

# What Franchisors and Franchisees Need to Know About the Corporate Transparency Act

*A federal law requires franchisor and franchisee business entities to disclose personal information and photographs of persons with ownership and control over their business.*

**Why this matters for you.** From Wall Street to Main Street to your street, the vast majority of private and many nonprofit entities, have been swept into Corporate Transparency Act (CTA) compliance. If you own or control a franchised business, or are a franchisor, you need to pay attention. Not only is initial reporting important, so is ongoing compliance and coordination with other information disclosures you are currently making.

**What is this law about?** If you have not heard of the CTA, you are not alone. Many business owners, executives and their professional advisors, are taken aback upon learning of the CTA's existence and scope. At its core, the CTA requires reporting of personal direct and indirect beneficial ownership and control information pertaining to businesses operating in the U.S. The personal identifying information (PII) includes name, date of birth, physical home address and your photograph. The Financial Crimes Enforcement Network of the U.S. Department of Treasury (FinCEN) has established a Beneficial Ownership Secure System (BOSS) to receive, store and manage this vast influx of information. FinCEN estimates that over 32 million now-existing businesses will be required to report this year alone. This law aims to prevent money laundering, illicit financial activities, corrupt practices and terrorist financing, at the expense of many legitimate businesses (and their owners and control persons) being swept up by these expansive new reporting requirements.

**Who must report?** PII must be reported for natural persons owning, directly or indirectly, 25% or more of any class or category of economic interest in a business entity, or who have or may assert, directly or indirectly, "substantial control" over a business entity. Both of these factors are nuanced and will require an exercise of business judgment in assessing their implications for a particular business entity.

Franchisors should take note, as certain control attributes in their agreements with franchisees may attribute "substantial control" of a franchisee's business to the franchisor and its control persons, necessitating reporting of such franchisor person's PII on their franchisees' CTA reporting. This may be particularly true in light of the recent National Labor Relations Board's expansion of the definition of "joint employer" as it may be applied to certain franchise arrangements.

**What ongoing reporting obligation exists?** Once the initial report is filed, this information must be updated within 30 days of any subsequent event that makes the previously reported information inaccurate. Attribution of ownership and what constitutes substantial control will vary from business to business and will require analysis and professional advice.

**Exempt Entities.** Some categories of business entities are exempted out of CTA compliance. These generally include regulated business entities, such as publicly traded companies, insurance businesses,

banking businesses, 501(c) federally tax-exempt non-profit entities, and governmental and quasi-governmental organizations. There are two other exemptions of particular importance to the franchise business sector:

#### *Large Operating Entity Exemption*

In addition to the other exempt categories, a catch-all exemption is available for any business entity that meets all three of the following thresholds: (1) operate from a physical commercial street address in the U.S., (2) have 21 or more full-time U.S. employees, and (3) generate more than \$5 million in annual U.S. gross receipts as reported on the business entity's prior year's federal tax filing. Missing any one of these criteria will render a business entity ineligible for this exemption. One key to this exemption is that only full-time, W-2 employees of the entity itself qualify.

Many franchise businesses rely upon part-time employees, leased employees, seasonal employees, independent contractors and other mechanisms that could frustrate an entity's ability to reach a 21 or more full-time employee count and to maintain such count throughout the year. Further, FinCEN has declined to permit companies to consolidate employee headcount across affiliated business entities.

#### *Exempt Entities' Wholly Owned Subsidiaries Exemption*

The CTA also contains an exemption for a wholly owned subsidiary of exempt entity(ies). For example, if a parent corporation is a large operating entity, and wholly-owns a subsidiary entity, that subsidiary entity would also be exempt from CTA reporting. This exemption only applies, however, to subsidiaries wholly owned by one or more CTA exempt entities. For firms with large and complex organizational structures, it is important to analyze each individual entity, because joint ventures would not qualify for this exemption (unless all owners are CTA exempt entities). This exemption also does not apply to upstream entities, meaning that a parent company that is not exempt would not qualify for exemption because of its investment in an exempt subsidiary entity.

**What will compliance look like?** Businesses will need to compile, maintain and update their reported PII constantly to meet the CTA's compliance requirements. Any change to or correction of previously reported information must be done within 30 days of the event, not when the business becomes aware of the event. All business entities newly formed in 2024 will be required to file their initial CTA report within 90 calendar days of formation.<sup>1</sup> Reporting company businesses in existence before January 1, 2024, will have until January 1, 2025, to make their initial CTA report filing.

**What happens if you don't comply?** There are steep fines (\$500 per day up to \$10,000 per incident)<sup>2</sup> and possible jail time (up to two years) for those failing to timely and properly comply with the CTA. Further, the IRS recently announced increased enforcement, intending to utilize new data analytics technology to identify audit targets. FinCEN's database has been identified by the IRS as a key component to such data analytics initiative.

**Who may access FinCEN's Beneficial Ownership Secure System (BOSS)?** Information in the BOSS will be accessible to law enforcement at the federal, state and local levels. Financial institutions may also have access upon their customer's consent—anticipate CTA disclosures becoming a key component of corporate and regulatory diligence for future transactions. Importantly, this reported information is not available to the general public, and is not accessible through Freedom of Information Act (FOIA) requests.

**Conclusion.** If you have a business entity, you now have existing compliance obligations under the CTA. Now is the time to discuss the CTA with our legal team for guidance.

For more information, visit our [Corporate Transparency Act](#) page or contact the authors: [Bill Quick](#) and [Joyce Mazero](#).

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[1] All newly formed business entities beginning January 1, 2025, and thereafter, will be required to file their initial CTA report within 30 calendar days of formation.

[2] These fine amounts have now been adjusted as of January 25, 2024, pursuant to the Federal Civil Penalties Inflation Adjustment Act of 1990 (FCPIAA), to \$591.00 per day up to a maximum of \$11,820.00 per violation.