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June 16, 2009

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VIA E-MAIL TRINA_TYRER@HSGAC.SENATE.GOV

Trina Tyrer
United States Senate Committee on Homeland Security
and Governmental Affairs
Washington, D.C. 20510-6250

Re: June 18, 2009 Hearing on S.569

Dear Ms. Tyrer:

A copy of my written testimony and a short biographical sketch are attached.

If you need any additional information, please do not hesitate to contact me.

Yours very truly,

Harry J. Haynsworth, IV

HJH/pmr
Attachments

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Mr. Haynsworth is Of Counsel in the firm of Briggs and Morgan, Professional Association. He is based in our Minneapolis office and is a member of the Business Law Section and Governance and Compliance Practice Group. He practices principally in the areas of:

- Closely held business law
- General commercial and corporate law
- Legal ethics and professionalism

Mr. Haynsworth's professional and academic focus over the past 40 years has been in commercial and corporate law, the legal problems of closely held businesses, and legal ethics and professionalism issues.

He is a member of the American, Minnesota State and South Carolina Bar associations, the American Law Institute (life member), 4th Circuit Court of Appeals Judicial Conference, and the Fellows of the American Bar Association. Mr. Haynsworth is licensed to practice in South Carolina, Minnesota and the U.S. Supreme Court.

Aside from his work at Briggs, Mr. Haynsworth has served as dean emeritus at William Mitchell College of Law since 2004. He was formerly president, dean and a professor of law at William Mitchell from 1995 to 2004.

Previously, Mr. Haynsworth was dean and professor of law at Southern Illinois University School of Law (1990-1995); associate dean (1975-1976, 1985-1986), acting dean (1976-1977), professor of law (1974-1990) and associate professor of law (1971-1974) at the University of South Carolina School of Law; Of Counsel (1986-1990) at Nexsen Pruet Jacobs and Pollard in Columbia, South Carolina; and an associate (1965-1969) and partner (1969-1971) in the firm formerly known as Haynsworth, Perry, Bryant, Marion and Johnstone in Greenville, South Carolina.

Mr. Haynsworth has published numerous books and journal articles dealing with closely held businesses, legal ethics and professionalism, and legal education.

Born in North Carolina, Mr. Haynsworth earned his B.A. and J.D. degrees from Duke University. While a student at Duke University School of Law, he served on the editorial board of the *Duke Law Journal*. He also received a Master of Arts and Religion degree from the Lutheran Theological Southern Seminary in Columbia, South Carolina. Mr. Haynsworth joined Briggs in 2005.

Bar Admission(s)
Minnesota
South Carolina
U.S. Court of Appeals 4th Circuit
U.S. Supreme Court

Related Practices
Closely Held Companies
Corporate Governance
Education
Mergers and Acquisitions
Nonprofits

Education
Duke University School of Law
J.D. , 1964

Lutheran Theological Southern Seminary
M.A.R. , 1989

Duke University
B.A. , 1961

Written Testimony of Harry J. Haynsworth
Chair, Drafting Committee on the Uniform Law
Enforcement Access to Entity Information Act
of the Uniform Law Commission

To the
United States Senate Committee on
Homeland Security and Governmental Affairs

On the Incorporation Transparency and
Law Enforcement Assistance Act (S.569)

June 18, 2009

Thank you for the opportunity to submit written testimony on behalf of the of Uniform Law Commission (ULC, also known as the National Conference of Commissioners on Uniform State Laws). I am the Chair of the ULC's Drafting Committee on Uniform Law Enforcement Access to Entity Information Act (the "Uniform Act").

I have been a ULC commissioner since 1992. My appointment must be approved by the Governor, the Attorney General and the Chief Justice of the Minnesota Supreme Court. I receive no remuneration for my work as a commissioner other than reimbursement of travel and meeting expenses. I have been a practicing lawyer and law school professor for almost 45 years. I have been the dean of three law schools (University of South Carolina, Southern Illinois University School of Law and William Mitchell College of Law in St. Paul, Minnesota). For the past several years I have been Of Counsel to Briggs and Morgan in Minneapolis, Minnesota. Throughout my career as a practitioner and an academic, my primary focus has been in the area of business law. Since becoming a commissioner, I have been a member of several uniform act business law entity acts in addition to the Uniform Law Enforcement Access to Entity Information Act, including the Uniform Partnership Act (1994), the Uniform Limited Partnership Act (2001), the Uniform Limited Liability Company Act (1996, 2006), and the Uniform Unincorporated Nonprofit Associations Act (2008). I have been the chair of several of these drafting committees and have been actively involved in getting these acts adopted by the states.

The Uniform Act deals with the same subject matter as the Incorporation Transparency and Law Enforcement Assistance Act (S.569) but differs in many respects from S.569. The following is a brief outline of my testimony:

- Basic information about the ULC;
- Background information on the development of the Uniform Act;
- An overview of the Uniform Act and the major differences between the Uniform Act and S. 569; and
- A recommendation on how to get a statute that meets the objectives of S.569 enacted on a uniform basis in all the states in the shortest possible time.

Uniform Law Commission

The ULC is a state governmental entity operated as a non-profit unincorporated association, comprised of state commissions on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. Each jurisdiction determines the method of appointment and the number of commissioners actually appointed. All commissioners must be lawyers, qualified to practice law. While some serve as state legislators, or employees of state government, most are private practitioners, judges, or law professors. Commissioners donate their time and expertise as a pro bono service and receive no salary or fee for their work with the ULC.

Now in its 117th year, the ULC works to harmonize state laws in critical areas where consistency is desirable and practical and supports the federal system by addressing issues of national significance best resolved at the state level. The ULC has drafted more than 250 uniform acts in various fields of law setting patterns for uniformity across the nation, in such areas as business entity law, interstate child support and custody, investment allocation rules, and trust and estates law. The ULC's work prevents states from having to perform duplicative and costly research in addressing shared legislative issues. Uniform Acts are voluntarily adopted by state legislatures and localized to respond to each state's statutory framework and concerns.

Draft acts are then submitted for initial debate of the entire ULC at an annual meeting. Each act must be considered section by section, at no less than two annual meetings by all commissioners sitting as a Committee of the Whole. Following extensive debate and promulgation in a vote by states, commissioners in each state and territory submit ULC acts for legislative consideration.

The ULC is not an interest group; drafting meetings are open to the public and all drafts are available on the internet at the ULC's website: www.nccusl.org. Because ULC drafting projects are national in scope, we are able to attract a broad range of advisors and observers to participate in our projects, resulting in a drafting process that has the benefit of a greater range and depth of expertise than could be brought to bear upon any individual state's legislative effort.

Background of the Uniform Act

In July 2007, the National Association of Secretaries of State (NASS) requested that the ULC and the American Bar Association draft legislation that would amend state legal entity statutes to address concerns about law enforcement access to entity ownership information raised by two major federal governmental reports, the 2006 GAO Report on Company Formations and the multi-agency report entitled "Money Laundering Threat Assessment," which led to an oversight hearing in November 2006 before the Senate Permanent Subcommittee on Investigations. At that hearing the compliance report of the Financial Action Task Force (FATF), an international organization which is engaged in a worldwide effort to combat money laundering and to stop the financing of terrorist activities, was considered. The report stated that the United States, which is a member of FATF, was not in compliance with FATF Recommendation 33 regarding information on the beneficial ownership and control of legal entities and the prohibition of bearer shares.

The NASS Company Formation Task Force Recommendations Report pointed out that what type of ownership information is kept by entities and what information about entities is filed in the offices of Secretaries of State has always been a matter of state statutes, and the ULC has promulgated all the major unincorporated entity acts (Uniform Partnership Act, Uniform Limited Partnership Act, Uniform Limited Liability Company Act, Uniform Limited Cooperative Association Act, Uniform Unincorporated Nonprofit Associations Act, and Uniform Statutory Trust Entity Act) and the American Bar Association has promulgated the two major corporate entity acts (the Model Business Corporation Act and the Model Nonprofit Corporation Act).

ULC and the ABA Business Law Section Committee on Corporate Laws (CCL) agreed to undertake the drafting projects requested by NASS. They each established drafting committees in 2007. The original charge of the committees was to draft a uniform set of amendments to all of the unincorporated and corporate entity acts. Last fall the ULC and the CCL decided that rather than requiring the states to make amendments to every one of their entity laws, it would be preferable to prepare a single statute that could be enacted by the states to address the issues raised by the various reports referred to above and the Incorporation Transparency and Law Enforcement Assistance Act, originally introduced in May 2008 as S.2956 and reintroduced in May 2009 as S.596.

The drafting process has been open, inclusive and intense. Beginning in the fall of 2007, the Uniform Act drafting committee has held four in-person meetings and four conference call meetings. Drafts of the Act were reviewed at each meeting. There were 12 commissioners on the drafting committee from across the country (Maine, Pennsylvania, Delaware, Kentucky, Arkansas, Alabama, Minnesota, Texas, Illinois and Oregon). In addition there were 22 advisors and observers from a very broad range of organizations that have expressed an interest in and would be impacted by this legislation, including three Secretaries of State, several entity filing officials from various states, representatives from the National Conference of State Legislatures, the American College of Trusts and Estates Counsel (ACTEC), the American College of Real Estate Lawyers (ACREL), the American Bankers Association, CT Corporation (a leading provider of registered agents and other services for corporations and other types of entities), and the American Bar Association and several of its sections and committees (Business Law Section Committee on Corporate Laws, Limited Liability Companies, Partnerships and Other Unincorporated Entities Committee; and the Real Property, Probate and Trust Section).

Three U.S. Treasury Department officials also have been observers. They forcefully presented Treasury's concerns about beneficial ownership issues and related matters raised by the Office of Terrorist Financing and Financial Crimes and other units within Treasury. No lawyers from the Department of Justice were advisors or observers, but members of the drafting committee met with various officials in the Department of Justice both before the drafting project was undertaken and during the course of our deliberations, and various drafts of the Uniform Act were sent to the Department of Justice. Drafts of the Uniform Act have also been reviewed by the stakeholder organizations, including bar association committees, NASS and IACA (International Association of Commercial Administrators), and the feedback from these draft reviews has been very helpful in the refinement of the Act.

The Uniform Act had a first reading at the ULC Annual Meeting last summer. It is scheduled for a second and final reading at the upcoming ULC Annual Meeting in July. Approval is anticipated. The Committee on Corporate Laws of the Section of Business Law of the American Bar Association formally approved the Annual Meeting Draft of the Uniform Act on June 13, 2009.

Guiding Principles

The following important principles have guided the drafting committee's work:

- The state entity laws need to be amended to provide law enforcement officials with better access to adequate, accurate and timely ownership, and control information about legal entities.

- The necessity of having a statutory prohibition against the issuance of bearer shares by entities.

- Unmanageable workloads for the Secretaries of State must not be created.

- Unnecessary and unworkable compliance burdens must not be imposed on legitimate businesses.

- Legitimate privacy rights must be protected.

- Foreign investment in the United States must not be discouraged.

- A uniform act enacted by all states covering all entities that file organic documents in the office of the Secretary of State is necessary because: (1) what entity documents are filed in the offices of the Secretaries of State are and always have been incorporated into state entity statutes throughout the United States; and (2) a substantially similar set of standards adopted by all states is the only way to achieve the law enforcement access goal.

The Uniform Act

The following is a brief overview of the Uniform Act. A more detailed summary of the Act and a copy of the Annual Meeting Draft of the Act are attached to my written testimony.

The Uniform Act deals with two principal issues. The first is a provision that prohibits all filing entities from issuing certificates of bearer shares. In some countries, it is possible to issue bearer shares, but to the best of my knowledge, no United States entity has ever issued bearer shares. Nevertheless, since FATF Recommendation 33 requires a country to prohibit bearer shares, including a specific prohibition in the Act was considered to be prudent.

The second principal issue is the access by law enforcement officials to ownership and control information about filing entities. Most of the Act deals with the various aspects of this issue: (1) who is entitled to get ownership and control information and how do they get it; (2) what types of entities are covered by the Act and what kinds of information are these entities required to provide law enforcement officials; and (3) what information relating to ownership and control is required to be filed in the office of the Secretary of State.

Subject to certain exceptions, the Act applies to all filing entities having 50 or fewer interest holders. These entities are called a "conventional privately held entity" (CPE). In most states this would include limited liability partnerships, limited partnerships, limited liability companies, statutory entity trusts (business trusts), co-operatives and for profit and nonprofit corporations. Some states have other types of filing entities, *e.g.*, professional associations, which would also

be covered by the Act if they have 50 or more interest holders. In terms of numbers of entities, the Uniform Act covers approximately 95% or more of all the approximately 18,000,000+ filing entities in the United States. Thus the Uniform Act has much broader coverage than S.569, which only covers corporations and limited liability companies. In addition, S.569 only covers corporations and limited liability companies formed after it has been enacted. In 2007, the latest year for which I could find reasonably complete statistics, there were approximately 2,000,000 corporations and limited liability companies formed in the United States. The Uniform Act, on the other hand, covers existing filing entities as well as newly formed filing entities. Existing entities have two years after a state enacts the Uniform Act to comply with its requirements. The principal reason for this broader coverage is that if some entities are covered and others are not, the individuals law enforcement most interested in pursuing will simply form (or acquire) a non-covered entity.

The entities exempted from the coverage of the Uniform Act are highly regulated companies like banks, and law enforcement officials already have the ability to obtain ownership and control information about them; filing entities that have a large enough number of owners that it is unlikely they would be controlled by individuals who are of interest to law enforcement officials, and entities that are tax exempt and file ownership and control information that is available to the public (*e.g.*, Form 990).

The Act requires that all CPEs file in the office of the Secretary of State an initial information statement (existing CPEs must file the initial information statement by the two-year deadline mentioned above) at the time the initial public organic document (*e.g.*, articles of incorporation) is filed. The entity information statement contains the name and business or residential address of the CPE's "record contact" (RC) and "responsible individual" (RI). The RC must be an individual whose principal residence is in the United States. The RI must also be an individual and must be someone who directly or indirectly participates in the control or management of the CPE. Any changes in the RC and RI must be promptly filed in the office of the Secretary of State. A CPE can be administratively dissolved if it fails to keep the information about the RC and RI current. A federal law enforcement authority, federal agency, or committee or subcommittee of the U.S. Congress (states have the option to expand the list to include state and local law enforcement authorities, state agencies and state legislatures) can obtain the name and contact information of the RI and RC from the Secretary of State and then proceed pursuant to a subpoena to contact the RI and RC.

Since the RI must be someone who is knowledgeable about the activities of the entity, the ability of law enforcement officials to directly contact the RI gives law enforcement officials a valuable investigative resource. The fact that the RI would be subject to perjury and other sanctions should be a sufficient deterrent for anyone who does not really know anything about the operations of the entity to sign a document filed in the Office of the Secretary of State stating he or she is the RI for the entity.

Upon receipt of an appropriate request for information from law enforcement officials, the RC is required to obtain from the CPE on a timely basis pursuant to the subpoena ownership and control information about the CPE. The records that the CPE must provide the RC, who in turn gives the information to the appropriate law enforcement officials, are:

1. a list of the name and last known address of each interest holder and transferee and, if the interest holder or transferee is an entity, the name of the state or country where it was formed;

2. the name and address of each governor (*e.g.,* director), including a government issued photo identification document of a governor whose principal residence is outside the United States;

3. a government issued photo identification document for its RI if the RI's principal residence is outside the United States;

4. the name and contact information of the RI of a non-U.S. entity that is an interest holder or transferee of a CPE;

5. any records the CPE maintains regarding the process by which its governors are elected or otherwise designated;

6. the voting power of each interest holder or a description of the manner in which each interest holder's voting power in the entity is determined;

7. the names of the individuals responsible for preparing the information; and

8. a certificate that the information accurately reflects the current records of the CPE.

