

States Worry About Impacts of Congressional Push to Federalize Corporate Disclosure Laws

By Kay Stimson

Secretaries of state and other officials are concerned about a push by Congress to federalize corporate disclosure laws. Those interviewed for this article say federal intervention is unwarranted, and they worry about the impacts of such a move on cash-strapped state budgets, as well as on small businesses. Meanwhile, several states that have been singled out for problems related to shell companies have amended their laws to help address real or perceived loopholes. Other states are working with national organizations to produce legislative language for states on this issue.

As states grapple with severe budget shortfalls and a grim financial outlook for the foreseeable future, secretaries of state and other state officials are concerned Congress could intervene in matters of state commerce and inadvertently hurt small business through efforts to address perceived gaps in domestic corporate disclosure practices.

At issue is whether states should be compelled to obtain—and verify—beneficial ownership information for the corporations formed under their laws, and the process by which law enforcement authorities and other interested parties can access such information.

U.S. Sen. Carl Levin, D-Mich., chairman of the Permanent Subcommittee on Investigations, has been pursuing the issue since 2000 and is once again pushing for legislation designed to help detect and prosecute abuses in the corporate formation process. His bill, the Incorporation Transparency and Law Enforcement Act, would restrict the level of corporate ownership privacy that states can allow and require them to collect, store and provide ownership information to law enforcement upon receipt of a subpoena or summons.

“This could make state business laws irrelevant and bring about a fundamental shift in the way we do business in the U.S.,” said North Carolina Secretary of State Elaine Marshall, co-chair of the National Association of Secretaries of State (NASS) Company Formation Task Force, a bipartisan panel of state officials that has studied the company formation process and developed a series of specific recommendations to help states address the federal government’s concerns.¹ “It will send a message that our government intends to make it more difficult to form a business entity in this country.”

Proponents of the tighter regulations—who include officials from the U.S. Department of Treasury, Internal Revenue Service, U.S. Department of Justice and U.S. Department of Homeland Security—

say they are necessary to help eliminate legal shelter for “shell companies”—business entities with no real operations, no employees and no physical assets—that may be involved with illegal activities such as tax evasion, money laundering or financial support for terrorism.

State officials opposing such broad federal intervention say current congressional proposals go too far and place unreasonable burdens on states and businesses, while adding that states themselves are better positioned to address any shortcomings in their corporate formation and reporting laws.

“I would do anything to help law enforcement, even up to asking our legislature to change what information we collect from companies, but it doesn’t have to be done by the federal government,” said Kansas Secretary of State Ron Thornburgh, co-chair of the NASS Company Formation Task Force.

Anonymity in Corporate Law

For the estimated 2 million corporations and limited liability companies—or LLCs—currently being formed within the U.S. each year, the process is generally a simple, inexpensive and potentially private matter. It is the level of anonymity many states accord to new corporations that has drawn the greatest share of criticism, particularly in the post-9/11 world.

Unlike publicly held companies, private corporations are not required to reveal ownership information. Most states require companies to list the names of their officers in their corporation reports, but at least a half dozen allow the use of nominee officers,² who may be registered agents or other paid representatives handling the entity’s paperwork and shielding the identities of true owners.

This process can be challenging for law enforcement authorities when the anonymity and privacy provided by laws of incorporation, combined with a large volume of case law, provide legal shelter for

SECRETARIES OF STATE

companies (or owners) that may be involved with criminal activities or other misconduct. A 2005 multi-agency federal government report singled out Delaware, Nevada and Wyoming for allowing levels of corporate confidentiality that approached what is available offshore.³ National publications have also called attention to the thriving mini-industry in these states, where promoters often try to capitalize on the ease and privacy with which corporations can be formed.⁴

But how widespread is the problem? Secretaries of state, who handle corporate registrations in 41 states and Puerto Rico,⁵ say although there is no hard and fast data, corporate abuse is not widespread or common enough to justify federal intervention.

“It would be burning down the haystack to find a needle,” said North Carolina’s Marshall, who points out that the vast majority of corporations are operating legally, generating new jobs, fueling economic expansion, and providing registration and reporting fee revenues.⁶

Officials involved in business filing matters point out there are good reasons that state statutes and case law have allowed for confidentiality in the process—the protection of trade secrets and high-profile investors are two of the most common examples cited. They are also concerned about the potential erosion of privacy and property rights that have historically been granted to business owners in the U.S., particularly to small business owners.

