calculated?

Ownership interest is calculated at the present time with all options treated as exercised. For reporting companies that issue capital and profit interests, an individual's percentage ownership interest is calculated as a percentage of the total outstanding capital and profit interests. For reporting companies who issue stock, an individual's percentage ownership interest is the greater of the total combined (i) voting power or (ii) value of ownership interest of the individual as a percentage of the total outstanding voting power or value of all ownership interests, respectively. When these calculations cannot be applied with reasonable certainty, the Final Rule provides a general catchall provision in which an individual will be deemed to own 25% of the total ownership interest in the reporting company if such individual owns or controls 25% or more of any class or type of ownership interest.

What is a FinCEN Identifier?

The FinCEN Identifier ("FinCEN ID") is a unique identifying number assigned by FinCEN which is specific to an individual or reporting company. An individual may obtain a FinCEN ID by submitting an application containing the information required to be reported for beneficial owners and company applicants. Any information submitted must be kept current and updated to reflect any change. A reporting company may use an individual's FinCEN ID in its report in lieu of the information required for beneficial owners and company applicants. We recommend individuals who frequently file formation documents for companies to obtain a FinCEN ID to streamline the process. FinCEN will provide further guidance in the future on the process for obtaining a FinCEN ID.

What changes warrant filing an updated report with FinCen?

All changes with respect to the information previously submitted concerning a reporting company or its beneficial owners should be filed with FinCen within 30 days of the change. For example, changes that must be reported include any changes related to information on identification documents, the exempt status of the reporting company, when a minor attains the age of majority, and the settlement of an estate. A reporting company must also file a corrected report within 30 days of the date it becomes aware that information submitted on a report was inaccurate.

How will the information collected by FinCEN be protected and who will be allowed access?

The Beneficial Ownership Information collected by FinCEN will be stored in a database and will be accessible to federal agencies involved in national security, intelligence and law enforcement. In the Final Rule, FinCEN states that Beneficial Ownership Information will be used only for statutorily authorized purposes and will be subject to stringent use and security protocols. FinCEN is required to promulgate appropriate protocols for protecting the security and confidentiality of the Beneficial Ownership Information.

What are the penalties for violating the Act?

While only reporting companies are required to file reports with FinCEN, information supplied by beneficial owners and company applicants are essential for the accuracy of the Beneficial Ownership Information database. Therefore, any person or entity that willfully (i) provides false or fraudulent Beneficial Ownership Information or (ii) fails to report complete or updated Beneficial Ownership Information to FinCEN in accordance with the Act may receive both civil and criminal penalties. A person or entity fails to report such information if such person or entity causes the failure or is a senior officer of the entity at the time of the failure. For the time being, FinCEN will prioritize education and outreach to ensure that all reporting companies are aware of and on notice regarding their reporting obligations.

On Our Watchlist: Non-Compete Clauses Under Scrutiny

In early January, the Federal Trade Commission ("FTC") proposed a rule that, if finalized and adopted as drafted, would prospectively and retroactively ban certain non-compete agreements (the "Proposed Non-Compete Ban"). According to the FTC, the proposal is intended to increase wages, improve working conditions and foster entrepreneurship and innovation by removing barriers to worker mobility.

The Proposed Non-Compete Ban would prohibit employers from entering into any new, or enforcing any existing, contractual term with a worker that prevents (or has the effect of prohibiting) such worker from "seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." The proposed rule is broad and expressly intended to reach de facto non-compete arrangements, such as certain non-disclosure or training reimbursement agreements that are deemed to effectively prohibit competition. Limited exceptions are provided, however, for certain non-compete clauses entered into in connection with the sale of a business or by certain franchisees.[1]

[1] There is some indication, however, that courts may be becoming less tolerant of broad non-compete agreements, even in the context of a sale of a business. The Delaware Court of Chancery, in *Kodiak Building Partners, LLC v. Philip D. Adams*, recently struck down a non-compete covenant included in a stock purchase agreement that it deemed unreasonable with respect to scope of activities and geography, noting that Delaware courts generally favor the public interest of competition.

Additionally, under the Proposed Non-Compete Ban, employers would be required to rescind any existing non-compete clauses and notify their current and certain former employees that such existing non-compete clauses are no longer in effect.

The Proposed Non-Compete Ban is currently in "proposal" stage and remains subject to a period of review and potential revision before it is ultimately considered for adoption. The FTC is actively seeking comments from the public and it is expected that, among other things, the FTC will consider whether the rule should differentiate between types of workers (e.g., with respect to the nature of the work performed or based upon compensation thresholds). Furthermore, the Proposed Non-Compete Ban will likely be subject to significant legal challenges. The FTC cites authority to enact the Proposed Non-Compete Ban pursuant to the Federal Trade Commission Act's ban on unfair methods of competition. It is unclear, however, whether such assertion would be upheld in light of existing legal precedent, including the Supreme Court's recent ruling in West Virginia v. Environmental Protection Agency, that the Environmental Protection Agency could not promulgate a regulation that would have significant impact on national economic activity without a clear demonstration of congressional authority. Employee non-compete agreements have historically been governed by state, not federal, law. Currently all states, except California, North Dakota and Oklahoma, permit non-compete agreements, generally providing that they must be narrowly tailored to protect the employer's legitimate business interests while not imposing unreasonable restrictions on the employee. In 2016, when President Obama sought to impose limitations on non-competes, he did so by encouraging states to make changes to their non-compete laws. More than twenty states responded by strengthening their restrictions on the use of non-competes, although none banned them entirely.

Federal regulation of non-competes has been increasingly pursued during the past decade. While several prior Congressional attempts at imposing legislative restrictions on non-competes have failed to gain sufficient support (e.g., Mobility and Opportunity for Vulnerable Employees Act of 2015; Freedom for Workers to Seek Opportunity Act of 2015; Workforce Mobility Act of 2018; Freedom to Compete Act of 2019; Workforce Mobility Act of 2019; Workforce Mobility Act of 2021; Restoring Workers' Rights Act of 2022), in February, 2023, the Workforce Mobility Act of 2023 was introduced in the House and Senate with bipartisan sponsorship. In addition, there has been an increase in FTC action directly against employers, seeking to prohibit them from imposing and enforcing non-compete agreements.

If adopted and upheld, the FTC's Proposed Non-Compete Ban could dramatically change employment relationships throughout the country. We will continue to follow the proposal's progress, as well as any new developments at the federal and state levels.

Attorney Contact Information

Harold S. Atlas
Partner
973.302.9712
hatlas@shermanatlas.com

Christine M. Amara
Counsel
973.302.9710
camara@shermanatlas.com

Jane L. Brody
Partner
973.302.9953
jbrody@shermanatlas.com

William G. Connolly
Partner
973.302.9665
wconnolly@shermanatlas.com

Deanna Christian
Associate
973.302.9717
dchristian@shermanatlas.com

Kathleen E. Clark
Counsel
973.302.9664
kclark@shermanatlas.com

David A. Falk
Counsel
973.302.9951
dfalk@shermanatlas.com

Andrew J. Stamelman
Partner
973.302.9714
astamelman@shermanatlas.com