

BALANCING ACT:

TRANSPARENCY

&

CORPORATE

FILINGS

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Overview

In some circles, to use the terms “transparency,” and “corporate flings” in the same sentence would be fighting words. Since 2008, Congress has attempted to pass some form of the Incorporation Transparency and Law Enforcement Assistance Act four times¹. Each time, the Act has died before becoming law. On its face, the Act, and similar legislative efforts, appear benign and sounds like a bill designed to strengthen national security. However, as the National Association of State Secretaries (NASS) has well documented², if such an Act became law, it could well do more harm than good by burdening the states with new requirements and no additional funds to implement the changes, not to mention the possibility of creating additional hoops for entrepreneurs to jump through when forming a new business entity. But what also seems to be lurking at the heart of the matter for both sides is the idea of what information belongs on corporate filings and other public documents. This paper will focus on the issues surrounding corporate filings and provide a possible solution that could increase law enforcement’s ability to track ownership information and keep state costs low, all while keeping state business filings simple.

Understanding Privacy

Every time a news story focuses on the ill-doings of a shell corporation or LLC, lawmakers and tax and transparency advocate groups apply more pressure and call for greater corporate transparency. From their point of view, it seems the only logical deterrent to those who would use a business entity inappropriately is to introduce federal legislation that requires anyone forming a business entity to clearly detail the individuals who would benefit from the business. The request seems simple enough, but without designated federal funding, its implementation and enforcement would prove a costly burden to state corporations and record keeping divisions, and the legislation that has been proposed (and will likely be proposed again in the near future) doesn’t seem to take into account why law-abiding business owners would prefer to keep their personal information off public record.

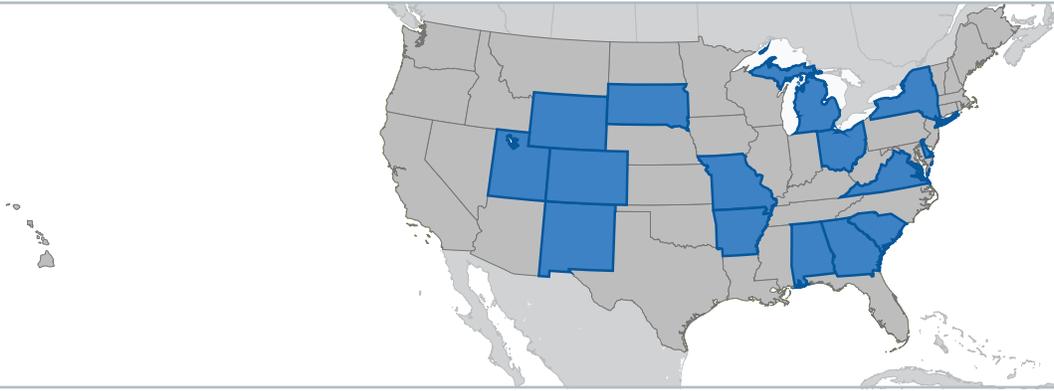
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1. Brian Kindle, “As Delaware Mulls Greater Corporate Transparency, US States Confront “Secrecy Haven” Label,” Association of Certified Financial Crime Specialists. June 20, 2014.
 2. National Association of Secretaries of State (NASS) Company Formation Task Force, “Report and Recommendations on Assisting Law Enforcement in Fighting the Misuse of Corporate Entities.” September 2012.

Entrepreneurs and long-time business owners seek the security afforded to them by the business entities of certain states for many of reasons. The most common reasons³ are:

Secure information: Some business owners are concerned about corporate identity theft. Some don't have storefronts and don't want to list their personal address. Others have personal safety concerns. In all these cases, a certain state business entities allow these business owners to keep their names and personal addresses off the public record when they form a business entity.

Avoid clearinghouses and solicitors: Running a business is a challenge, no matter what kind of entity an entrepreneur chooses. But it's only made more complicated when a business owner's personal information is scraped from the Web put on a list which is then sold to clearinghouses and solicitors who will call, mail, and personally try to contact business owners to make a sale. Many business owners will use secure entities just to avoid the junk mail and telemarketers.

While personal and business security may seem like trivial concerns to the proponents of federal corporate transparency legislation, as US citizens, business owners enjoy all the same rights as other individuals, and simply owning a business shouldn't serve as cause to cede their individual right to security.



Problem Analysis

In 15 states, an entrepreneur can form at least one type of secure business entity. Secure business entities are corporations and LLCs that do not require the company's ownership information to be disclosed when forming and maintaining the company. This is the sticking point for federal legislators and advocacy groups. However, as the NASS Company Formation Task Force has previously documented in its 2012 Report and Recommendations, the federal government can aptly track corporate entity ownership information through federal tax filings, the revised Form SS-4, the FBAR (Report of Foreign Bank and Financial Accounts), as well as financial institutions' customer due diligence requirements. Despite those findings, attempts at federal legislation have persisted.