In addition to the number and types of entities covered, the Uniform Act differs from S.569 with respect to the required ownership and control information in several respects. A topical chart comparing the two acts is attached to my written testimony. The two most significant differences between the Uniform Act and S.569 concern: (1) what entity information is filed in the office of the Secretary of State; and (2) beneficial ownership information.

S.569 requires that entity beneficial ownership information be filed in the office of the Secretary of State at the time the entity is formed and that the information be updated annually in states which do not require annual reports, a CPE would be required to file any changes in beneficial ownership at the time the change occurs.

The Uniform Act only requires the names and contact information of the RC and RI to be filed in the office of the Secretary of State. There are three principal reasons why the drafting committee chose this path. The first is that the Secretaries of State do not currently keep any substantial ownership and control information and what information they do require to be filed is public record information. Setting up a filing system to accommodate and maintain detailed ownership and control information would be very expensive. The second reason is that maintaining this information as confidential documents would immensely complicate the filing process, and in some states could not be accomplished without amending the state's constitution. The third reason is that since updates are only required annually in states that require annual reports, the information on file would not reflect any changes in ownership and control occurring between the filing of the initial information statement and the filing of the first annual report or between

annual reports. Moreover, requiring CPEs to file an updated list of changes on a real-time basis would be an administrative nightmare both for the CPEs and the Secretaries of State.

After careful study and consideration, the ULEAEIA Drafting Committee determined that requiring entities to collect and maintain beneficial ownership records that would comply with the definition in S.569 (and its predecessor S.2956) would be an enormous burden, a radical departure from existing entity record keeping requirements, and because of the complexities involved in determining beneficial ownership, would create a records system with massive amounts of noncompliance, most of which would be unintentional.

S.569 defines a beneficial owner as:

> an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or limited liability company that, as a practical matter, enables the individual, directly or indirectly, to control, manage or direct the corporation or limited liability company.

This definition is far too general and vague to be a concrete guide for determining exactly what kind of information must be kept by entities. The key operative terms "control" and "directly and indirectly" would have to be defined. All the other statutes and regulations that use the term "control" as the critical factor have a threshold percentage of ownership interest that determines if control exists, *e.g.,* more than 50% of the stock of a corporation. What is meant by "direct and indirect" ownership would have to be spelled out in the statute. The difficulty and complexity is in determining "indirect" ownership. Other existing statutes and regulations generally contain two categories of indirect or constructive ownership. The first is family members and the second is constructive ownership based on ownership interests in trusts, estate, and various forms of business entities.

I have attached to my written testimony a Memorandum I prepared for the Uniform Act Drafting Committee which describes some of the major issues that would have to be dealt with in drafting a statute containing indirect or constructive ownership rules. The statutes would of necessity be very complex. Two examples, one from the UK and one from the Internal Revenue Code Tax Regulations are included as exhibits to the Memorandum.

In order to determine if there were any beneficial owners who were in control of an entity, the entity would have to know all the members of the family, as defined in the statute, of each of its individual record owners, and the names of all the shareholders, partners and members of any entity that is an equity owner of the entity. If one or more of the equity owners is an entity of some kind, the entity would also need to know the owners of that entity, and so on down the chain, as well as the names of the beneficiaries of any trust and estates that hold an ownership interest in the entity. An additional complexity would be the necessity of keeping track of any changes in the various ownership interests, for example, a change in the beneficiaries of a trust that owns stock in a corporation A or one of the shareholders of corporation B that owns stock in corporation A sells his corporation A stock to C. Unless the trustee of the trust or corporation B notifies corporation A of the change, corporation A would not have any way of knowing about these changes.

The Uniform Act gives law enforcement officials access, through the RC, to current, accurate information on the record ownership, voting rights and managers of an entity which is the overall objective of S.569 without the complexities of the beneficial ownership concept. In some cases after receiving the required information from the RC, additional investigation into identification of family members of interest holders, beneficiaries of trust and estates that are interest holders and the owners of entities that are interest holders in the entity being investigated will have to be conducted, but the ownership, management and control information received from the RC will provide law enforcement officials with the necessary basic information to trace this ownership trail.

The Uniform Act accomplishes the purposes set forth in S.569 in a more comprehensive, more cost effective and less complex manner than that Act. Since the states will have to enact legislation to implement S.569, it makes sense to amend S.569 to provide that states must adopt the Uniform Act.

We believe that federal legislation incorporating the Uniform Act should have at least the following elements:

- It would require that states adopt legislation substantially similar to the Uniform Act by a date certain that is long enough in the future to permit all state legislatures a reasonable opportunity to consider and act upon the Uniform Act.

- Provide a reliable source of federal funding to assist states in funding the one-time costs of revising their procedures and systems to obtain and manage the information required by the Uniform Act; and

- In addition to the funding "carrot," the federal legislation would provide some form of penalty or other consequence if a state has not adopted legislation substantially similar to the Uniform Act by some future date certain.

The broad discussions that we have had around the country concerning S.569 and the Uniform Act have led us to conclude that, while there is broad support for the Uniform Act as a far preferable vehicle than S.569 for providing law enforcement additional effective tools to combat money-laundering and the financing of terrorism, there also is little likelihood that the Uniform Act would achieve anything near widespread adoption unless there were both a federal "carrot" and a federal "stick" to encourage action by the states.

The ULC has had valuable experience in drafting uniform state legislation that is incorporated in federal legislation that provides a mandate that states enact the uniform legislation by some date certain.

- At the request of the State Department and the Department of Human Services, during 2007-08 ULC drafted amendments to the Uniform Interstate Family Support Act (UIFSA) in order to implement provisions of the Hague Family Maintenance Convention, which the United States had recently signed. Those UIFSA revisions were adopted by the ULC in July 2008 and proposed federal legislation requires states to adopt UIFSA by

a future date or risk loss of child support funding. Action on the proposed legislation and Senate Advice and Consent to the Treaty are pending.

- In 1999 the ULC drafted the Uniform Electronic Transactions Act (UETA), and in 2000 Congress enacted the Electronic Signatures in Global and National Commerce Act ("E-Sign"), which provided pre-emptive federal legislation covering essentially the same topics as UETA and provided that the federal legislation would control unless a state adopted state legislation substantially similar to UETA. To date 46 states have adopted UETA.

Conclusion

The ULC welcomes the opportunity to work with the Chair and other members of the Committee to craft workable legislation that will provide law enforcement officials with improved and timely access to accurate ownership and control information about legal entities.

D R A F T

FOR DISCUSSION ONLY

UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

NATIONAL CONFERENCE OF COMMISSIONERS

ON UNIFORM STATE LAWS

Annual Meeting Draft

With Prefatory Note and Comments

The ideas and conclusions set forth in this draft, including the proposed statutory language and prefatory note, legislative notes, and comments, have not been passed upon by the National Conference of Commissioners on Uniform State Laws. They do not necessarily reflect the views of the Conference and its Commissioners and the Drafting Committee and its Members and Reporter. Proposed statutory language may not be used to ascertain the intent or meaning of any promulgated final statutory proposal.

June 2, 2009

DRAFTING COMMITTEE ON UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

The Committee appointed by and representing the National Conference of Commissioners on Uniform State Laws in preparing this Act consists of the following individuals:

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UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

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UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

Prefatory Note

This act is part of an international effort to fight money laundering and stop the financing of terrorist activities. Among other things, the act implements Recommendation 33 of the Financial Action Task Force (FATF).

The website of FATF describes the history of FATF as follows:

> "In response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognizing the threat posed to the banking system and to financial institutions, the G-7 Heads of State or Government and President of the European Commission convened the Task Force from the G-7 member States, the European Commission and eight other countries.
>
> "The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, the FATF issued a report containing a set of Forty Recommendations, which provide a comprehensive plan of action needed to fight against money laundering."

Recommendation 33 of the Forty Recommendations provides that:

> "Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures."

A Congressional hearing relating to the issues raised by FATF Recommendation 33 was held on November 14, 2006 by the Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs of the United States Senate. The testimony at that hearing led to the introduction of legislation in both the 110th Congress (S. 681, S. 2956, and H.R. 2136) and the 111th Congress (S. 569).

On June 11, 2007, the National Association of Secretaries of State (NASS) requested that the Conference draft amendments to the various uniform unincorporated entity laws to address the issues raised by FATF Recommendation 33. NASS similarly requested that the Committee

on Corporate Laws (CCL) of the Section on Business Law of the American Bar Association prepare similar amendments to the Model Business Corporation Act. Underlying the NASS requests was a desire to address the issues in a way that would be less burdensome for the private sector and Secretaries of State than the proposals in the federal legislation but still meet the needs of law enforcement and satisfy FATF Recommendation 33.

Both the Conference and the CCL agreed to undertake the drafting efforts requested by NASS. Proposed amendments to the Uniform Limited Liability Company Act were given first reading at the 2008 annual meeting of the Conference, and the CCL prepared a first draft of amendments to the Model Business Corporation Act. The Conference and the CCL then decided that, rather than requiring the states to make amendments to each of their entity laws, it would be preferable to prepare a single statute that could be enacted by a state to address the issues raised by FATF Recommendation 33. The unified approach taken in this act was considered desirable particularly because each state has a unique pattern of entity laws and no state has adopted the Model Business Corporation Act and all of the current uniform unincorporated entity laws. This act provides a single statute that can be enacted to address the issues raised by FATF Recommendation 33.

UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Law Enforcement Access to Entity Information Act.

SECTION 2. DEFINITIONS. In this [act]:

(1) "Appropriate request" means:

(A) a civil, criminal, or administrative subpoena or summons from a [state, local, or] federal law enforcement authority, [state agency,] federal agency, or committee or subcommittee of the United States Congress [or a state legislature]; or

(B) a request in the form of a record made by a federal agency on behalf of another country under:

(i) an international treaty, agreement, or convention; or

(ii) 28 U.S.C. Section 1782.

(2) "Conventional privately held entity":

(A) means a domestic filing entity that has, or will have on the effective date of its initial public organic record, no more than 50 interest holders; and

(B) does not include a domestic filing entity:

(i) in which one or more domestic or foreign entities with more than 50 interest holders each holds, directly or indirectly, more than 25 percent of the outstanding interests;

(ii) that is licensed or otherwise authorized to conduct business, or has filed an application which has not been denied with the appropriate federal or state agency for a license or other authorization to conduct business, as a bank or other depository institution, trust

company, insurance company, public utility, or securities or commodities broker or dealer;

(iii) that is registered, or has filed an application for registration which has not been denied, as an investment company under the Investment Company Act of 1940;

(iv) that is registered, or has filed an application for registration which has not been denied, as an investment advisor under the Investment Advisors Act of 1940 or the law of any state;

(v) in which one or more domestic or foreign entities of the types described in subparagraph (ii), (iii), or (iv) holds, directly or indirectly, a majority of the outstanding interests;

(vi) that holds, directly or indirectly, a majority of the outstanding interests in a domestic or foreign entity of a type described in subparagraph (ii), (iii), or (iv);

(vii) that has filed with the Internal Revenue Service a current annual information return as an exempt organization or private foundation; or

(viii) that has filed with the Internal Revenue Service an application for recognition of exemption from federal income tax, if that exemption has not been denied and the due date (including any extension granted) for filing its first annual information return as an exempt organization or private foundation has not yet passed.

(3) "Domestic", with respect to an entity, means an entity whose internal affairs are governed by the law of this state.

(4) "Domestic filing entity" means:

(A) a domestic business corporation;

(B) a domestic nonprofit corporation;

(C) a domestic limited liability partnership that is not also a limited partnership;

(D) a domestic limited partnership, including a limited liability limited partnership;

(E) a domestic limited liability company;

(F) a domestic limited cooperative association; [or]

(G) a domestic statutory trust entity[; or]

[(H) list other types of entities authorized by the law of the state].

(5) "Entity information statement" means the initial or amended statement described in Section 4(a) or (c).

(6) "Foreign", with respect to an entity, means an entity whose internal affairs are governed by the law of a jurisdiction other than this state.

(7) "Governance interest" means the right under the organic law or organic rules of an unincorporated entity, other than as a governor, agent, assignee, or proxy, to:

(A) receive or demand access to:

(i) information concerning the entity; or

(ii) the books and records of the entity;

(B) vote for the election of the governors of the entity; or

(C) vote on issues involving the internal affairs of the entity.

(8) "Governor" means:

(A) a director of a business corporation [or a shareholder of a close corporation that is managed by its shareholders instead of a board of directors];

(B) a director [or member of a designated body] of a nonprofit corporation;

(C) a general partner of a limited liability partnership that is not also a limited partnership;

(D) a general partner of a limited partnership;

(E) a manager of a limited liability company or other person that materially participates in the management of a limited liability company pursuant to its organic law and organic rules;

(F) a director of a limited cooperative association; [or]

(G) a trustee of a statutory trust entity[; or]

[(H) list governors of other types of entities authorized by the law of the state].

(9) "Interest" means:

(A) a governance interest;

(B) a transferable interest;

(C) a share of a business corporation; or

(D) a membership in a nonprofit corporation.

(10) "Interest holder" of an entity means:

(A) a shareholder of a business corporation;

(B) a member of a nonprofit corporation;

(C) a general partner of a limited liability partnership that is not also a limited partnership;

(D) a general partner of a limited partnership;

(E) a limited partner of a limited partnership;

(F) a member of a limited liability company;

(G) a member of a limited cooperative association; [or]

(H) a beneficiary of a statutory trust entity[; or]

[(I) list similar persons in other types of entities authorized by the law of the

state].

(11) "Non-US entity" means an entity whose internal affairs are governed by the laws of a jurisdiction other than a state or the United States.

(12) "Organic law" means the statutes of an entity's jurisdiction of incorporation, organization, or other formation which govern the internal affairs of the entity.

(13) "Organic rules" means the public organic record and private organic rules of an entity.

(14) "Person" means an individual, corporation, estate, trust, partnership, limited liability company, business or similar trust, cooperative, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(15) "Private organic rules" means:

(A) the bylaws of a business corporation;

(B) the bylaws of a nonprofit corporation;

(C) the partnership agreement of a limited liability partnership that is not a limited partnership;

(D) the partnership agreement of a limited partnership;

(E) the operating agreement of a limited liability company;

(F) the bylaws of a limited cooperative association;

(G) the trust instrument of a statutory trust entity; [and]

(H) [list similar documents for other types of entities authorized by the law of the state; and

(I)] any other rules, whether or not in a record, that govern the internal affairs of

a domestic filing entity, are binding on all of its interest holders, and are not part of its public organic record, if any.

(16) "Public organic record" means:

(A) the articles of incorporation of a business corporation;

(B) the articles of incorporation of a nonprofit corporation;

(C) the statement of qualification of a limited liability partnership that is not a limited partnership;

(D) the certificate of limited partnership of a limited partnership;

(E) the certificate of organization of a limited liability company;

(F) the articles of organization of a limited cooperative association; [and]

(G) the certificate of trust of a statutory trust entity[; and]

[(H) list similar documents for other types of entities authorized by the law of the state].

(17) "Record", used as a noun, means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(18) "Records contact" means an individual whose principal residence is in the United States and who has access to and can produce within the United States on a timely basis upon appropriate request the information described in Section 7(a).

