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Statutory Recordkeeping and Inspection Requirements for Corporations and LLCs

WHITE PAPER

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STATUTORY RECORDKEEPING AND INSPECTION REQUIREMENTS FOR CORPORATIONS AND LLCS

Virtually every state requires a statutory entity, such as a corporation or limited liability company (LLC), to maintain certain records related to that entity. Records that must be retained include organizational and ownership documents, as well as documents related to the functioning and financing of the business. However, the requirements vary widely from state to state.

ALMOST EVERY STATE IMPOSES RECORDKEEPING REQUIREMENTS

In exchange for the privilege of doing business within a state, a statutory entity, such as a corporation or a limited liability company (LLC), must comply with a wide variety of state requirements. Among them is the requirement that the entity maintain a statutorily prescribed set of records related to that entity.

Practice Pointer: *Delaware is one of the few states that does not statutorily require the keeping of books and records. This is an example of the pro-business climate that inspires many entities to choose Delaware as their formation state.*

Each state's business entity statutes specify the recordkeeping requirements for corporations and limited liability companies. As is generally the case in state law, there is wide variation regarding which documents must be kept. While most states impose more extensive recordkeeping requirements on entities formed in that state, states may also require that foreign entities maintain records of ownership at the entity's home office or at its registered or transfer office. Therefore, it is essential to be aware of the rules—not only for the entity's home state but for each state in which it operates.

LIMITED LIABILITY COMPANIES CAN BE SUBJECT TO EXTENSIVE RECORDKEEPING REQUIREMENTS

It is often said that one key benefit to operating as a limited liability company is the lack of state-required documents. While it is true that a corporation must comply with many more operational formalities—such as holding and documenting shareholders' and directors' meetings—it is not true that operating as an LLC means that there are no required documents. In fact, many states impose surprisingly invasive requirements.

EACH STATE'S BUSINESS ENTITY STATUTES SPECIFY THE RECORDKEEPING REQUIREMENTS FOR CORPORATIONS AND LIMITED LIABILITY COMPANIES. AS IS GENERALLY THE CASE IN STATE LAW, THERE IS WIDE VARIATION REGARDING WHICH DOCUMENTS MUST BE KEPT.

For example, Ohio requires that an LLC keep at its principal office (even if the office is outside of the state) an extensive array of documents including: 1) a current list of each member's full name, the amount of cash, property or services contributed by each member, and when the contributions were made or scheduled to be made; 2) the articles of organization and all amendments; 3) the operating agreement and all amendments; 4) the three most recent annual financial statements; and 5) the three most recent federal, state and local tax returns. Ohio is far from alone. Well over half of the states require that LLCs retain current and prior year's tax returns, and few impose time periods of more than three years.

In general, LLCs are required to keep the same type of information as a corporation regarding the ownership of the entity, but are often required to maintain financial and tax information that is not required of domestic corporations.

WHAT RECORDS MUST BE KEPT?

While there are differences from state to state, statutorily mandated records fall into these major categories:

- ***Organizational documents.*** These documents include a copy of the articles of incorporation for a corporation and the articles of organization for an LLC. Nearly all states also require that the entity keep copies of all amendments to, or restatements of, those articles.

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IN GENERAL, THE REQUIRED RECORDS MUST BE STORED AT THE ENTITY'S PRINCIPAL PLACE OF BUSINESS. SOME STATES REQUIRE A FOREIGN ENTITY TO RETAIN COPIES OF SOME OR ALL OF THESE DOCUMENTS AT ITS TRANSFER AGENT'S PLACE OF BUSINESS OR REGISTERED OFFICE WITHIN THE STATE.

- ***Ownership documents.*** These include shareholder lists for corporations and member lists for LLCs. Most states require disclosure of the full name and address of each shareholder or member.

- ***Operating documents.*** These contain the entity's internal rules. For corporations, the main operating document is the by-laws. For LLCs, the operating agreement serves this purpose. A significant number of states require that the LLC keep a copy of its operating agreement at its principal place of business. The bulk of the states also mandate keeping a copy of all amendments made to the operating documents.

- ***Capital contribution documents.*** A significant number of states require LLCs to keep records of the amount of cash contributed by each member, the agreed value of other property or services contributed by each member and any additional contributions that will be required of each member. Most states require corporations to retain documents regarding the type of stock and number of shares owned by each shareholder.

- ***Records of actions taken.*** Corporations are generally required to keep a record of each shareholder and director meeting, as well as the resolutions adopted or actions taken. When actions are taken pursuant to consent in lieu of a meeting, documentation supporting that action must be produced and retained.