Type of private entity

States that allow private business filings

LLC	Arkansas, Colorado, Delaware, Georgia, Michigan, Missouri, New Mexico, New York, Ohio, Utah, Virginia, Wyoming.
Corporation	Colorado
Member-managed LLC	Alabama, South Carolina, South Dakota

Admirably, states have also implemented requirements into their respective Limited Liability Company and Corporation Acts in attempts to find the right balance between transparency and corporate flings. Several of these attempts are highlighted below:

Delaware⁴: Recently, the state amended its LLC and Uniform LP Acts to require that these entities keep record of their members, managers, and/or partners. § 18-305 (h) of the LLC act explicitly requires an LLC to maintain an updated list of its members and managers. The simplicity of such a statement should not be overlooked. Delaware is leading the way in clearly outlining an LLC's duties by requiring that these entities keep accurate records of members, managers, and partners. The registered agent is required to maintain a communications contact, and the communications contact is required to either have personal knowledge of, or be able to provide the information of a natural person who does have access to an updated list of the company's members, managers, and/or partners.

Wyoming⁵: The state requires that a registered agent maintain an accurate communications contact for each entity it represents, as well as the names and addresses of officers, directors, and managers. The communications contact cannot be an incorporation service or attorney, but needs to be a natural person that operates or owns the company. If the registered agent can't produce this information upon demand by authorities, the agent could face up to \$1500 in fines per company it represents. If law enforcement needed the management information of an LLC in Wyoming, they could simply arrive at the registered agent's ofce with a court order to produce these documents and receive them instantly.

Nevada⁶: Although Nevada doesn't provide flers with the option of forming a secure business entity, it remains a popular state to incorporate in, and many entrepreneurs simply form two LLCs to have one LLC manage the other in an effort to keep their personal names of the public record. The state has been a leader in modernization and allowing instant and easy on-line business flings. Nevada also requires that corporations keep at its registered ofce a certified copy of its bylaws and all amendments; its articles of incorporation or articles and all amendments; and a stock ledger, updated annually, that lists all shareholders. LLCs have similar requirements, but are only required to keep these records at an office in Nevada, not at its registered office. Both entity types, however may fle with its registered agent a statement that gives the contact information of a custodian who keeps membership or shareholder information.

4. Delaware Limited Liability Company Act, Del. Laws, c. 302, § 1.

5. Wyoming Limited Liability Company Act, 17-29-113.

6. NRS 78: Private Corporations, NRS 78.105, Maintenance of records at registered ofce.

Each of these states tries to tackle the issues of transparency and corporate filings in similar yet slightly different ways, but each method has its vulnerabilities. In Delaware, the communications contact could be a limiting resource for law enforcement. Wyoming doesn't require all of an LLC's or corporation's ownership information to be kept with the registered agent. Nevada LLCs and corporations have the option of listing with the registered agent the contact information of a custodian who tracks the entity's documents and may or may not actually keep the documents.

Proposed solution

This proposed solution to the problem of creating a form of transparent business filings for business owners is not complex. Although each state mentioned has vulnerabilities in its current methods of tracking business ownership, each one has its merits, and if certain aspects of each method were combined, a shared answer, one that relies on government and private citizens, arises:

1. Require the registered agent to keep at its registered office the following: a copy of the business entity's formation documents and all amendments to such; a current copy of the entity's internal, governing documents (such as bylaws or operating agreements); and an annually updated stock ledger or membership list which would include the name of each officer, director, manager, and/or member.
2. Implement a fine to be levied on any registered agent that fails to maintain and produce the required information should that information be required by law enforcement or other government agencies.
3. Require only a minimum amount of information on a business' formation documents as Delaware and Wyoming do, initially and annually.

This solution provides a myriad of benefits:

- Provides a bipartisan solution to tracking beneficial ownership in which both transparency advocates and business owners seeking security win.
- Reduces state labor costs in approving and rejecting filings (initially and with annual reports).
- Reduces federal scrutiny of corporations divisions by giving the state a reliable resource for law enforcement when a company's ownership information is required.
- Eliminates the ability of criminals to hide behind shell companies.
- Provides a firm, secure, and clear way to store beneficial ownership information.
- Reduces the threat of corporate identity theft, as less company information would be displayed on-line via public corporate filings.

Conclusion

In many states, an entrepreneur can now form an LLC or corporation in minutes with a few simple clicks on their home computer. This ability to form a business entity with little effort has helped to make starting a business a fast, accessible, and inclusive process for entrepreneurs from all walks of life. However, this simple process is threatened by the looming prospect of federal legislation that could drastically slow business formations and introduce a wide range costs to states in spite of any ongoing budget deficits or other financial struggles. The sensible response to such a threat is to find an answer of the states' choosing rather than have one forced upon them. Fortunately, it appears the states have already created their own solutions, and they exist in one another's Limited Liability Company and Corporation Acts. By combining the beneficial ownership tracking methods, the states can provide answers to satisfy both the needs of federal legislators and advocacy groups and give business owners the security they desire and deserve.



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