(19) "Responsible individual" means an individual who, directly or indirectly, participates in the control or management of an entity or, in the case of an entity being formed, will participate in the control or management of the entity.

(20) "Sign" means, with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

(B) to attach to or logically associate with the record an electronic sound, symbol, or process.

(21) "Transferable interest" means the right under the organic law of an unincorporated entity to receive distributions from the entity.

(22) "Transferee" means a person to which all or part of a transferable interest has been transferred without a governance interest, whether or not the transferee is an interest holder.

(23) "Unincorporated entity" means an entity that is not a corporation.

Legislative Notes:

(1) "Appropriate request": An enacting state must decide whether to include the optional provisions in this definition which have the effect of extending to local or state authorities the right of access to information provided in this act.

(2) "Conventional privately held entity": Subparagraph (B) should be revised to omit any of the types of entities listed that are formed under a law that applies only to that type of entity, for example a banking corporation act or insurance company act. Those entities should also not be included in the definition of "domestic filing entity" because this act does not need to include those entities for any purpose.

(4) "Domestic filing entity": The entities referred to in this definition are illustrative only. The list as enacted by a state should include all the types of non-governmental entities that may be created under the state's laws where a filing must be made with the Secretary of State to create or confirm the status or existence of the entity. An enacting state should revise this definition so that (i) the entities are referred to in the manner they are referred to in the state's other laws and (ii) it includes all of the types of entities that fit within the concept and are recognized by the laws of the state.

It is not necessary to list in this definition entities that are a subset of a type of entity listed if reference to the more generic type of entity includes entities in that subset. For example, if professional corporations are subject to the state's business corporation law so that referring to business corporations includes professional corporations, this definition does not need to list professional corporations; but if professional corporations are incorporated under a separate statute and a reference to business corporations would not include professional corporations, then professional corporations should be listed separately.

If a type of entity described in subparagraph (B)(ii) of the definition of "conventional privately held entity" is formed under a law that applies only to that type of entity, for example a banking corporation act or insurance company act, that type of entity may be omitted from this definition because "domestic filing entity" does not need to include that type of entity for any

purpose under this act.

(8) "Governor": An enacting state should revise this definition so that it refers to the appropriate persons with respect to each type of entity listed in the definition of "domestic filing entity."

If an enacting state authorizes a business corporation with a limited number of shareholders to dispense with a board of directors in favor of management by its shareholders, the optional phrase at the end of subparagraph (A) should be included with appropriate changes to conform to the terminology used in the enacting state.

The Model Nonprofit Corporation Act permits a nonprofit corporation to give some of the responsibilities and obligations of the board of directors to another group of persons known as a "designated body." If the law of an enacting state permits that type of governance structure, the optional phrase in subparagraph (B) should be included with appropriate changes to conform to the terminology used in the enacting state.

(10) "Interest holder": An enacting state should revise this definition so that it includes references to the appropriate persons with respect to each type of entity listed in the definition of "domestic filing entity."

(15) "Private organic rules": An enacting state should revise this definition so that it refers to the appropriate item with respect to each type of entity listed in the definition of "domestic filing entity."

(16) "Public organic record": An enacting state should revise this definition so that it refers to the appropriate document with respect to each type of entity listed in the definition of "domestic filing entity."

Comment

"Appropriate request." This definition is patterned after Section 2009(a)(1)(D) of the Homeland Security Act of 2002 (6 U.S.C. § 601 et seq.), as proposed to be added by S. 569 (111th Congress).

"Conventional privately held entity." The annual information returns referred to in subparagraphs (B)(vii) and (viii) of this definition are the form 990, 990-EZ, and 990-PF returns that are filed by private foundations or organizations exempt from federal income tax under sections 501(c), 527, or 4947(a)(1) of the Internal Revenue Code. Those returns, as well as applications for tax exempt status, are publicly available and require disclosure of, among other things, the officers, directors, trustees, and most highly compensated employees of an exempt organization and thus it is not necessary to require those organizations to comply with the disclosure provisions of this act.

If a nonprofit corporation does not have any members, it will fall within subparagraph (A) of this definition because it will have fewer than 50 interest holders, i.e., none.

"Governor." The second clause of subparagraph (E) of this definition, which refers to persons who are not managers of a limited liability company but participate materially in its management, is patterned after 6 Del. Code § 18-109(a). It is not intended that the power to elect or otherwise select or to participate in the election or selection of a person to be a manager of a limited liability company will, by itself, constitute participation in the management of the company.

"Interest holder." Whether a person is a member of a nonprofit corporation will be determined under a state's nonprofit corporation law. Many nonprofit corporations refer to their financial supporters as "members" even though those contributors do not have governance rights under the organic law and organic rules of the corporation.

"Responsible individual." A responsible individual may be an individual who is a governor of the entity, an agent of another person, or an agent or officer of the entity itself, or who meets the requirements of this definition because of ownership of an interest in the entity or other factors. To qualify as a responsible individual, what is required is that the individual participate in the control or management of the entity. A responsible individual may have sole responsibility for the management of the entity or may share that responsibility with others. The term has been created for use in this act and is not intended to change the law with respect to the governance of any form of entity.

SECTION 3. PUBLIC ORGANIC RECORDS.

(a) The public organic record of a domestic filing entity must include, in addition to any other information required by its organic law, a statement as to whether the entity is a conventional privately held entity. The delivery to the [Secretary of State] for filing of an initial or amended public organic record is an affirmation under the penalties of perjury by the entity and by any person signing the record that the statement required by this subsection is correct.

(b) When the initial public organic record of a conventional privately held entity is delivered to the [Secretary of State] for filing, it must be accompanied by an initial entity information statement.

(c) If the statement required by subsection (a) becomes incorrect, the entity shall deliver promptly to the [Secretary of State] for filing an amendment of its public organic record correcting the statement. [An amendment pursuant to this subsection need not be approved by

the governors or interest holders.] [The [Secretary of State] may not charge a fee for filing an amendment pursuant to this subsection.]

(d) An amendment filed under subsection (c) indicating that an entity has become a conventional privately held entity must be accompanied by an entity information statement.

(e) Subsection (b) does not apply to an initial public organic record delivered to the [Secretary of State] before [the effective date of this act]. Subsections (a), (c), and (d) do not apply to a domestic filing entity that is in existence on [the effective date of this act] until the date provided in Section 16.

Legislative Notes:

Subsection (a): States should consider adding a reference to the requirements of subsection (a) in the section of the organic law of each domestic filing entity dealing with the entity's public organic record so that people consulting that law will be aware of the requirements of subsection (a). Such a reference in the section of the organic law of an entity dealing with the contents of its public organic record might read, for example, "the statement required by [Section 3(a) of the Uniform Law Enforcement Access to Entity Information Act]."

Subsection (c): The optional penultimate sentence of subsection (c) is intended to simplify the procedure for approving an amendment of the public organic record so that, for example, an amendment to the articles of incorporation of a business corporation to change the statement as to whether the corporation is a conventional privately held entity may be filed without action by the board of directors or shareholders. Enacting states may choose to place that type of provision in the individual organic laws for each type of entity listed in the definition of "domestic filing entity" in Section 2 or may decide to vary the rule of that sentence for some types of entities by requiring, for example, approval by the governors.

The last sentence of subsection (c) is optional because an enacting state may choose to require a fee for filing an amendment of the public organic record that is required under subsection (c). It will be preferable, however, for states not to require a fee as a way of encouraging amendments that keep the public records up to date regarding the status of an entity. If a state chooses to impose a fee, the fee will presumably be the same as for filing any other amendment to a public organic record. Thus the possibility of a fee being charged for a filing under subsection (c) has not been included in Section 13.

Comment

The public organic record of every domestic filing entity must include a statement satisfying subsection (a), either that the entity is a conventional privately held entity or that the

entity is not a conventional privately held entity.

If a domestic filing entity ceases to be a conventional privately held entity, for example because it conducts a public offering of its equity securities, it will need to amend its public organic record to reflect the change in its status. Entity information statements previously delivered to the Secretary of State will remain in the records of the Secretary of State, but the entity will no longer have an obligation to update the information in the statements. The individuals previously identified as its records contact and responsible individual will cease to have that status.

Most organic laws provide that it is a criminal offense to sign a document delivered to the Secretary of State for filing that the signatory knows to be false in any material respect. The last sentence of subsection (a) confirms that result and also imposes liability on the entity for a false statement as to its status as a conventional privately held entity.

SECTION 4. ENTITY INFORMATION STATEMENT.

(a) An entity information statement must set forth:

(1) the name of the conventional privately held entity;

(2) the name and a business or residential address of the records contact of the entity; and

(3) the name and a business or residential address of a responsible individual of the entity.

(b) An initial entity information statement must be signed:

(1) on behalf of the conventional privately held entity;

(2) by the records contact named in the statement; and

(3) by the responsible individual named in the statement.

(c) If any of the information in a filed entity information statement becomes incorrect or incomplete, the conventional privately held entity shall deliver promptly to the [Secretary of State] for filing an amended entity information statement that is correct as of the date of its delivery to the [Secretary of State] and includes the information required by subsection (a).

(d) An amended entity information statement must be signed:

(1) on behalf of the conventional privately held entity;

(2) by any new records contact or new responsible individual named in the amended statement; and

(3) by any records contact or responsible individual whose address is being changed.

(e) A records contact or responsible individual may change his or her address or resign by delivering to the [Secretary of State] for filing a statement of change signed by the records contact or responsible individual that sets forth:

(1) the name of the conventional privately held entity; and

(2) either:

(A) the new address; or

(B) a statement that the records contact or responsible individual resigns.

(f) A records contact or responsible individual who delivers to the [Secretary of State] for filing a statement of change pursuant to subsection (e) shall furnish promptly to the conventional privately held entity notice in a record of the delivery to the [Secretary of State] of the statement of change and a copy of the statement.

(g) An initial entity information statement filed under subsection (a) takes effect upon filing or any later effective time of the initial or amended public organic record in connection with which the statement is delivered to the [Secretary of State] for filing. An amended entity information statement filed under subsection (c) or a statement of change filed under subsection (e) takes effect upon filing.

(h) The signing by a records contact or responsible individual of an entity information statement or a statement of change that reflects a change of address constitutes an affirmation

under the penalties of perjury that:

(1) the address of the signing person is correct; and

(2) either:

(A) the records contact understands the duties of a records contact under this [act] and has agreed to serve in that capacity; or

(B) the responsible individual meets the definition of a responsible individual in Section 2.

(i) Every signature of a records contact or responsible individual on an entity information statement or statement of change must be notarized.

(j) If the principal residence of the responsible individual identified in the current entity information statement is outside the United States, the responsible individual must provide to the records contact a copy of a passport, driver's license, or other government-issued photo identification document for the responsible individual.

[(k) The [Secretary of State] may not charge a fee for filing an amended entity information statement or statement of change.]

Legislative Notes:

Subsection (i): Subsection (i) does not specify the manner in which the required notarizations must be submitted. That is an issue to be determined by the enacting state and may require amendment of subsection (i) or other state law. Some states may choose to accept only paper filings, while other states may provide for electronic notarization or delivery of notarized documents by electronic means. If the Secretary of State only accepts electronic filings, an enacting state will need to provide for either electronic notarization or the delivery of notarized documents by electronic means.

Subsection (k): Subsection (k) is optional because an enacting state may choose to require a fee for filing an amended entity information statement or statement of change. It will be preferable, however, for states not to require a fee as a way of encouraging filings that keep the public records up to date. If a state chooses to impose a fee, the fee should be included in Section 13.

Comment

1. The same individual may serve as the records contact and responsible individual for a conventional privately held entity. When an entity needs to be formed on a rush basis, or when a records contact or responsible individual has not yet been identified for an entity, a person forming the entity, such as an incorporator, may serve as an accommodation in the capacities of records contact and responsible individual. Regardless of the reason why the person forming the entity is also shown as the records contact, so long as the person is named in that capacity, the person will have the duties and liabilities attendant to that position under this act.

2. Because subsection (c) requires an amended entity information statement to include all of the information required by subsection (a), a conventional privately held entity must always have a records contact and responsible individual identified in the records of the Secretary of State. *But see* the transitional provisions in Section 16.

3. Subsection (d) does not require that an amended entity information statement be signed by an individual named in an earlier statement as records contact or responsible individual if the information regarding that individual has not changed.

4. Subsection (g) provides that a statement of change under subsection (e), which could include a resignation by a records contact or responsible individual, takes effect upon filing. That is different from the practice in some states of delaying the effectiveness of a resignation of a registered agent. *See, e.g.*, Model Registered Agents Act § 11 (delaying a resignation for 31 days). The main function of a registered agent is simply to forward service of process to the represented entity, and delaying resignation from that position typically does not pose problems for either the registered agent or the represented entity. A records contact or responsible individual, in contrast, has an important place in the law enforcement process created by this act, making it more important for the records contact or responsible individual to be able to resign immediately in appropriate circumstances. Making a resignation effective immediately under subsection (g) also provides an earlier start to the period in which the entity must replace the records contact or responsible individual if the entity wishes to avoid administrative dissolution under Section 9.

5. The purpose of subsection (i) is to use the notarial process to provide some verification of the identity of a records contact or responsible individual since notarization requires the notary to know or verify the identity of the individual whose signature is being notarized.

Notarization may include taking an acknowledgment, administering an oath or affirmation, taking a verification upon oath or affirmation, or witnessing or attesting a signature. *See* Uniform Law on Notarial Acts (1982) § 1(1) ("notarial act"). The persons who may perform those acts are determined by state law and may be changed by a state to broaden or restrict the types of persons so authorized.

The manner in which a document with a notarized signature may be delivered to the Secretary of State will be determined by the Secretary of State and may include by fax or in

portable document form (pdf). Modern law on notarial acts is also evolving to permit notarization of electronic records, and thus even in those states where all entity filings are made electronically it should be possible to comply with subsection (i).

Every state has statutory provisions dealing with notarial acts, although not every state has adopted the Uniform Law on Notarial Acts (1982). Those state statutes typically have separate provisions covering notarial acts performed within the state, under federal authority, and in foreign countries. Section 6 of the Uniform Law on Notarial Acts (1982) provides, for example, with respect to notarial acts performed in foreign countries:

> (a) A notarial act has the same effect under the law of this State as if performed by a notarial officer of this State if performed within the jurisdiction of and under authority of a foreign nation or its constituent units or a multi-national or international organization by any of the following persons:
>
> (1) a notary public or notary;
>
> (2) a judge, clerk, or deputy clerk of a court of record; or
>
> (3) any other person authorized by the law of that jurisdiction to perform notarial acts.
>
> (b) An "Apostille" in the form prescribed by the Hague Convention of October 5, 1961, conclusively establishes that the signature of the notarial officer is genuine and that the officer holds the indicated office.
>
> (c) A certificate by a foreign service or consular officer of the United States stationed in the nation under the jurisdiction of which the notarial act was performed, or a certificate by a foreign service or consular officer of that nation stationed in the United States, conclusively establishes any matter relating to the authenticity or validity of the notarial act set forth in the certificate.
>
> (d) An official stamp or seal of the person performing the notarial act is prima facie evidence that the signature is genuine and that the person holds the indicated title.
>
> (e) An official stamp or seal of an officer listed in subsection (a)(1) or (a)(2) is prima facie evidence that a person with the indicated title has authority to perform notarial acts.
>
> (f) If the title of office and indication of authority to perform notarial acts appears either in a digest of foreign law or in a list customarily used as a source for that information, the authority of an officer with that title to perform notarial acts is conclusively established.