Practice Pointer: *Even when documentation of actions, such as establishing bonus compensation plans or purchasing assets, is not required by statute, this evidence is often necessary to support the tax treatment of items. Thus, it is a best practice to keep any records that would be necessary to support an item included on the entity's tax return or on its financial statements.*

- ***Tax and financial records.*** A significant number of states require that some type of tax or financial records be maintained. For LLCs, the requirement is frequently the three most recent tax returns. For corporations, the most recent annual report or financial statement will usually suffice.

In general, the required records must be stored at the entity's principal place of business. Some states require a foreign entity to retain copies of some or all of these documents at its transfer agent's place of business or registered office within the state.

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Practice Pointer: *In the age of digital information, some states have adopted rules regarding electronic records. In general, these states provide that digital records are acceptable provided that the information can be converted to readable, hard copy within a reasonable period of time.*

REQUIREMENTS GOVERNING THE INSPECTION OF RECORDS

Under certain circumstances, some types of statutorily required records must be made available for inspection by the entity's owners.

Practice Pointer: *The failure to honor an inspection request can trigger penalties. Some states impose penalties if the entity does not retain the required records or does not permit inspection of the records. These penalties can be quite steep and may include the imposition of monetary penalties or the imposition of attorney's fees in the event of a lawsuit.*

UNDER CERTAIN CIRCUM-STANCES, SOME TYPES OF STATUTORILY REQUIRED RECORDS MUST BE MADE AVAILABLE FOR INSPECTION BY THE ENTITY'S OWNERS.

Limited Liability Companies. Many states provide that an LLC must allow a member to inspect the statutorily required records. In general, there must be:

- A written demand made
- A purpose related to the member's LLC ownership
- A request for a time of inspection that is "reasonable." Some statutes specify that the inspection must occur during normal working hours.

Corporations. Corporations generally must honor two types of inspection requests. The first type is similar to that discussed above for the LLC. In most states, a shareholder can make a written request to examine the statutorily required documents provided there is a proper purpose for making the request. (Some states allow a corporate director to make such a request.) A proper purpose is one related to the shareholder's interests as a shareholder and includes determining the value of his or her shares, or investigating specific acts of mismanagement.

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In addition, corporations are required to provide a shareholder list in advance of the corporation's annual meeting. How far in advance varies from state to state, but in most cases it is within a "reasonable" time. A corporate shareholder has the right to obtain this list, which usually must include the names and addresses of all the shareholders and the number and type of shares held.

DOCUMENTATION OF INSPECTION REQUESTS

Nearly all statutes that authorize inspection of books and records require that the request be in writing and the time of inspection be reasonable. "Reasonable" is often construed to mean "during normal business hours." Most often, the right to inspect includes the right to make copies.

The statutes do not mandate a specific form for making a request or documenting compliance. Nevertheless, best practices indicate that the entity compliance officer should put in place standard, documented policies regarding how an information request will be handled.

BEST PRACTICES INDICATE THAT THE ENTITY COMPLIANCE OFFICER SHOULD PUT IN PLACE STANDARD, DOCUMENTED POLICIES REGARDING HOW AN INFORMATION REQUEST WILL BE HANDLED.

The policy should be reviewed periodically to ensure that it is current. It should cover the following areas:

- ***Contents of request.*** The request must be in writing. (Legal counsel should be consulted for guidance as to whether an email request satisfies the "written form" requirement, as the rules may vary from state to state and may change over time.)

  The request must contain: the requestor's full name and address; the requestor's membership interest in the entity; the specific documents that the request covers, or a statement that the request is for all statutorily required documents; the time and date proposed for the inspection; and the reason for the request in sufficient detail to allow a determination to be made whether the purpose is permissible.

- ***Authorization of request.*** When a request is received (other than for a shareholder list prior to the annual meeting), the legal department's authorization to allow the inspection should be obtained before the inspection. This step will ensure that the request is for a proper motive.

- ***Documentation of compliance.*** Given that nearly all states impose penalties for failure to comply with inspection requests, it is important to document the entity's compliance. To this end, a paper or digital copy of the written request for inspection should be maintained in a central location.

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At the time of the inspection, the following should also be documented: the date, time and place of the inspection; the name of the person(s) inspecting the documents; the documents inspected; the documents copied; and the person supervising the inspection. This record should be signed by the person inspecting the documents, as well as by the individual supervising the inspection.

CONCLUSION

Every statutory entity is obligated to retain some records, although the nature of the requirement will vary from state to state. The entity's compliance officers should be aware of what records are required for each state in which the entity does business. Moreover, many states provide entity owners with a right to inspect statutorily mandated records. Compliance officers should be proactive in establishing policies and processes to comply with inspection demands smoothly and document compliance effectively. By doing so, the entity will avoid penalties for failure to comply with statutory record retention and record inspection requirements.

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