

# CORPORATE ALERT

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December 2023

## The Corporate Transparency Act

On January 1, 2024, a new Federal law called the Corporate Transparency Act (“CTA”) goes into effect, with the purpose of creating a national database of entities operating in the United States and identifying their owners and control persons as part of an increasing effort to combat money-laundering, terrorism, tax evasion, and other financial crimes.

The CTA will require almost all LLCs, corporations, limited partnerships, and other closely held entities formed and/or operating in the United States (referred to as “reporting companies”) to register with the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”). Notable exemptions include public corporations, certain larger private operating companies, tax-exempt entities, and other categories of entities that are already required to disclose significant identifying information under current law.

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The information that must be provided to FinCEN under the CTA is in addition to, and is significantly more burdensome than, the information you may be accustomed to filing in annual reports in the jurisdiction of organization of your reporting companies. In addition to requiring information about the reporting company, the CTA also requires identifying information regarding each “beneficial owner” of the reporting company.

The definition of a beneficial owner under the CTA is broad and generally includes anyone who either exercises “substantial control” over a reporting company or owns or controls at least 25% of a reporting company’s ownership interests. The determination of what constitutes “substantial control” of an entity is fact-based but, at a minimum, includes anyone who directs or has substantial influence over important decisions of the reporting company, such as directors and senior officers and those with the power to appoint or remove officers and directors.

For all existing entities, the deadline to register with FinCEN and provide all required information is January 1, 2025. However, all entities newly formed on or after January 1, 2024 and before January 1, 2025 will have 90 days from the date of formation to register with FinCEN.

Entities newly formed on or after January 1, 2025 will have 30 days from the date of formation to register with FinCEN. Additionally, once a reporting company has registered with FinCEN, it will be required to report any change to the information set forth in its FinCEN filing within 30 days of the date of such change.

There are stiff civil and criminal penalties for failing to timely register and make all required filings – these include \$500 per day of civil penalties, and criminal fines of up to \$10,000, two years in prison, or both.

If you own any interest in an LLC, private corporation, or limited partnership, or if you are a director, manager, or senior officer of such an entity (even if you do not have any ownership interests in such entity), then you may be subject to these new filing requirements. If you have questions about the foregoing or would like our assistance in complying with CTA requirements, please reach out to one of your Sherman Atlas contacts and we can discuss what’s involved and how we can assist.

*Legislation is pending that may change the filing deadlines described above.*

## New Jersey's Entity Conversion Statute

Governor Murphy signed a new law permitting the conversion of New Jersey limited liability companies (LLCs) (and other entities) into New Jersey corporations and, conversely, for the conversion of New Jersey corporations into New Jersey LLCs. The new law also allows for the domestication of foreign, i.e. out of state, entities into New Jersey corporations and vice versa. The law went into effect on November 4, 2023.

### **What is an entity conversion?**

In a conversion, an existing entity converts directly into a different type of entity without the intermediate steps of creating a new entity, merging or winding up the affairs of the old entity. There are a number of reasons why a business may want to change its entity type. For example, an LLC may choose to convert into a corporation in preparation for a fundraising round or a public offering.

### **What is an entity domestication?**

Domestication is the process through which an existing entity changes its home state of formation, such as a Delaware corporation domesticating into a New Jersey corporation. The new law does not

specifically refer to entity domestication, but the statute permits the conversion of foreign entities, including foreign corporations, into New Jersey corporations. An entity might choose to domesticate from one state to another for regulatory or taxation purposes.

### **What was the status of entity conversion in New Jersey prior to the new law?**

In 2012, New Jersey passed the Revised Uniform Limited Liability Company Act (RULLCA), allowing an entity to convert into an LLC and likewise for an LLC to convert into another entity type, so long as the other entity's governing statute authorized such conversion. However, New Jersey's law governing corporations did not allow for the conversion of New Jersey corporations.

As a result, a New Jersey LLC could convert into an out of state corporation in a state with laws allowing conversion, such as Delaware, but it could not directly convert into a New Jersey corporation. To convert into a New Jersey corporation, a New Jersey LLC needed to effect a restructuring transaction, such as forming a new corporation in New Jersey and then subsequently merging the existing LLC into the new corporation, or transferring the LLC's assets and liabilities to a newly formed New Jersey corporation and then dissolving the LLC. The new law will

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eliminate the need for such intermediate steps and allow New Jersey LLCs and corporations to directly convert into other entity types.

## **What is allowed under the new law? Conversion of an “other entity” into a New Jersey corporation**

An “other entity,” which includes New Jersey LLCs, foreign LLCs, and foreign corporations, may now convert or domesticate into a New Jersey corporation. First, the entity must approve a plan of conversion following the requirements outlined by the governing statute of the entity to be converted.

The converting entity must then file a signed certificate of conversion and a certificate of incorporation with the New Jersey Division of Revenue and Enterprise Services (DORES).

Once the conversion is in effect and the entity is converted into a New Jersey corporation, the new corporation will be deemed to be the same entity as the pre- conversion entity and will have been formed on the date the converted entity was originally formed.

## **Conversion of a New Jersey corporation into an “other entity”**

A New Jersey corporation may also now convert into any other entity, including a New Jersey LLC, under the new law. To do so, the board of directors of the New Jersey corporation must first draft a plan of conversion, adopt a resolution approving the plan of conversion and specify the type of entity into which the corporation will be converted. Then the shareholders must approve the plan of conversion. The corporation must file a certificate of conversion with DORES. If a New Jersey corporation is converting into a New Jersey LLC, it must also file a completed certificate of formation with DORES.

In undergoing a conversion, the converting corporation is not required to wind up its affairs or pay its liabilities or distribute its assets.

## **Domestication of a New Jersey entity into an out of state corporation**

If a New Jersey entity, whether a corporation or an LLC, wishes to reform in a state other than New Jersey but still desires to do business in New Jersey, the converted

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foreign entity must file an application with DORES. Upon filing of the application, the foreign entity will be issued a certificate of authority to transact business in New Jersey. This process allows the newly formed entity to continue to do business in New Jersey without having to re-register with the state.

## **Results of a conversion**

Whether an existing entity converts into a New Jersey corporation or a New Jersey corporation converts into a different type of entity, the converting entity will not be required to wind up its affairs and the conversion will not be deemed a dissolution of the original entity. The resulting entity will be deemed to be the same entity as the entity from which it converted. Further, the conversion will not, in and of itself, affect any obligations or liabilities the converting entity incurred prior to the conversion (however, any contracts of the entity should be considered in order to avoid triggering any events relating to a conversion). Interests in the converted entity may be exchanged for cash, property, or shares of stock, rights or securities of the new entity, or they may be canceled.

It is important to note that a conversion may have tax consequences. While the specific tax implications for the conversion of a particular entity must be reviewed on an individual basis, as a general matter, the conversion of an LLC into a corporation usually qualifies for tax-deferred treatment, while the conversion of a corporation into an LLC often triggers tax with respect to unrealized appreciation in the corporation's assets. No entity conversion should be undertaken without consulting the entity's tax advisors.

## **Shortcomings of the new law and the road ahead**

Although the language of the new law covers both general partnerships and limited partnerships as "other entities," the governing statutes for both of these entities in New Jersey do not allow for conversion. As a result, New Jersey general partnerships and limited partnerships cannot directly convert into a New Jersey corporation or LLC, or vice versa. This may soon change, however, as Assembly Bill 3831 is currently pending before the New Jersey legislature. The bill would amend the Uniform Partnership Act and allow for the conversion of general partnerships and limited partnerships into other types of entities, such as a corporation or LLC.

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