Subsection (i) does not address the duty of the Secretary of State to verify that the notarization of a signature on an entity information statement is valid. The procedures for acceptance of notarized documents by the Secretary of State will be governed by other law of the state. That law often deals separately with notarizations performed within the state, outside of the state, under federal authority, or in foreign countries. *See, e.g.*, Uniform Law on Notarial Acts (1982) §§ 3-6.

SECTION 5. DUTIES OF RECORDS CONTACT.

(a) A records contact for a conventional privately held entity must:

(1) inquire at the time the records contact signs an initial or amended entity information statement whether the current responsible individual is required to comply with Section 4(j) and, if the responsible individual is required to comply but does not do so within five business days after the [Secretary of State] files the initial or amended entity information statement, to resign as records contact in the manner provided in Section 4(e);

(2) request promptly from the entity the information described in Section 7 when the records contact receives an appropriate request for the information;

(3) produce on a timely basis to a party making an appropriate request:

(A) the photo identification document, if any, for the entity's responsible individual required by Section 4(j);

(B) any information described in Section 7(a) which is provided by the entity to the records contact; and

(C) any certification described in Section 7(b) which is provided by the entity to the records contact;

(4) resign under Section 4(e) if the records contact acquires actual knowledge, before receiving an appropriate request, that a request by the records contact to the entity for the information described in Section 7(a) will not be honored by the entity on a timely basis; and

(5) if information in response to an appropriate request is not provided on a timely basis by the entity upon request by the records contact, notify the party that made the appropriate request of:

(A) the name and a business or residential address of the individual whom

the records contact believed would supply the information to the record contacts; or

(B) if there is no such individual, the source or location from which the records contact believed the information could be obtained.

(b) A records contact, as such, does not have a duty to verify the accuracy of information described in Section 4(j) or 7(a) or a certification under Section 7(b).

Comment

If there is a failure to respond to an appropriate request for information, the consequences of that failure and possible sanctions will depend on the nature of the request. For example, failure to respond to a subpoena will have the same consequences and sanctions as any other failure to respond to a subpoena under the applicable federal or state law. Whether the consequences of a failure to respond to an appropriate request for information should be imposed on the records contact or on the conventional privately held entity will depend on whether the records contact has performed the duties required by this section.

If an entity believes that it has defenses to a failure to respond to an appropriate request or should be excused from responding, it may raise those defenses or excuses in a proceeding to enforce the appropriate request or the entity may commence a proceeding to contest the appropriate request.

The requirement in subsection (a)(3) that information be produced on a "timely basis" is intended to satisfy Recommendation 33 of the 40 Recommendations of the Financial Action Task Force. In the case of a subpoena, what will be a timely response will be controlled by the response date in the subpoena and whether an appropriate challenge to the subpoena is made. A response date in a request made under a treaty, however, does not have the force of law and will not necessarily be binding.

A records contact may wish as a matter of good business practice to verify periodically that the records contact continues to have the required access to information, although an obligation to verify that the records contact continues to have access to information is not part of the required duties of a records contact.

If a records contact acquires actual knowledge that information will not be provided by an entity as required by this act, the records contact has a duty to resign under subsection (a)(4) even though there is no pending appropriate request.

A records contact is defined in Section 2(18) as an individual who has access to the information required by Section 7, and when a records contact signs an entity information statement under Section 4 that signature constitutes an affirmation that the individual understands the duties of a records contact.

Subsection (b) applies only to a records contact in the individual's capacity as a records contact. If the individual also maintains the records required to be produced under Section 7(a) in another capacity, for example as a corporate secretary, the individual will have the obligations associated with serving in that capacity. This act does not address those obligations.

SECTION 6. INTEREST HOLDERS FROM OUTSIDE UNITED STATES.

(a) Except as provided in subsection (e), when a non-US entity first becomes a transferee or interest holder in a conventional privately held entity after [the effective date of this act], whether by transfer, issuance of an interest, or admission as an interest holder, the transferee or interest holder shall provide the entity with a certification signed under the penalties of perjury stating the name and a business or residential address of a responsible individual for the transferee or interest holder.

(b) Except as provided in subsection (e), if any of the information in a certification provided under subsection (a) becomes incorrect, the interest holder or transferee shall provide promptly to the conventional privately held entity a corrected certification.

(c) A certification provided under subsection (a) or (b) that is incorrect or incomplete, or the failure of a conventional privately held entity to obtain a required certification, does not affect the existence of the conventional privately held entity, the validity of any acts of the entity, the interest of any interest holder or transferee, or the status of a person as an interest holder or transferee.

(d) A non-US entity that is required to provide a certification under this section may not maintain a proceeding in any court in this state with respect to the interest giving rise to the obligation to provide the certification unless the non-US entity complies with this section.

(e) Subsections (a) and (b) apply only to an interest holder or transferee that would be a conventional privately held entity if the interest holder or transferee were a domestic filing entity.

Comment

This section is patterned in part after Section 2009(a)(2) of the Homeland Security Act of 2002 (6 U.S.C. § 601 et seq.), as proposed to be added by S. 569 (111th Congress).

This section is not intended to require the conventional privately held entity to track transfers of interest. It is the obligation of a transferee to provide the certifications required by this section.

Subsection (c) is patterned in part after Model Business Corporation Act, 4th Ed. § 2.03 and Uniform Limited Liability Company Act § 2.01(d). Section 2.03(b) of the Model Act, for example, provides that "The secretary of state's filing of the articles of incorporation is conclusive proof that the incorporators satisfied all conditions precedent to incorporation except in a proceeding by the state to cancel or revoke the incorporation or involuntarily dissolve the corporation." States should consider whether to amend those types of provisions in their entity laws to make them consistent with subsection (c).

Subsection (d) is patterned after the provision found in many state entity laws that prohibits a foreign entity from maintaining a lawsuit in a state if the entity is transacting business in the state but has not registered to do business as a foreign entity. See, e.g., Model Business Corporation Act (4th Ed.) § 15.02(a) and Uniform Limited Liability Company Act (2006) § 808(a).

SECTION 7. RECORDS OF CONVENTIONAL PRIVATELY HELD ENTITIES.

(a) A conventional privately held entity must have a records contact at all times while it is a conventional privately held entity. When the records contact notifies the entity that an appropriate request has been received, the entity shall provide on a timely basis to the records contact information in a record that:

(1) includes the name and last known address of each current transferee of which the entity has actual knowledge, each current interest holder in the entity, and any other person to which the entity has been instructed to send distributions;

(2) indicates for each current transferee of which the entity has actual knowledge or current interest holder that is a foreign or domestic entity, the jurisdiction whose laws govern its internal affairs;

(3) includes the name and a residential or business address for each governor of

the entity;

(4) includes a copy of a passport, driver's license, or other government-issued photo identification document for:

(A) each governor of the entity who is an individual and whose principal residence at the time the individual became a governor was outside the United States; and

(B) its responsible individual if the principal residence of the responsible individual is outside the United States;

(5) includes any records maintained by the entity regarding the process by which the governors of the entity are elected or otherwise designated;

(6) indicates the voting power in the entity held by each of its interest holders or describes the manner in which each interest holder's voting power in the entity is determined;

(7) identifies the individuals responsible for preparing the information provided to the records contact under this subsection; and

(8) includes the certifications required by section 6(a) and (b).

(b) When information is provided pursuant to subsection (a), it must include a certification by the conventional privately held entity, signed under the penalties of perjury, that the information accurately reflects the current records of the entity.

Comment

A non-U.S. resident is not required to supply a photo identification document as a condition to becoming a governor under paragraph (a)(4)(A). That paragraph simply requires that when an appropriate request is made the conventional privately held entity must be able to supply the required document. The entity may obtain the document at that time, but many entities will choose to obtain the document earlier because they otherwise run the risk of being unable to obtain the document on a timely basis once an appropriate request has been made. In contrast, if the principal residence of a responsible individual is outside the United States, the entity has a continuing obligation to obtain a photo identification document under subparagraph (a)(4)(B). The responsible individual also has an obligation to provide a photo identification document to the records contact under Section 4(j).

The obligation to provide information under paragraph (a)(6) about voting power in the conventional privately held entity may be satisfied by supplying a copy of the operative documents that determine that voting power. Those documents will often be simply the public organic record or private organic rules of the entity, such as the articles of incorporation of a corporation or the operating agreement of a limited liability company; but may include other documents such as shareholder agreements, voting agreements, investor rights agreements, etc.

SECTION 8. JUDICIAL DISSOLUTION.

(a) The [name or describe court or courts] may dissolve a conventional privately held entity in a proceeding by [the Attorney General] if it is established that the entity materially failed to comply with Sections 7 or 12.

(b) It is not necessary to make interest holders or transferees parties to a proceeding to dissolve a conventional privately held entity under this section unless relief is sought against them individually.

(c) Until a full hearing is held, the court may issue injunctions, appoint a receiver or custodian with the powers and duties the court directs, and order other action required to preserve the assets and carry on the business of the conventional privately held entity.

(d) The court may appoint a receiver to wind up and liquidate the business and affairs of the conventional privately held entity. The court shall hold a hearing, after notifying all parties to the proceeding and any interested persons designated by the court, before appointing a receiver. The court appointing a receiver has exclusive jurisdiction over the entity and all of its property wherever located.

(e) The court may appoint as a receiver an individual, a domestic entity, or a foreign entity authorized to transact business in this state. The court may require the receiver to post bond, with or without sureties, in an amount the court directs.

(f) The court shall prescribe the powers and duties of the receiver in its appointing order,

which may be amended. The powers of the receiver may include the power to:

(1) dispose of all or any part of the assets of the conventional privately held entity wherever located, at a public or private sale, if authorized by the court; and

(2) sue and defend in the receiver's own name as receiver of the entity in all courts of this state.

(g) The court from time to time during the receivership may order compensation paid and expense disbursements or reimbursements made to the receiver and counsel for the receiver from the assets of the conventional privately held entity or from proceeds from the sale of the assets.

(h) If after a hearing the court determines that a ground under this section exists for judicial dissolution of a conventional privately held entity, the court shall order dissolution of the entity and specify the effective date of the dissolution. The clerk of the court shall deliver a certified copy of the decree to the [Secretary of State] for filing.

(i) After ordering dissolution, the court shall direct the winding-up of the business and affairs of the conventional privately held entity in accordance with the organic law of the entity.

Legislative Note: *If an enacting state has existing judicial dissolution procedures for some or all of the entities included in the definition of "domestic filing entity" in Section 2, this section may be revised so that it only applies to those entities for which the state does not already have judicial dissolution procedures. For those entities excluded from the scope of this section, subsection (a) will need to be added to the judicial dissolution provisions in the organic laws of those entities as an additional basis for judicial dissolution.*

Comment

If a conventional privately held entity believes that it has defenses to a proceeding to dissolve it under this section, those issues may be raised and tried in the dissolution proceeding.

An action under this section will usually involve just the conventional privately held entity. However, subsection (b) permits the interest holders or transferees to be made parties to the dissolution proceeding because it may be appropriate to seek relief against them, for example in a proceeding brought to dissolve an entity that has violated the prohibition in Section 12 on

issuing bearer interests.

Judicial dissolution under this section is in addition to judicial dissolution on other grounds that may be provided in the organic law of an entity or an enacting state's other law.

SECTION 9. ADMINISTRATIVE DISSOLUTION.

(a) The [Secretary of State] shall administratively dissolve:

(1) a conventional privately held entity if the records of the [Secretary of State] do not show a current records contact or responsible individual for the entity for [60] consecutive days; and

(2) a domestic filing entity if its public organic record does not contain the statement required by Section 3(a).

(b) If the [Secretary of State] determines that a ground exists for dissolving an entity under subsection (a), the [Secretary of State] shall file a record of the determination and serve the entity with a copy of the filed record.

(c) If not later than [60] days after service of the copy pursuant to subsection (b) the entity does not correct each ground for dissolution or demonstrate to the reasonable satisfaction of the [Secretary of State] that each ground determined by the [Secretary of State] does not exist,, the [Secretary of State] shall administratively dissolve the entity by preparing, signing, and filing a declaration of dissolution stating the grounds for dissolution. The [Secretary of State] shall serve the entity with a copy of the filed declaration.

(d) An entity that has been dissolved under this section continues in existence but, subject to subsection (i), may carry on only activities necessary to wind up its activities under its organic law.

(e) The dissolution of an entity under this section does not terminate the authority of its agent for service of process or the responsibilities of a records contact shown in the records of

the [Secretary of State] at the time of dissolution.

(f) An entity that has been dissolved under this section may apply to the [Secretary of State] for reinstatement by delivering to the [Secretary of State] for filing an application signed by the entity that states:

(1) the name of the entity and the effective date of its dissolution;

(2) either:

(A) the name and a business or residential address of the entity's records contact and the name and a business or residential address of the entity's responsible individual; or

(B) that the entity is not a conventional privately held entity; and

(3) if the entity's name is no longer available, a new name that satisfies the requirements of the entity's organic law.

(g) If the statement required by Section 3(a) in the public organic record of an entity that has been dissolved under this section is not consistent with the entity's application for reinstatement under subsection (f), the application must be accompanied by an amendment of the public organic record which states whether the entity is a conventional privately held entity.

(h) If the [Secretary of State] determines that an application under subsection (f) contains the required information and is accompanied by any required amendment of the entity's public organic record, the [Secretary of State] shall prepare a declaration of reinstatement that states those determinations, sign and file the original of the declaration of reinstatement, and serve the entity with a copy.

(i) When a reinstatement under subsection (h) becomes effective, it relates back to and takes effect as of the effective date of the administrative dissolution and the entity may resume

its activities as if the dissolution had not occurred.

(j) This section does not apply to a domestic filing entity in existence on [the effective date of this act] until the date provided in Section 16(b).

Legislative Note: *If an enacting state has existing administrative dissolution procedures, or procedures for voiding or cancelling an entity that is not in compliance with tax obligations or requirements of its organic law (all of the foregoing, "pre-existing procedures") for some or all of the entities included in the definition of "domestic filing entity" in Section 2, this section may be revised so that it only applies to those entities for which the state does not already have pre-existing procedures. For those entities excluded from the scope of this section, subsection (a) will need to be added to the pre-existing procedures in the organic laws of those entities as an additional basis for dissolution, voiding, or cancellation.*

This section may be conformed to the pre-existing procedures in the state. For example, if the existing practice in a state is for the Secretary of State to mail notice of an administrative dissolution, voiding, or cancellation to the entity, that practice may be substituted for the requirement in subsection (c) that the Secretary of State serve the filed declaration of dissolution on the entity.

Some state administrative dissolution statutes may include a time limit on reinstatement, unlike this section which does not impose a time limit on reinstatement. States should decide whether they wish to impose such a limit under this section.

Comment

This section applies to all domestic filing entities and not just conventional privately held entities. After the transition period provided in Section 16, failure of a domestic filing entity that is not a conventional privately held entity to include in its public organic record the statement required by Section 3(b) will be grounds for administrative dissolution of the entity.

A consequence of administrative dissolution in many states is to permit the use of the name of the dissolved entity by another entity. Thus subsection (f)(3) requires an entity seeking reinstatement to adopt a new name if its prior name has become unavailable because it has been appropriated by another entity during the period the entity seeking reinstatement was dissolved. *See, e.g.*, Model Business Corporation Act (4th Ed.) § 14.22(a)(3) and Uniform Limited Liability Company Act (2006) § 706(a)(3).