“We’ve always assumed the U.S. government has a role in the process when it comes to large corporations with securities activities, but why should small, privately-held businesses be held to disclosure requirements about their ownership matters involving familial relationships, marriages, divorces and trust information?” asked Richard Geisenberger, Delaware’s assistant secretary of state and the director of its division of corporations. “Once you put that information into a state database and require it to be stored, there’s no reason to believe it wouldn’t be accessible to the public.”

States Taking Action

Spurred by federal efforts to fight money laundering and other corporate abuses among shell companies, several states that have come under criticism for a lack of transparency in their statutes have already taken the initiative to enact changes that close real or perceived loopholes in their laws of incorporation.

Wyoming is no longer the place where anyone can “smile and file,” according to Secretary of State Max Maxfield. Citing a case where overseas employees

of a Turkish airline were discovered to be illegally funneling money through a Wyoming-based shell corporation, Maxfield said he realized that he needed to work with the state legislature to make the process more transparent. A 2008 law now requires businesses to register a local company representative who must serve as the entity’s primary contact with the law enforcement community.

“For the longest time, our leaders were using our company formation laws as an economic development tool to bring corporations to the state,” said Maxfield. “But over time, we realized that a problem had evolved and we needed to do a better job of finding a balance between being business-friendly and protecting against fraud.” He added that his office can now impose stricter penalties and quickly dissolve companies for failing to comply with state law. The Wyoming Secretary of State’s office is also tracking the number and types of requests it receives from law enforcement agencies related to corporate fraud.

Meanwhile, in an effort to help thwart criminals, a new Nevada law permits law enforcement investigators to request ownership records from corporations and LLCs. If the company fails to respond, the secretary of state can dissolve the corporation.⁷

In business-friendly Delaware, where chartering out-of-state companies is big business, the state has attempted to shore up its laws by retooling its requirements for registered agents.

Other states have worked together to provide input on uniform state legislation currently being drafted by the American Bar Association and the Uniform Law Commission, a collection of lawyers from across the U.S. who research, draft and promote the enactment of uniform laws in the states. The final language from these groups is likely to address the key recommendations of the NASS Company Formation Task Force, including a call to require corporate entities to file a report that includes the name and address of a person in the U.S. who has access to the list of owners of record for the corporation; that person would also serve as the official contact for law enforcement inquiries on such matters.

Secretaries of state and state business services division chiefs serving on the NASS Company Formation Task Force are hopeful that the resulting legislation, developed with state input, will keep the burden of tracking beneficial company ownership information where it belongs—with the private sector, including registered agents and financial institutions. At the same time, it would enable states to better assist federal government and law enforcement officials who need to track down company owners whenever nec-

essary. State officials argue this is the better solution to address concerns about shell companies during a recession that is hitting states hard.

“In the current economic climate, states are not prepared to foot the bill for additional employees and technology costs they would incur in order to achieve the requirements in the current congressional proposals,” said Leslie Reynolds, executive director of the National Association of Secretaries of State.

Added Delaware’s Geisenberger, “The reality is, criminals will simply find new ways to hide their assets and evade the law, but people who play by the rules—and the states that are responsible for assisting them with the corporate registration and filings process—will bear the brunt of any new federal regulations.”

Notes

¹National Association of Secretaries of State (NASS), *NASS Company Formation Task Force Report & Recommendations*, (July 2007), available at http://nass.org/index.php?option=com_content&task=view&id=113&Itemid=312.

²National Association of Secretaries of State (NASS), *NASS State Business Entity Law Survey*, (March 2008), available at http://nass.org/index.php?option=com_content&task=view&id=113&Itemid=312.

³U.S. Department of Treasury, et al., *Money Laundering Threat Assessment*, (December 2005), available at http://www.treas.gov/press/releases/reports/js3077_01112005_MLTA.pdf.

⁴Kevin McCoy, “Corporate Owners Hide Assets, Identities,” *USA Today*, May 23, 2007, 1A.

⁵Council of State Governments, *The Book of the States 2008*, Volume 40, 226.

⁶According to annual reports provided by the International Association of Commercial Administrators (IACA), more than 18 million corporations currently exist in the U.S., with states such as Delaware, Florida, and Nevada collecting large revenues from corporate filing and reporting fees. Available at <http://www.iaca.org/node/80>.

⁷John G. Edwards, “Transparency Bill Draws Mixed Reactions,” *Las Vegas Review-Journal*, May 3, 2008, B1, available at <http://www.lvrj.com/business/18544189.html>.

About the Author

Kay Stimson is director of communications and special projects for the National Association of Secretaries of State in Washington, D.C. A former television news reporter who covered the state legislatures in Maryland and South Carolina, she frequently writes about state and federal policy issues for lawmakers.