



## Peeking Behind the Curtain of The Incorporation Transparency Act

By StartUpAdmin on August 18, 2011



***“Pay no attention to that man behind the curtain! The great OZ has spoken!” – Wizard of OZ, 1939.***

There have been tons of changes to the legal rights of all Americans since 9/11, initiated by both local and national legislators. It even seemed a while back that the fries we received with our Happy Meals were going to become freer than most of us were. Little of what has occurred has affected startups. However, that might now change. Senators Levin and Grassley recently introduced a bill that they titled the [Incorporation Transparency and Law Enforcement Assistance Act](#). The purpose of the bill is to ensure that law enforcement authorities can at any time obtain from the states information about the beneficial owners of corporations or other business entities. Its purpose is:

“To ensure that persons who form corporations in the United States disclose the beneficial owners of those corporations, in order to prevent wrongdoers from exploiting United States corporations in ways that threaten homeland security, to assist law enforcement in detecting, preventing, and punishing terrorism, money laundering, and other misconduct involving United States corporations, and for other purposes.”

The reality of the bill, if it becomes law, is that it is going to make life more difficult for businesses, especially rapidly growing businesses that are raising capital and issuing



equity on a regular basis. It is going to impose new burdens on persons starting businesses that don't exist today, which will continue for the life of many companies. It is going to require states to create new bureaucracies to collect this information, and it is going to levy potentially heavy fines and possible criminal penalties on people who don't comply, whether their noncompliance was intentional or not.

## Legislative Shoes Sticking Out From Under the Curtain

The call for disclosure of beneficial owners of corporations in order to prevent wrongdoing is a call that legislators make from time to time.

The new proposed law would require businesses to:

- **Collect US passport or US state driver's license or ID info for every shareholder**
- **File such information with the state**
- **Update with the state no later than 60 days after each change**
- **If a business screws up, face up to \$10K in penalties for every screw up**
- **Face potential criminal liability (as described below)**
- **Who knows if this will become law or not**

## How The [Levin-Grassley Bill](#) Works

**Identification of Beneficial Owners** – The bill requires each applicant forming a corporation or LLC to provide to the state during the formation process a list of the beneficial owners of the corporation or LLC that:

- Identifies each beneficial owner by name, current residential or business street address, and a unique identifying number from a nonexpired US passport or a nonexpired state drivers license or ID card;
- If any beneficial owner exercises control over a corporation or LLC through another legal entity, identifies each such entity and each such beneficial owner who will use such entity to exercise control over the corporation or LLC (I suppose this means that if a VC invests in a company, the VC's managing principals must provide their passports or drivers licenses); and
- If the applicant is not a beneficial owner, provides the identification described in the first bullet point above with respect to such applicant.

**Updated Information** – The corporation or LLC will be required to submit to the state an updated list of beneficial owners and the information described above for each such beneficial owner not later than 60 days after the date of any change in the beneficial



owners; and the corporation or LLC will be required to submit an annual filing containing the list of beneficial owners and the information described above for each beneficial owner.

**Beneficial Owners Without Nonexpired US Passports or Nonexpired State Drivers Licenses or ID Card** – If a beneficial owner does not have a nonexpired US passport or nonexpired drivers license or ID card issued by a state, the formation agent has to certify that the formation agent has obtained for each such person a current residential or business street address and a legible and credible copy of the pages of a nonexpired passport issued by a government of a foreign country bearing a photograph, date of birth, and a unique identifying number of the person; has verified the name, address and identify of such person; and will provide the information described and the proof of verification upon request; and will retain the information for 5 years.

**Application to Existing Entities** – If this bill comes into law, it will apply to existing entities, unless they are exempt.

**Exemptions** – There are number of exemptions. But there is no exemption per se for startups. There is an exemption for any business concern that (i) employs more than 20 people on a full time basis, (ii) files income tax returns in the US demonstrating more than \$5M in gross receipts or sales, **and** (iii) has an operating presence at a physical location in the US. This exemption will very likely not be of any assistance for many brand new and early stage companies.

How could the bill be improved? Theoretically by broadening the above exemption to cover ordinary, run of the mill startups—which won't generate \$5M in gross receipts or sales and who may be “lean” and not have 20 employees potentially for years to come. The trouble with this, of course, is that such an exemption could swallow the rule.

**Penalties** – knowingly providing, or attempting to provide, false or fraudulent beneficial ownership information, or willfully failing to provide complete or updated beneficial ownership information, or knowingly disclosing the existence of a subpoena, summons or other request for beneficial ownership information will be against the law. Any person who violates the above rules will be liable to the US for civil penalties of not more than \$10,000, and may be imprisoned for not more than 3 years, or both.

## Drawing The Curtain

What's wrong with this bill? It is going to create paperwork for startups. It is going to create short fuses for filing paperwork with the state (60 days). As a lawyer who guides



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startups through the maze of the paperwork that they are subject to already, I do not like to see more paperwork burdens being imposed. Sure, you could say in response to this—but it is only collecting a copy of a passport or drivers license and filing it with the state. To which my response is—sure, it is theoretically only a little bit of extra work along the way. But all those little amounts of extra work add up, and companies are already over burdened—in my opinion—with too much paperwork. I think we ought to be going in the opposite direction—repealing law and removing paperwork burdens. The bill is a yellow brick road of great intentions, no doubt, but I think that even the scarecrow would tell you that this bill will impose too great a burden on honest Americans and states than the benefits that will be derived from it.

*The opinions expressed here are the author's only.*

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