Administrative dissolution under this section is in addition to administrative dissolution on other grounds that may be provided in the organic law of an entity or an enacting state's other law.

SECTION 10. LIMITATION OF LIABILITIES.

(a) A records contact of a conventional privately held entity is not liable to the entity or

its interest holders or transferees for producing upon an appropriate request the information described in Section 7(a) or the certification described in Section 7(b).

(b) Unless a contract between a conventional privately held entity and a records contact provides otherwise, a records contact is not liable for any inaccuracy in or omission from the information described in Section 7(a) or the certification described in Section 7(b), but this subsection does not limit the liability of a records contact for recklessness, intentional misconduct, or criminal conduct.

(c) A records contact or responsible individual is not liable under law other than this [act] solely because of being identified as a records contact or responsible individual in the records of the [Secretary of State].

(d) Compliance or noncompliance by a domestic filing entity with this [act] is not a ground for imposing liability on its interest holders, beneficial owners, transferees, or governors for the debts, obligations, or other liabilities of the entity.

Comment

Identifying an individual as a responsible individual does not by itself confer on the individual any power, or impose any duties, with respect to the control or management of the conventional privately held entity. The individual must have, however, whatever powers or duties are the basis for the determination that the individual participates in the control or management of the entity in a manner that satisfies the definition of "responsible individual" in Section 2(19). Similarly, identifying an individual as a responsible individual does not by itself make the individual liable for any of the debts, obligations, or liabilities of the entity.

Subsection (d) makes clear that the failure of a domestic filing entity to comply with the requirements of this act is not a basis for piercing the veil of the entity. That subsection also makes clear that complying with this act is not a basis for imposing liability on the interest holders or governors of an entity on the basis of an alter ego theory.

SECTION 11. ADDRESSES. Whenever this [act] requires the provision of an address, the following information must be provided:

(1) a street address or rural route box number; and

(2) a mailing address, if different from the address under paragraph (1).

SECTION 12. PROHIBITION OF BEARER INTERESTS. A domestic filing entity may not issue a certificate in bearer form evidencing either a whole or fractional interest.

Legislative Note: *Enacting states may choose to omit this section and instead prohibit the issuance of bearer certificates in the individual organic laws for each type of entity listed in the definition of "domestic filing entity" in Section 2.*

Comment

In states that require legislation to be limited to a single subject, a question may arise as to whether this section deals with the same subject as the rest of the act. As discussed in the Prefatory Note, an important purpose of this act is to comply with FATF Recommendation 33, which requires both disclosure of ownership and control of entities and also the prohibition of bearer shares. When a purpose of the act is seen as complying with FATF Recommendation 33, the inclusion of this section should be within that single purpose. If a state nonetheless believes that including this section in the act may make the act unconstitutional, this section (or the alternative approach described in the Legislative Note) should be enacted by separate legislation.

SECTION 13. FEES.

Alternative A

(a) The [Secretary of State] shall collect the following fees when a document is delivered for filing under this [act]:

(1) initial entity information statement $___

(2) [amended entity information statement $___

(3) statement of change $___

(4)] application for reinstatement following administrative dissolution $___

Alternative B

(a) The [Secretary of State] shall adopt rules, in accordance with [the state's administrative procedure act] setting the fees for processing filings under this [act]. [The fees must be set at amounts such that the total amount of fees collected during a year is not less than

the annual costs incurred by the [Secretary of State] in administering this [act].]

End of Alternatives

[(b) The fees collected under subsection (a) shall be deposited into a restricted account within the [general fund]. Funds in the restricted account shall be used only to administer this [act].]

Legislative Notes:

Alternative A: With respect to optional paragraphs (a)(2) and (3), see the Legislative Note to Section 4(k).

Subsection (b): Subsection (b) is optional. If subsection (b) is omitted by a state and Alternative B for subsection (a) is used, the last sentence of subsection (a) should also be omitted. If subsection (b) is adopted by a state, it should be revised to conform to the state's practice in establishing special purpose funds.

SECTION 14. PROCESSING OF DOCUMENTS. The [Secretary of State] may not file a document if the document or any aspect of its delivery to the [Secretary of State] does not comply with this [act].

[SECTION 15. CONFIDENTIALITY.

(a) The initial entity information statement of a conventional privately held entity and any amended statement or statement of change must be kept confidential by the [Secretary of State] and may be disclosed only:

(1) to an authorized agent of a [state, local, or] federal law enforcement agency, [state agency,] federal agency, or committee or subcommittee of the United States Congress [or a state legislature] upon the request of the agent in a signed record;

(2) in response to a request made in a record by a federal agency on behalf of another country under:

(A) an international treaty, agreement, or convention; or

(B) 28 U.S.C. Section 1782; or

(3) to a person that is shown in the records of the [Secretary of State] as a current records contact, responsible individual, governor, or officer of the entity upon the request of the person in a signed record.

(b) A request pursuant to subsection (a)(1) or (2) must be kept confidential by the [Secretary of State] and may be disclosed only pursuant to a request under subsection (a)(1) or (2).]

Legislative Note: *With respect to subsection (a)(1), see the Legislative Note to Section 2(1).*

Comment

This section is optional because it implicates policy concerns beyond the scope of this act. Enactment or omission of this section will not affect the purpose of this act to provide law enforcement with important sources of information about conventional privately held entities. Some states may decide that it is appropriate to keep entity information statements confidential as permitted by this section. Other states may conclude that it is appropriate to make the contents of entity information statements publicly available.

This section does not require that the request of a law enforcement agency for access to an entity information statement must be an "appropriate request" as defined in Section 2. Any request in a record from an authorized law enforcement agent should be honored by the Secretary of State.

SECTION 16. TRANSITIONAL PROVISION.

(a) On or before the date provided in subsection (b), a domestic filing entity in existence on [the effective date of this act] shall deliver to the [Secretary of State] for filing:

(1) an amendment of its public organic record that contains the statement required by Section 3(a); and

(2) if it is a conventional privately held entity, an initial entity information statement.

(b) A domestic filing entity shall comply with subsection (a) by the earlier of:

(1) two years after the effective date of this act; or

(2) the date the entity first delivers any other document to the [Secretary of State] for filing under its organic law.

(c) The [Secretary of State], not earlier than one year after the effective date of this act, shall mail to every domestic filing entity that has not complied with subsection (a) a notice advising the entity of the requirement to comply with subsection (a). Failure by the [Secretary of State] to provide the notice to any entity, or failure by any person to receive the notice, shall not relieve an entity of the obligation to comply with subsection (a).

[(d) The amendment required by subsection (a)(1) need not be approved by the governors or interest holders of a domestic filing entity.]

Legislative Note: *Optional subsection (d) is intended to simplify the procedure for approving an amendment of the public organic record so that, for example, an amendment to the articles of incorporation of a business corporation to adopt the statement as to whether the corporation is a conventional privately held entity may be filed without action by the board of directors or shareholders. As with the similar optional provision in Section 3(c), an enacting state may choose to place that provision in the individual organic laws for each type of entity listed in the definition of "domestic filing entity" in Section 2 or may decide to vary the rule of subsection (d) for some types of entities by requiring, for example, approval by the governors.*

Comment

The intention of this act is that all entities will be in compliance within two years after the effective date of the act. Subsection (d) requires the Secretary of State to send out a reminder notice one year after the effective date to facilitate compliance. That notice or lack thereof does not modify or affect the requirement that all entities must comply with subsection (a) within two years after the effective date of the act. Failure of a domestic filing entity to comply with subsection (a) is grounds for administrative dissolution of the entity under Section 9.

SECTION 17. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this uniform act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 18. RELATION TO ELECTRONIC SIGNATURES IN GLOBAL AND

NATIONAL COMMERCE ACT. This [act] modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq., but does not modify, limit, or supersede Section 101(c) of that act, 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in Section 103(b) of that act, 15 U.S.C. Section 7003(b).

SECTION 19. REPEALS. The following acts and parts of acts are repealed:

(1)

Legislative Note: *If a state chooses to include optional Section 15, it must consider the relationship between that section and its open records or similar right to know law. The state could amend or repeal its open records or similar law to the extent it would require that an entity information statement or statement of change not be kept confidential as provided in Section 15, or Section 15 could provide that initial and amended entity information statements and statements of change are not subject to the state's open records or similar law.*

SECTION 20. EFFECTIVE DATE. This [act] takes effect on . . . .

SUMMARY OF THE UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT

All domestic filing entities are prohibited from issuing certificates of bearer shares and are required to include in their initial public organic document (IPOD) filed in the office of the Secretary of State (SOS) a statement declaring whether or not the entity is a "conventional privately-held entity entity" (CPE).

A CPE is an entity that has no more than 50 interest holders. In addition to that ownership test, there are several exceptions. The most significant are: (i) highly regulated business entities such as depository institutions, insurance companies, public utilities, securities and commodity brokers or dealers, and registered investment companies and investment advisors; (ii) a majority owned subsidiary of one of those highly regulated entities; (iii) entities in which an entity with more than 50 interest holders holds more than 25% of the outstanding interests; and (iv) tax exempt entities and private foundations that have filed an annual information return as an exempt organization with the Internal Revenue Service.

A CPE must file an initial information statement (EIS) in the SOS at the same time the CPE files its IPOD. The EIS must contain the name and business or residential address of the CPE's "record contact" (RC) and "responsible individual" (RI). Changes in the RC and RI must promptly be filed in the SOS. The RI and RC must sign the EIS or a statement of change and these signatures must be notarized. An enacting state can elect to have the EIS treated as a confidential document to be disclosed only to authorized agents of law enforcement agencies and other specified agencies and committees.

An entity in existence when the Act becomes effective has 2 years from the effective date to amend its IPOD to state whether or not it is a CPE and if it is, to file in the SOS the required information concerning its RI and RC.

The RC must seek to obtain specified information about the ownership and control of a CPE upon receiving a subpoena or summons from a federal law enforcement authority, federal agency or committee or subcommittee of the United States Congress or a request by a federal agency on behalf of another country ("appropriate request") (AR). States have the option of expanding the list of persons who can make ARs to include state and local law enforcement authorities, state agencies and state legislatures.

The CPE must provide the RC on a timely basis: the name and last known address of each interest holder and transferee; the name and address for each governor; any records regarding the process by which governors are elected or otherwise designated; the voting power of each interest holder; and the names of the individuals responsible for preparing this information. The CPE must include a certification, signed under penalties of perjury, that the information accurately reflects its current records.

Non-US entities that become interest holders or transferees of a CPE must provide the CPE with a certification, signed under penalties of perjury, stating the name and address of a RI. If a RI's principal residence is outside the US, the RI must provide a photo I.D. to the CPE. If the principal residence of a governor is outside the US, the governor must provide a photo I.D. to the CPE.

A RI is defined as an individual who, directly or indirectly, participates in the control or management of a CPE. A RI can be anyone associated with the CPE that meets the definition. He or she may, but need not, be a governor or have agency authority to bind the CPE to third parties. The purpose of having a RI is to have an individual who has detailed knowledge about a CPE that federal law enforcement officials and others who are entitled to make ARs can talk to about the entity and its operations.

A RC is liable for recklessness, intentional misconduct, or criminal conduct. A RI could be held liable for perjury if it turns out that he or she does not meet the qualifications of a RI and also may be held liable for refusal to comply with a AR subpoena or summons.

The enacting state's attorney general can bring a proceeding to dissolve a CPE for materially failing to provide the AR information requested by the RC or for issuing bearer certificates. The SOS must administratively dissolve an entity for failure to designate in its IPOD whether or not it is a CPE or if the SOS records do not show a current RC or RI for 60 consecutive days. Reinstatement is possible if the deficiencies are corrected.

Filing fees for the various documents required to be filed by the Act are authorized. The fees are required to be deposited in a restricted account that can only be used for administration of the Act.

The SOS can refuse to file any document required by the Act that does not comply with the Act. The SOS does not have any responsibility to verify any information submitted in any document filed pursuant to the Act.

COMPARISON OF UNIFORM LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT AND THE LEVIN-GRASSLEY-MCCASKILL INCORPORATION TRANSPARENCY AND LAW ENFORCEMENT ASSISTANCE ACT (S.569)

Uniform Act	**S.569**
Coverage: Conventional privately held entities (CPE) defined as an entity with no more than 50 interest holders (e.g., shareholders) that must file an initial public organic record to be formed as a legal entity.	**Coverage**: Initially only corporations and limited liability companies (LLCs); possibility of additional legislation to cover partnerships, trusts and other legal entities on the basis of a report by Comptroller General 1 year after enactment.
Entities otherwise qualifying as a CPE in which an entity with more than 50 interest holders holds more than 25% of the outstanding interests, entities that are generally classified as "regulated" industries such as banks and other depository institutions, trust companies, insurance companies, public utilities, and securities and commodities brokers or dealers, investment companies, investment advisors and tax exempt entities that have filed a return as an exempt organization or private foundation with the Internal Revenue Service are exempt.	Corporations and LLCs that have issued securities registered under Section 12 or that are required to file reports under Section 15 of the 1934 Securities Exchange Act, and entities formed by state or the United States are exempt. Other exemption must be jointly approved by the Attorney General and the Administration of the Department of Homeland Security.
Entities in existence at the time the Act is effective have 2 years to comply.	Only Corporations and LLCs formed after the effective date of the Act are subject to the Act.
Compliance. A filing entity must include in its initial public organic record a statement as to whether or not it is a CPE. A CPE must also file in the office of the Secretary of State an "entity information statement" (EIS) at the time the initial public organic document is filed. The EIS contains the name and address of a "responsible individual" (RI), defined as an individual who directly or indirectly participates in the control or management of the entity, and the name and address of a records contact (RC), defined as an individual whose	**Compliance.** Corporations and LLCs must file with the State (no office, e.g. Secretary of State is designated) during the "formation process" (an undefined term) a list of the names and current addresses of all "beneficial owners" and must update the list annually if the state requires an annual filing. If no annual report is required, then the CPE must file updates at the time there are any changes in the list. "Beneficial owner" is defined as "an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or

principal residence is in the United States who has access to and can produce on a timely basis ownership and control information about the entity.

The records that the CPE must provide the RC upon an appropriate request are:

(1) a list of the name and last known address of each interest holder and transferee and if the interest holder or transferee is an entity, the name of the state or country where it was formed;

(2) name and address of each governor (e.g., director);

(3) any records the CPE maintains regarding the process by which its governors are elected or otherwise designated;

(4) the voting power of each interest holder or a description of the manner in which each interest holder's voting power in the entity is determined;

(5) the names of the individuals responsible for preparing the information; and

(6) a certificate that the information accurately reflects the current records of the CPE.

Appropriate Request: The RC contacts the CPE for the above information upon service of a civil, criminal or administrative subpoena or summons from a federal law enforcement authority, federal agency or committee or subcommittee of the US Congress (states can expand the list to include state and local law enforcement authorities, state agencies and state legislatures); and a written request made by a federal agency

limited liability company that, as a practical matter, enables the individual directly or indirectly, to control, manage, or direct the corporation or limited liability company." An individual who controls an entity that is a record owner of a corporation or LLC is a beneficial owner of the corporation or LLC if that entity is an a position to exercise control of the corporation or LLC.

Appropriate Request: The state must provide the beneficial ownership information pursuant to a civil or criminal subpoena or summons from a state or federal agency or congressional committee or subcommittee; and a written request made by a federal agency on behalf of another country under an international treaty, agreement or convention, or 28 U.S.C. § 1782.

on behalf of another country under an international treaty, agreement, or convention or 28 U.S.C. § 1782.

Special Requirements for Non-US Entities/Citizen/Residents. A CPE must have in its records and deliver to the RC: (1) a certification from a non-US entity that is an interest holder or transferee stating the name and address of a RI for the Non-US entity; (2) a copy of a passport, driver's license, or other photo ID for any RI whose principal residence is outside the US; and (3) a copy of a passport, driver's license or other government-issued photo ID for each governor whose principal residence is outside the US at the time the individual becomes a governor.

Penalties and Sanctions

(1) the State's civil and criminal penalties for violation of a subpoena or summons.

(2) the entity and the person signing any document filed in the office of the Secretary of State that contains false information is subject to the state remedies for perjury.

(3) the RI and RC certify, under penalties of perjury that they meet the statutory qualifications for their positions; and the signature of both the RI and the RC in the EIS and any change in the RI or RC must be notarized.

(4) the person signing the certification that the records provided to the RC accurately reflect the current records of

Special Requirements for Non-US Entities/Citizen/Residents. Beneficial owners who are not US citizens or lawful permanent residents of the US must provide to the formation agent (defined as a "person, who, for compensation acts on behalf of another person to assist in the formation of a corporation or limited liability company") a copy of a page of the government-issued passport on which a photograph of the beneficial owner appears. The formation agent must certify that he or she has verified the name, address and identity of each of these beneficial owners and has obtained the required photo ID in the document containing the beneficial ownership information filed with the state. The formation agent must also provide proof of the verification and the photograph as part of the response to the subpoena or summons.

Penalties and Sanctions

In addition to any civil or criminal penalty that may be imposed by a state, any person who "knowingly" provides fake beneficial ownership information to a state or "intentionally" fails to provide beneficial ownership information (1) shall be liable to the United States for a civil penalty or not more than $10,000; and (2) may be fined under title 18, US Code, imprisoned for not more than 3 years, or both.

the entity is subject to penalties or perjury.

(5) the certificates filed by a non-US entity designating a RI must be signed under penalties of perjury; and the non-US entity cannot maintain any proceeding in the state with respect to its interest in the CPE until it files the certificate.

(6) an enacting state's attorney general can bring an action to dissolve a CPE for material failure to comply with an appropriate request for information or for issuing bearer certificates. The court can issue appropriate injunctions and appoint a receiver for the entity.

(7) The secretary of state must administratively dissolve an entity for (a) failure to comply with the requirement that the entity state whether or not it is a CPE in its initial public organic document filing; or (b) the secretary of state's records do not show a current RC or RI for a period of 60 consecutive days.

(8) The RC is liable for "recklessness, intentional misconduct; or criminal conduct" for failure to perform his or her responsibilities.

Confidentiality. An enacting state has the option of designating the EIS which names the RI and RC and any document indicating changes in the RI and RC confidential and available only to (1) law enforcement agencies and others who have the right to make an appropriate request, (2) the current RI or RC or (3) a governor or officer of the entity.

Bearer Interests. No filing entity can issue bearer equity interests in the entity.

Confidentiality. S.569 does not address the issue of confidentiality.

Bearer Interests. S.569 does not address bearer interests. The equivalent bill introduced in congress in 2008 did prohibit bearer

interests.

Funding. Filing fees for the various documents that must be filed pursuant to the Act are authorized and are required to be held in a restricted account for use only in the administration of the act.

Funding. The administration of the Department of Homeland Security may allocate DHS funds "to enable a State to obtain and manage" beneficial ownership information for corporations and LLCs, including funding to "assess, plan, develop, test, or implement relevant policies, procedures, or systems modifications."

Compliance Date. Each enacting state determines the effective date of the Act. All CPEs formed after the effective date must comply with the Act at the time of formation. Each one formed before the effective date must be in compliance no later than from 2 years after the effective date.

Compliance Date. Every state that receives DHS funding must "use an incorporation system" that meets the requirements of S.569 by no later than the beginning of fiscal year 2012.

Memorandum

TO: DRAFTING COMMITTEE ON RECORD OWNERS OF BUSINESSES ACT

FROM: Harry J. Haynsworth, Chair

DATE: March 4, 2008

RE: **Overview of Issues Involved in Determining Beneficial Ownership and Control of Interests in Business Entities**

Collection and maintenance of accurate business entity beneficial ownership and control information is a key component of the anti-money laundering business entity proposals that have been made by FATF, the U.S. Senate Homeland Security Committee Permanent Subcommittee on Investigations, the Department of Justice and various units within the Treasury Department dealing with money laundering issues. The purpose of this memorandum is to provide a brief overview of the issues and problems that will arise if business entities are required to collect and maintain complete beneficial ownership information in addition to record owner information, which is and always has been the recordkeeping standard in U.S. business entity laws.

Several samples of beneficial ownership statutes are attached as exhibits. All of them share certain common characteristics. First, all of them have as their objective determining who actually controls the entity. Second, they all contain an indirect as well as a direct ownership requirement.

1. Control

Control is generally defined as having a specified percentage of voting power sufficient to elect or remove the managers of a business entity. The percentage figure used in current statutes varies considerably. European Union Directive 2005/60/EC (Exhibit 1) uses 25% as does the United Kingdom definition (Exhibit 2). The most recent Department of Justice proposal (Exhibit 3) specifies 15%. I have seen some control definitions relating to publicly-traded corporations that use a 10% figure (*see* Exhibit 4). The general statutory rule for election of directors in a corporation is a majority (50%+) of the shares entitled to vote for directors. The general statutory rule in U.S. uniform unincorporated entity statutes is unanimity (100%), but this percentage can be changed by agreement of the partners (partnership) or members (limited

liability company).[1] Many state unincorporated entity statutes, however, use a majority member or percentage of capital vote as the default rule for the election of managers.

Two additional differences between corporate and unincorporated entity statutes complicate the control analysis. The first is that in U.S. unincorporated entities managerial and financial rights are severable. Therefore, it is possible to have 100% of the voting and managerial rights in one or more individuals and 100% of the financial rights in another person. This type of arrangement is fairly common in limited partnerships where there is typically a single general partner who manages the partnership and may have a right to some of the profits and limited partners who have few, if any, voting rights but are entitled to most of the profits and distributions.[2] Also, it is possible in an unincorporated entity for an owner to transfer all of the owner's rights to profits distributions to a third party (called a transferee), but to retain all of the voting and managerial rights.

A second difference is that in many U.S. unincorporated entities both voting rights and distribution rights are based on the relative percentage of each partner's or member's capital account (roughly capital contributions and undistributed profits), which can change on a daily basis, whereas in a corporation voting rights and distribution and equity rights are based on the relative percentage of stock ownership rights and change only where there is a transfer of the underlying stock. Thus in a partnership a partner might have 51% of the total capital accounts on day 1 and because of a disproportionate distribution made at the end of day 1 have only 49% of the capital on day 2 without any transfer of the underlying equity interest having taken place. If a 50% control test was the benchmark, the partner would be in control on day 1 but not on day 2.

The beneficial ownership proposals made by FATF, et al. all exclude publicly held companies[3] and seem to be aimed at determining "control" in companies that are classified as closely held, a term that is generally understood to mean a business entity having a small number of equity owners.[4] This being the case, it would seem that the "control" standard should be

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[1] The default unanimity rule in many unincorporated entity statutes raises an interesting "control" issue. Since each owner has in effect a veto power on all decisions, does that mean that all the owners have a controlling interest or that none of them have a controlling interest?

[2] It is possible to achieve basically the same result in a corporation by use of non-voting stock.

[3] As a general rule, a publicly held company is one whose ownership interests are widely held. A common standard would be a business entity whose ownership interests are listed on a stock exchange and/or are required to file reports with the SEC under the 1934 Securities and Exchange Act (300 or more shareholders). Publicly held companies constitute less than 1% of all U.S. business entities.

[4] There is no agreed-upon standard for the maximum number of owners in a closely held business. The maximum number of shareholders a corporation can have to qualify for taxation under Subchapter S of the Internal Revenue Code is 75 (when Subchapter S was first enacted approximately 50 years ago, the maximum was 10). The Subchapter S maximum would be on the high side of "closely held" definitions used in other statutes and in cases.

"more than 50%"[5] since that is the standard for election of directors/managers in U.S. corporation statutes and many U.S. unincorporated entity statutes. A 25% or less control standard makes more sense with respect to publicly held companies because the holders of large blocks of stock constituting much less than 50% in a publicly held corporation can in many cases be sufficient to control the outcome of director elections, etc.

2. Indirect Ownership

A second characteristic shared by all existing beneficial ownership statutes is that an individual is deemed to own not only the equity interest in a business entity that the individual owns directly but also equity interests that the individual owns indirectly. These indirect interests are added to the direct interests to determine the total interest the individual owns. The existing statutes generally contain two categories of indirect or constructive ownership. The first is family members and the second is constructive ownership based on ownership interests in trusts, estates, and various forms of business entities.

Under family member constructive ownership rules, stock (or any other ownership interest) is attributed to and from other family members. First, you have to determine which family members are included. How far up and down the family tree is appropriate, *i.e.*, are grandparents and grandchildren included? What about stepchildren and adopted children and spouses and the spouse's parents, etc.? Are individuals who live in the same home as the record owner but are not related by blood to the record owner considered as family for purposes of the constructive ownership rules?[6]

Several issues involving attribution to and from trusts, estates and various business entities must also be resolved. With respect to trusts, should there be a distinction between revocable and irrevocable trusts? What if an individual is the trustee of the trust but is not a beneficiary of the trust? How should contingent as opposed to vested interests be treated? What percentage of beneficial interest is necessary to trigger the attribution of the interest to an individual in order to determine control? Beneficial ownership interests in estates raise these same questions. With respect to attribution to and from various forms of business entities, you would have to specify in the statute what percentage ownership in the entity is necessary to trigger the attribution. Other issues that have to be determined are how are options and warrants and convertible securities treated? Is non-voting stock included in the calculation? In unincorporated entities, is the attribution based solely on voting rights, as is the case with a corporation, or should it be based on the partner's share of the capital account or both? Should S

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[5] Any statute or regulation defining control would have to state how options to acquire stock or other equity interests should be treated in determining the interest held by an individual. Whether only vested options should be counted would also have to be specified.

[6] A category not included in many of the existing beneficial ownership statutes is a relationship based not on family but on employment or a contractual relationship. For example, what if Osama Bin Laden's chauffeur is the record owner of stock in a corporation. Should that stock nevertheless be attributed to Osama Bin Laden because of the "control" he would have over the chauffeur?

corporations, which are corporations for state law purposes but are treated somewhat like partnerships for federal tax purposes, be treated the same as C corporations or as partnerships?

Once the constructive ownership rules have been established, then you have to apply them to a specific set of facts. The examples in Treas. Reg. 1-318-2 through -4, (*see* Exhibit 6), applying the constructive ownership rules in Section 318 of the Internal Revenue Code illustrate the complexities of making this determination.[7] For the most part, the determination of beneficial ownership must be made by accountants and lawyers for the entity and the owners of the entity for a particular purpose (*e.g.,* taxes, SEC reporting requirements) at a particular point in time. The calculation is not made on a day-to-day basis because so many events can occur (*e.g.,* death, bankruptcy, voluntary transfers) that can affect the beneficial ownership calculation.

Requiring a business entity to collect and maintain on an ongoing basis all the information necessary to make the beneficial ownership determination would be an enormous burden and a radical departure from existing recordkeeping requirements. Moreover, because of the complexities involved, there would undoubtedly be massive amounts of noncompliance, most of which would be unintentional. An entity would have to know all of an individual's family, as defined in the statute and the names of all the shareholders, partners and members of any entity that is an equity owner in the entity responsible for keeping the information. It would also need to know the name of the owners of any entity that was an owner of that second entity, and so on, as well as the beneficiaries of estates and trusts that have an ownership interest in any of the entities in the chain. It is quite common in the U.S. to have three or more tiers of entity ownership, which complicates the analysis. An even more difficult task would be the necessity to obtain knowledge of any changes in the various ownership interests in the chain, many of which it would have no notice of unless the transferor notifies the entity of the change because the transfer does not cause a change in the record owners of the entity. A change in beneficiaries of an estate or trust is an example. Another example would be a transfer by an owner of an entity that is an equity holder of the entity that is required to keep the beneficial ownership information current where the transfer does not result in a change in the name of that entity.[8]

Having individuals maintain beneficial owner records and file any changes in any company they own with the Secretary of State, which is Part B of the Department of Justice Proposal (Exhibit 3) does not solve any of the complex problems involved with having these records kept by business entities. The statute would still have to define what control and indirect ownership rules apply and inadvertent noncompliance would undoubtedly be even greater than if companies were required to keep the information. Moreover, requiring this information to be filed in the Secretary of State raises another level of additional complexity. The issues that

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[7] The examples show that in many cases more than one individual could be deemed to own a "controlling" interest because of the constructive ownership rules. *See* Treas. Reg. §1.318-2(b) where four family members each own directly 25% of the stock but constructively three of the four own 100% of the stock and the fourth owns 75% of the stock.

[8] Control can also be achieved by private contractual arrangements such as voting agreements, which the business entity might not know about because this type of arrangement does not involve a change of record ownership in the entity.

would have to be determined include the following: Would the individual have to file this information in the state of his or her residence or in the state where the business entity was formed (or in which it has become domesticated). Would these beneficial owner records be public or non-public? Who would have access to this information? Are the secretaries of state capable of keeping dual sets of easily retrievable records on companies, one set dealing with public information and a second dealing with non-public information? Who would have to bear the cost of this new recordkeeping requirement?[9]

Amending the record owner provisions in existing U.S. entity laws to enable law enforcement officials to trace ownership in an entity back to the individuals who ultimately control the entity (using whatever definition of control is deemed appropriate under applicable criminal statutes) will provide a workable system that will accomplish the legitimate needs of law enforcement officials to obtain beneficial ownership information without the imposition or the enormous costs and complexities of amending business entity laws to require companies to maintain accurate, current beneficial ownership records.

HJH/nr
Attach.

[9] If only individuals rather than entities are required to keep and/or file beneficial ownership records, this would require statutory law other than amendments to the state business entity statutes, which only deal with compliance issues applicable to an entity, the relationship between the owners and managers and the entity and the rights and liabilities of the entity to third parties.

EXHIBIT 1

(6) 'beneficial owner' means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25 % plus one share shall be deemed sufficient to meet this criterion;

(ii) the natural person(s) who otherwise exercises control over the management of a legal entity;

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or entity;

(ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;

(iii) the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity;

(7) 'trust and company service providers' means any natural or legal person which by way of business provides any of the following services to third parties:

(a) forming companies or other legal persons;

(b) acting as or arranging for another person to act as a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;

(c) providing a registered office, business address, correspondence or administrative address and other related services for a company, a partnership or any other legal person or arrangement;

(d) acting as or arranging for another person to act as a trustee of an express trust or a similar legal arrangement;

(e) acting as or arranging for another person to act as a nominee shareholder for another person other than a company listed on a regulated market that is subject to disclosure requirements in conformity with Community legislation or subject to equivalent international standards;

(8) 'politically exposed persons' means natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons;

(9) 'business relationship' means a business, professional or commercial relationship which is connected with the professional activities of the institutions and persons covered by this Directive and which is expected, at the time when the contact is established, to have an element of duration;

(10) 'shell bank' means a credit institution, or an institution engaged in equivalent activities, incorporated in a jurisdiction in which it has no physical presence, involving meaningful mind and management, and which is unaffiliated with a regulated financial group.

Article 4

1. Member States shall ensure that the provisions of this Directive are extended in whole or in part to professions and to categories of undertakings, other than the institutions and persons referred to in Article 2(1), which engage in activities which are particularly likely to be used for money laundering or terrorist financing purposes.

2. Where a Member State decides to extend the provisions of this Directive to professions and to categories of undertakings other than those referred to in Article 2(1), it shall inform the Commission thereof.

Article 5

The Member States may adopt or retain in force stricter provisions in the field covered by this Directive to prevent money laundering and terrorist financing.

Meaning of beneficial owner

(1) In the case of a body corporate, "beneficial owner" means any individual who—
(a) as respects any body other than a company whose securities are listed on a regulated market, ultimately owns or controls (whether through direct or indirect ownership or control, including through bearer share holdings) more than 25% of the shares or voting rights in the body; or
(b) as respects any body corporate, otherwise exercises control over the management of the body.

(2) In the case of a partnership (other than a limited liability partnership), "beneficial owner" means any individual who—
(a) ultimately is entitled to or controls (whether the entitlement or control is direct or indirect) more than a 25% share of the capital or profits of the partnership or more than 25% of the voting rights in the partnership; or
(b) otherwise exercises control over the management of the partnership.

(3) In the case of a trust, "beneficial owner" means—
(a) any individual who is entitled to a specified interest in at least 25% of the capital of the trust property;
(b) as respects any trust other than one which is set up or operates entirely for the benefit of individuals falling within sub-paragraph (a), the class of persons in whose main interest the trust is set up or operates;
(c) any individual who has control over the trust.

(4) In paragraph (3)—
"specified interest" means a vested interest which is—
(a) in possession or in remainder or reversion (or, in Scotland, in fee); and
(b) defeasible or indefeasible;
"control" means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to—
(a) dispose of, advance, lend, invest, pay or apply trust property;
(b) vary the trust;
(c) add or remove a person as a beneficiary or to or from a class of beneficiaries;
(d) appoint or remove trustees;
(e) direct, withhold consent to or veto the exercise of a power such as is mentioned in subparagraph (a), (b), (c) or (d).

(5) For the purposes of paragraph (3)—
(a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest in the capital of the trust property or which has control over the trust, the individual is to be regarded as entitled to the interest or having control over the trust; and
(b) an individual does not have control solely as a result of—
(i) his consent being required in accordance with section 32(1)(c) of the Trustee Act 1925 (power of advancement);
(ii) any discretion delegated to him under section 34 of the Pensions Act 1995 (power of investment and delegation);
(iii) the power to give a direction conferred on him by section 19(2) of the Trusts of Land and Appointment of Trustees Act 1996 (appointment and retirement of trustee at instance of beneficiaries); or
(iv) the power exercisable collectively at common law to vary or extinguish a trust where the beneficiaries under the trust are of full age and capacity and (taken together) absolutely entitled to the property subject to the trust (or, in Scotland, have a full and unqualified right to the fee).

(6) In the case of a legal entity or legal arrangement which does not fall within paragraph (1), (2) or (3), "beneficial owner" means—

EXHIBIT 3

DRAFT

The following is a draft summary of the basic requirements that the Department of Justice deems necessary to include in any legislation establishing minimum requirements for the collection of beneficial owner information by the States. The objective of any legislative change is to establish the collection and maintenance of accurate records which identify the true beneficial owner(s) of a business. The proposed legislation must include the following:

A. Establish a definition of "beneficial owner". There are a number of definitions worldwide for "beneficial owner", which may assist in drafting this important definition, including but not limited to the definitions contained in: 31 CFR 103.175; 17 CFR 240.13d-3; the United Kingdom Money Laundering Regulations, effective December 15, 2007;[1] and the European Union (Third Anti-Money Laundering Directive).[2] For purposes of this concept paper, the following definition of beneficial owner has been elected:

> "beneficial owner" means (a) a natural individual who has a level of control over, or entitlement to, the funds or assets of the corporation or limited liability company or partnership that, as a practical matter, enables such individual, directly or indirectly, to control, manage or direct such entity; or (b) a natural individual who owns more than 15% of the corporation or limited liability company or partnership. If a natural individual exercises such control or ownership over such corporation or limited liability company or partnership through another legal entity, such as a corporation, limited liability company or a partnership, the beneficial owners shall also identify each such legal entity being used by such individual to exercise control over the corporation or limited liability company or partnership and the majority beneficial owner of such entity.

B. Require the beneficial owner of a business:

> 1. to provide a State with adequate information regarding the identity and location of the beneficial owners, prior to the initial incorporation of the entity. The objective of this requirement is that the beneficial owners provide, and that the States collect the names, current addresses and photos of the natural individuals (rather than legal entities) who will be the true owners of the business that the States are being asked to form. For United States Citizens, the beneficial owner must provide either a copy of his or her driver's license or passport. All other beneficial owners must provide a copy of his or her passport.

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[1] Used by the United Kingdom in conjunction with the Financial Action Task Force (FATF), a leading international organization combating money laundering and terrorist financing.
[2] Used by the European Union in conjunction with the FATF.

2. to verify through signature, subject to criminal penalty, that the information provided to the States has been reviewed, and is true and accurate. This provision is to ensure that there are sufficient criminal penalties to allow either State or Federal authorities to prosecute individuals who provide false information to the State regarding beneficial owners.

3. to be subject to criminal and civil liability until the new beneficial owners' documents are provided to the incorporating State, when an existing business is sold or transferred to a new beneficial owner. This provision is to ensure that businesses maintain and update accurate records with the incorporating State. It is anticipated that there will be criminal penalties for the knowing failure to document the attempted transfer of beneficial ownership. Additionally, it is anticipated that—when the identity documents for a new beneficial owner has not been filed with the proper State authorities—any attempted transfer of ownership will be void, and civil liability for damages caused by the corporation after the date of the putative transfer will attach to the existing beneficial owners. This civil liability will include a rebuttable presumption that the corporate veil is pierced as to the beneficial owners.

C. Require the States to maintain the information regarding the beneficial owner. This provision is to ensure that law enforcement has access to the beneficial owner documents (including payment information for State taxes and fees) for a reasonable period of time (e.g. five to seven years) after the business has ceased to exist.

D. Allow State and Federal law enforcement access to the beneficial owners' information within a reasonable amount of time, after a written request has been made by a law enforcement agency. This provision is to ensure that State and Federal law enforcement have timely access to the beneficial owners' information so the agents may expeditiously use and benefit from the information when investigating criminal activity. State and Federal law enforcement must also have the ability to share beneficial owner records with their foreign law enforcement counterparts when requested within the context of their official duties. To address concerns of those States that do not wish to make the beneficial owners' information available to the general public, this provision will be limited so that only law enforcement will have access to the information in conjunction with a criminal investigation or request from a foreign counterpart.

E. Establish an exception to the above requirements for publicly traded companies, such as those traded on the New York Stock Exchange (e.g. Ford Motor Company); and for larger legitimate privately owned companies (e.g. Mars Incorporated). This provision is intended to avoid burdening both the States and the larger legitimate public and private corporations with the requirement to produce and maintain a large number of documents. These larger corporations have no history of facilitating criminal activity through the use of shell companies; and are already required, as are the corporations' subsidiary companies, to provide Federal and State regulators with significant amounts of information regarding the corporation's ownership and management.

EXHIBIT 4

Notes on Terms Used in Comments

In the Official Comments to subchapter F sections, the director who has a conflicting interest is for convenience referred to as "the director" or "*D*," and the corporation of which he or she is a director is referred to as "the corporation" or "*X* Co." A subsidiary of the corporation is referred to as "*S* Co." Another corporation dealing with *X* Co. is referred to as "*Y* Co."

§ 8.60 Subchapter Definitions

In this subchapter:

(1) "Director's conflicting interest transaction" means a transaction effected or proposed to be effected by the corporation (or by an entity controlled by the corporation)

(i) to which, at the relevant time, the director is a party; or

(ii) respecting which, at the relevant time, the director had knowledge and a material financial interest known to the director; or

(iii) respecting which, at the relevant time, the director knew that a related person was a party or had a material financial interest.

(2) "Control" (including the term "controlled by") means (i) having the power, directly or indirectly, to elect or remove a majority of the members of the board of directors or other governing body of an entity, whether through the ownership of voting shares or interests, by contract, or otherwise, or (ii) being subject to a majority of the risk of loss from the entity's activities or entitled to receive a majority of the entity's residual returns.

(3) "Relevant time" means (i) the time at which directors' action respecting the transaction is taken in compliance with section 8.62, or (ii) if the transaction is not brought before the board of directors of the corporation (or its committee) for action under section 8.62, at the time the corporation (or an entity controlled by the corporation) becomes legally obligated to consummate the transaction.

(4) "Material financial interest" means a financial interest in a transaction that would reasonably be expected to impair the objectivity of the director's judgment when participating in action on the authorization of the transaction.

(5) "Related person" means:

(i) the director's spouse;

(ii) a child, stepchild, grandchild, parent, step parent, grandparent, sibling, step sibling, half sibling, aunt, uncle, niece or nephew (or spouse of any thereof) of the director or of the director's spouse;

(iii) an individual living in the same home as the director;

(iv) an entity (other than the corporation or an entity controlled by the corporation) controlled by the director or any person specified above in this subdivision (5);

(v) a domestic or foreign (A) business or nonprofit corporation (other than the corporation or an entity controlled by the corporation) of which the director is a director, (B) unincorporated entity of which the director is a general partner or a member of the governing body, or (C) individual, trust or estate for whom or of which the director is a trustee, guardian, personal representative or like fiduciary; or

(vi) a person that is, or an entity that is controlled by, an employer of the director.

(6) "Fair to the corporation" means, for purposes of section 8.61(b)(3), that the transaction as a whole was beneficial to the corporation, taking into appropriate account whether it was (i) fair in terms of the director's dealings with the corporation, and (ii) comparable to what might have been obtainable in an arm's length transaction, given the consideration paid or received by the corporation.

(7) "Required disclosure" means disclosure of (i) the existence and nature of the director's conflicting interest, and (ii) all facts known to the director respecting the subject matter of the transaction that a director free of such conflicting interest would reasonably believe to be material in deciding whether to proceed with the transaction.

Official Comment

The definitions set forth in section 8.60 apply only to subchapter F's provisions and, except to the extent relevant to subchapter G, have no application elsewhere in the Model Act. (For the meaning and use of certain terms used below, such as "*D*," "*X* Co." and "*Y* Co.", see the Note at the end of the Introductory Comment of subchapter F.)

1. Director's Conflicting Interest Transaction

The definition of "director's conflicting interest transaction" in subdivision (1) is the core concept underlying subchapter F, demarcating the transactional area that lies within—and without—the scope of the subchapter's provisions. The definition operates preclusively in that, as used in section 8.61, it denies the power of a court to invalidate transactions or otherwise to remedy conduct that falls outside the statutory definition of "director's conflicting interest transaction" solely on the ground that the director has a conflict of interest in the transaction. (Nevertheless, as stated in the Introductory Comment, the transaction might be open to attack under rules of law concerning director misbehavior other than rules based solely on the existence of a conflict of interest transaction, as to which subchapter F is preclusive).

EXHIBIT 5

Chapter 80B
CORPORATE TAKEOVERS

For complete statutory history see Minnesota Statutes Annotated.

80B.01. Definitions

Subdivision 1. Scope. When used in sections 80B.01 to 80B.13, unless the context otherwise requires, the following words shall have the meanings herein ascribed to them.

Subd. 2. Affiliate. "Affiliate" of a person means any person controlling, controlled by, or under common control with such person.

Subd. 3. Associate. "Associate" of a person means any person acting jointly or in concert with such person for the purpose of acquiring, holding or disposing of, or exercising any voting rights attached to the equity securities of an issuer.

Subd. 4. Commissioner. "Commissioner" means the commissioner of commerce.

Subd. 5. Equity security. "Equity security" means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the commissioner shall deem to be of similar nature and consider necessary or appropriate, by such rules as the commissioner may prescribe in the public interest and for the protection of investors, to treat as an equity security.

Subd. 6. Offeror. "Offeror" means a person who makes or in any way participates in making a takeover offer. Offeror does not include any bank or broker-dealer loaning funds to an offeror in the ordinary course of its business, or any bank, broker-dealer, attorney, accountant, consultant, employee, or other person furnishing information or advice to or performing ministerial

duties for an offeror, and not otherwise participating in the takeover offer. When two or more persons act as a partnership, limited partnership, syndicate, or other group pursuant to any agreement, arrangement, relationship, understanding, or otherwise (whether or not in writing) for the purpose of acquiring, owning, or voting securities of a target company, all members of the partnership, syndicate, or other group constitute "a person."

Subd. 7. Offeree. "Offeree" means the beneficial owner, residing in Minnesota, of equity securities which an offeror offers to acquire in connection with a takeover offer.

Subd. 8. Takeover offer. "Takeover offer" means the offer to acquire any equity securities of a target company from a resident of this state pursuant to a tender offer or request or invitation for tenders, if after the acquisition of all securities acquired pursuant to the offer either (1) the offeror would be directly or indirectly a beneficial owner of more than ten percent of any class of the outstanding equity securities of the target company and was directly or indirectly the beneficial owner of less than ten percent of any class of the outstanding equity securities of the target company prior to the commencement of the offer; or (2) the beneficial ownership by the offeror of any class of the outstanding equity securities of the target company would be increased by more than ten percent of that class and the offeror was directly or indirectly the beneficial owner of ten percent or more of any class of the outstanding equity securities of the target company prior to the commencement of the offer. Takeover offer does not include:

(a) an offer in connection with the acquisition of a security which, together with all other acquisitions by the offeror of securities of the same class of equity securities of the issuer, would not result in the offeror having acquired more than two percent of this class during the preceding 12-month period;

(b) an offer by the issuer to acquire its own equity securities unless the offer is made during the pendency of a takeover offer by a person who is not an associate or affiliate of the issuer;

(c) an offer in which the target company is an insurance company subject to regulation by the commissioner, a financial institution regulated by the commissioner, or a public service utility subject to regulation by the public utilities commission.

Subd. 9. Target company. "Target company" means an issuer of publicly traded equity securities (a) which (1) has its principal place of business or its principal executive office located in this state, or (2) owns or controls assets located within this state which have a fair market value of at least $1,000,000, and (b) which (1) has more than ten percent of its beneficial or record equity securityholders resident in this state, (2) has more than ten percent of its equity securities owned beneficially or of record by residents in this state, or (3) has more than 1,000 beneficial or record equity securityholders resident in this state. For the purposes of this chapter, an equity security is publicly traded if a trading market exists for the security at the time the offeror makes a takeover offer for the security. A trading market exists if the security is traded on a

national securities exchange, whether or not registered pursuant to the Securities Exchange Act of 1934,[1] or the over-the-counter market.

Subd. 10. Beneficial owner. "Beneficial owner" includes, but is not limited to, any person who directly or indirectly through any contract, arrangement, understanding, relationship, or otherwise has or shares the power to vote or direct the voting of a security and/or the power to dispose of, or direct the disposition of, the security. "Beneficial ownership" includes, but is not limited to, the right, exercisable within 60 days, to acquire securities through the exercise of options, warrants, or rights or the conversion of convertible securities, or otherwise. The securities subject to these options, warrants, rights, or conversion privileges held by a person shall be deemed to be outstanding for the purpose of computing the percentage of outstanding securities of the class owned by this person, but shall not be deemed to be outstanding for the purpose of computing the percentage of the class owned by any other person. A person shall be deemed the beneficial owner of securities beneficially owned by any relative or spouse or relative of the spouse residing in the home of this person, any trust or estate in which this person owns ten percent or more of the total beneficial interest or serves as trustee or executor, any corporation or entity in which this person owns ten percent or more of the equity, and any affiliate or associate of this person.

Laws 1973, c. 331, § 1. Amended by Laws 1974, c. 406, §§ 94, 95; Laws 1980, c. 516, § 2; Laws 1984, c. 488, § 2; Laws 1985, 1st Sp., c. 5, §§ 1 to 3; Laws 1986, c. 444; Laws 1987, 1st Sp., c. 1, §§ 1, 2, eff. June 1, 1987.

[1] 15 U.S.C.A. §§ 77b to 77e, 77j, 77k, 77m, 77*o*, 77s, 78a to 78*o*, 78*o*–3, 78p to 78hh.

Historical and Statutory Notes

Laws 1984, c. 488, § 1, provides:

"Subdivision 1. Findings. The legislature finds that take-overs, particularly hostile take-overs:

"(1) exaggerate the tendency of many businesses to focus on short-term performance to the detriment of such long-term societal interests as increased research and development, improved productivity, and the modernization of physical plant and employee capabilities;

"(2) are often inconsistent with the economic interests of shareholders;

"(3) in many instances threaten the jobs and careers of Minnesota citizens and undermine the ethical foundations of companies, as when jobs are eliminated and career commitments to employees are breached or ignored;

"(4) often result in plant closings or consolidations that damage communities dependent on the jobs and taxes provided by these plants;

"(5) not infrequently wipe out long-standing customer/supplier relationships and the stability and continuity which these relationships provide throughout society;

"(6) frequently tie up billions of dollars of scarce capital that could be more effectively applied;

"(7) all too often stifle, and ultimately destroy, the entrepreneurial, innovative spirit of creative individuals in independent firms; and

"(8) are usually conducted in an atmosphere and pursuant to laws that do not provide a reasonable opportunity for affected parties to make informed decisions.

"Subd. 2. Purposes. The purposes of Laws 1984, chapter 488, sections 1 to 18 [amending §§ 80B.01, 80B.03, 80B.05, 80B.06 to 80B.08, 80B.10, 80B.12, 302A.011, 302A.449, 302A.671 and repealing § 80B.02] are to:

"(1) assure that the impacts of take-overs on all affected constituencies are identified and disclosed prior to the consummation of these transactions;

"(2) provide to shareholders both necessary information and the opportunity to thus cast fully informed votes on any take-over transactions;

"(3) encourage reasoned decision-making by assuring equal financial treatment of all share-

EXHIBIT 6

'86 Code

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person.

(b) CROSS REFERENCES.—

For provisions to which the rules contained in subsection (a) apply, see—

(1) section 302 (relating to redemption of stock);

(2) section 304 (relating to redemption by related corporations);

(3) section 306(b)(1)(A) (relating to disposition of section 306stock);

(4) section 338(h)(3) (defining purchase);

(5) section 382(l)(3) (relating to special limitations on net operating loss carryovers);

(6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts);

(7) section 958(b) (relating to constructive ownership rules with respect to controlled foreign corporations); and

(8) section 6038(e)(2) (relating to information with respect to certain foreign corporations).

.01 Amended by P.L. 109-135 (clerical amendment), P.L. 105-34 (technical amendment), P.L. 99-514 (conforming amendment), P.L. 98-369, P.L. 97-248 (technical amendment), P.L. 88-554, P.L. 87-834 and P.L. 86-779. For details see the Code Volumes.

.019 Committee Report on P.L. 99-514 (Tax Reform Act of 1986) is at ¶17,101.0125.

Committee Report on P.L. 98-369 (Deficit Reduction Act of 1984)

.02 Under present law, in applying attribution of ownership rules under section 318, a partnership is deemed to own proportionately stock owned by the partnership, and the partnership is deemed to own all the stock owned by the partners. In the case of a corporation, attribution to and from shareholders occur[s] only with respect to shareholders owning 50 percent or more in value of the corporation's stock.

The bill provides that the attribution of stock to or from an S corporation and its shareholders would apply in the same manner as if the S corporation (and its shareholders) were a partnership (with partners). Thus, attribution will occur to and from shareholders owning less than 50 percent of the corporation's stock.—**House Committee Report.**

.03 Committee Report on P.L. 88-554 (1964) is at 1964-2 CB 705, 707.

.035 Committee Report on P.L. 87-834 (Revenue Act of 1962) is at 1962-3 CB 405.

.04 Committee Report on P.L. 86-779 (1960) was reproduced at 624 CCH ¶4099A.20.

.10 Committee Reports on 1954 Code Sec. 318 as originally enacted were reproduced at 562 CCH ¶2388.10.

• *Regulations*

[¶15,901] §1.318-1. **Constructive ownership of stock; introduction.**—(a) For the purposes of certain provisions of chapter 1 of the Code, section 318(a) provides that stock owned by a taxpayer includes stock constructively owned by such taxpayer under the rules set forth in such section. An individual is considered to own the stock owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and by or for his children, grandchildren, and parents. Under section 318(a)(2) and (3), constructive ownership rules are established for partnerships and partners, estates and beneficiaries, trusts and beneficiaries, and corporations and stockholders. If any person has an option to acquire stock, such stock is considered as owned by such person. The term "option" includes an option to acquire such an option and each of a series of such options.

(b) In applying section 318(a) to determine the stock ownership of any person for any one purpose.—(1) A corporation shall not be considered to own its own stock by reason of section 318(a)(3)(C);

(2) In any case in which an amount of stock owned by any person may be included in the computation more than one time, such stock shall be included only once, in the manner in which it will impute to the person concerned the largest total stock ownership; and

(3) In determining the 50-percent requirement of section 318(a)(2)(C) and (3)(C) all of the stock owned actually and constructively by the person concerned shall be aggregated. [Reg. § 1.318-1.]

.01 Historical Comment: Proposed 12/11/54. Adopted 12/2/55 by T.D. 6152. Amended 4/25/62 by T.D. 6598, 11/30/62 by T.D. 6621, and 8/22/68 by T.D. 6969.

• *Regulations*

⋙→ Caution: Reg. §1.318-2 does not reflect recent law changes. For details, see ¶15,902.01.

[¶15,902] § 1.318-2. **Application of general rules.**—(a) The application of paragraph (b) of § 1.318-1 may be illustrated by the following examples:

Example (1). H, an individual owns all of the stock of Corporation A. Corporation A is not considered to own the stock owned by H in Corporation A.

Example (2). H, an individual, his wife, W, and his son, S, each own one-third of the stock of the Green Corporation. For purposes of determining the amount of stock owned by H, W, or S for the purpose of section 318(a)(2)(C) and (3)(C), the amount of stock held by the other members of the family shall be added pursuant to paragraph (b)(3) of § 1.318-1 in applying the 50-percent requirement of such section. H, W, or S, as the case may be, is for this purpose deemed to own 100 percent of the stock of the Green Corporation.

(b) The application of section 318(a)(1), relating to members of a family, may be illustrated by the following example:

Example. An individual, H, his wife, W, his son, S, and his grandson (S's son), G, own the 100 outstanding shares of stock of a corporation, each owning 25 shares. H, W, and S are each considered as owning 100 shares. G is considered as owning only 50 shares, that is, his own and his father's.

(c) The application of section 318(a)(2) and (3), relating to partnerships, trusts and corporations, may be illustrated by the following examples:

Example (1). A, an individual, has a 50 percent interest in a partnership. The partnership owns 50 of the 100 outstanding shares of stock of a corporation, the remaining 50 shares being owned by A. The partnership is considered as owning 100 shares. A is considered as owning 75 shares.

Example (2). A testamentary trust owns 25 of the outstanding 100 shares of stock of a corporation. A, an individual, who holds a vested remainder in the trust having a value, computed actuarially equal to 4 percent of the value of the trust property, owns the remaining 75 shares. Since the interest of A in the trust is a vested interest rather than a contingent interest (whether or not remote), the trust is considered as owning 100 shares. A is considered as owning 76 shares.

Example (3). The facts are the same as in (2), above, except that A's interest in the trust is a contingent remainder. A is considered as owning 76 shares. However, since A's interest in the trust is a remote contingent interest, the trust is not considered as owning any of the shares owned by A.

Example (4). A and B, unrelated individuals, own 70 percent and 30 percent, respectively, in value of the stock of Corporation M. Corporation M owns 50 of the 100 outstanding shares of stock of Corporation O, the remaining 50 shares being owned by A. Corporation M is considered as owning 100 shares of Corporation O, and A is considered as owning 85 shares.

Example (5). A and B, unrelated individuals, own 70 percent and 30 percent, respectively, of the stock of corporation M. A, B, and corporation M all own stock of corporation O. Since B owns less than 50 percent in value of the stock of corporation M, neither B nor corporation M constructively owns the stock of corporation O owned by the other. However, for purposes of certain sections of the Code, such as sections 304 and 856(d), the 50-percent limitation of section 318(a)(2)(C) and (3)(C) is disregarded or is

»»→ Caution: Reg. §1.318-2 does not reflect recent law changes. For details, see ¶15,902.01.

reduced to less than 30 percent. For such purposes, B constructively owns his proportionate share of the stock of corporation O owned directly by corporation M, and corporation M constructively owns the stock of corporation O owned by B. [Reg. §1.318-2.]

.01 **Historical Comment:** Proposed 12/11/54. Adopted 12/2/55 by T.D. 6152. Amended 8/22/68 by T.D. 6969. [Reg. §1.318-2 does not reflect P.L. 98-369 (1984). See ¶15,900.02 and ¶15,906.035.]

• *Regulations*

[¶15,903] §1.318-3. **Estates, trusts, and options.**—(a) For the purpose of applying section 318(a), relating to estates, property of a decedent shall be considered as owned by his estate if such property is subject to administration by the executor or administrator for the purpose of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent's heirs, legatees or devisees immediately upon death. The term "beneficiary" includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution. A person shall no longer be considered a beneficiary of an estate when all the property to which he is entitled has been received by him, when he no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote possibility that it will be necessary for the estate to seek the return of property or to seek payment from him by contribution or otherwise to satisfy claims against the estate or expenses of administration. When, pursuant to the preceding sentence, a person ceases to be a beneficiary, stock owned by him shall not thereafter be considered owned by the estate, and stock owned by the estate shall not thereafter be considered owned by him. The application of section 318(a) relating to estates may be illustrated by the following examples:

Example (1). (a) A decedent's estate owns 50 of the 100 outstanding shares of stock of corporation X. The remaining shares are owned by three unrelated individuals, A, B, and C, who together own the entire interest in the estate. A owns 12 shares of stock of corporation X directly and is entitled to 50 percent of the estate. B owns 18 shares directly and has a life estate in the remaining 50 percent of the estate. C owns 20 shares directly and also owns the remainder interest after B's life estate.

(b) If section 318(a)(5)(C) applies (see paragraph (c)(3) of §1.318-4), the stock of corporation X is considered to be owned as follows: the estate is considered as owning 80 shares, 50 shares directly, 12 shares constructively through A, and 18 shares constructively through B; A is considered as owning 37 shares, 12 shares directly, and 25 shares constructively (50 percent of the 50 shares owned directly by the estate); B is considered as owning 43 shares, 18 shares directly and 25 shares constructively (50 percent of the 50 shares owned directly by the estate); C is considered as owning 20 shares directly and no shares constructively. C is not considered a beneficiary of the estate under section 318(a) since he has no direct present interest in the property held by the estate nor in the income produced by such property.

(c) If section 318(a)(5)(C) does not apply, A is considered as owning nine additional shares (50 percent of the 18 shares owned constuctively by the estate through B), and B is considered as owning six additional shares (50 percent of the 12 shares owned constructively by the estate through A).

Example (2). Under the will of A, Blackacre is left to B for life, remainder to C, an unrelated individual. The residue of the estate consisting of stock of a corporation is left to D. B and D are beneficiaries of the estate under section 318(a). C is not considered a beneficiary since he has no direct present interest in Blackacre nor in the income produced by such property. The stock owned by the estate is considered as owned proportionately by B and D.

(b) For the purpose of section 318(a)(2)(B) stock owned by a trust will be considered as being owned by its beneficiaries only to the extent of the interest of such

beneficiaries in the trust. Accordingly, the interest of income beneficiaries, remainder beneficiaries, and other beneficiaries will be computed on an actuarial basis. Thus, if a trust owns 100 percent of the stock of Corporation A, and if, on an actuarial basis, W's life interest in the trust is 15 percent, Y's life interest is 25 percent, and Z's remainder interest is 60 percent, under this provision W will be considered to be the owner of 15 percent of the stock of Corporation A, Y will be considered to be the owner of 25 percent of such stock, and Z will be considered to be the owner of 60 percent of such stock. The factors and methods prescribed in §20.2031-7 of this chapter (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes shall be used in determining a beneficiary's actuarial interest in a trust for purposes of this section. See §20.2031-7 of this chapter (Estate Tax Regulations) for examples illustrating the use of these factors and methods. [Reg. §20.2031-7 of this chapter is reproduced at ¶15,904.—CCH.]

(c) The application of section 318(a) relating to options may be illustrated by the following example:

Example. A and B, unrelated individuals, own all of the 100 outstanding shares of stock of a corporation, each owning 50 shares. A has an option to acquire 25 of B's shares and has an option to acquire a further option to acquire the remaining 25 of B's shares. A is considered as owning the entire 100 shares of stock of the corporation. [Reg. §1.318-3.]

.01 Historical Comment: Proposed 12/11/54. Adopted 12/2/55 by T.D. 6152. Amended 5/5/60 by T.D. 6462 and 8/22/68 by T.D. 6969.

• *Estate Tax Regulations*

⋙→ Note: Reg. §20.2031-7, below, and Reg. §20.2031-7A, below, are estate tax Regulations, reproduced here in connection with the references in income tax Reg. §1.318-3(b), above.

[¶15,904] §20.2031-7. **Valuation of annuities, interests for life or term of years, and remainder or reversionary interests.**—(a) *In general.*—Except as otherwise provided in paragraph (b) of this section and §20.7520-3(b) (pertaining to certain limitations on the use of prescribed tables), the fair market value of annuities, life estates, terms of years, remainders, and reversionary interests for estates of decedents is the present value of such interests, determined under paragraph (d) of this section. The regulations in this and in related sections provide tables with standard actuarial factors and examples that illustrate how to use the tables to compute the present value of ordinary annuity, life, and remainder interests in property. These sections also refer to standard and special actuarial factors that may be necessary to compute the present value of similar interests in more unusual fact situations.

(b) *Commercial annuities and insurance contracts.*—The value of annuities issued by companies regularly engaged in their sale, and of insurance policies on the lives of persons other than the decedent, is determined under §20.2031-8. See §20.2042-1 with respect to insurance policies on the decedent's life.

(c) *Actuarial valuations.*—The present value of annuities, life estates, terms of years, remainders, and reversions for estates of decedents for which the valuation date of the gross estate is after April 30, 1999, is determined under paragraph (d) of this section. The present value of annuities, life estates, terms of years, remainders, and reversions for estates of decedents for which the valuation date of the gross estate is before May 1, 1999, is determined under the following sections:

Valuation Dates		
After	*Before*	*Applicable Regulations*
	01-01-52	20.2031-7A(a)
12-31-51	01-01-71	20.2031-7A(b)