



SEMINAR REFERENCE BOOK - 2018

Business Compliance Basics

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2018

Seminar Reference Book

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I. Introduction

Every business entity, regardless of its organizational form, its size, who owns it, what business it is in, or how successful it is, is subject to at least some compliance requirements. Some business entities are subject to a great many compliance requirements.

The topic of compliance is heavily talked about, debated, and regulated. A comprehensive discussion of compliance is beyond the scope of this reference book. Instead, we will look at some of the many requirements facing corporations and LLCs, focusing mainly on those imposed by state corporation and LLC statutes and other laws with filing or reporting requirements.

In discussing these requirements, references may be made to the model and uniform statutes, as they are generally representative of the state statutes, and to Delaware law, because of its position as a popular and important formation state. However, before taking any actions related to compliance it is necessary to research and follow the requirements of the specific governing laws.

II. What We Will Cover

Compliance can be defined in a number of ways. For the purposes of this reference book, when we talk about compliance we mean the state, federal, and local statutes, rules and regulations, court decisions, and internal business entity documents that require a business entity to take some affirmative action and that impose penalties on the business entity if it fails to take that action.

There are a wide number and variety of compliance requirements. However, our discussion will focus on the following:

Corporations and LLCs – Although limited partnerships, general partnerships, and other forms of business entities have compliance requirements, corporations and LLCs are the most popular forms and our discussion will be limited to them.

State business corporation and LLC statutes – These impose compliance obligations on the widest range of companies. It generally does not matter what type of business the corporation or LLC is in or what activities it is undertaking. As long as the corporation or LLC is a domestic or qualified foreign entity it will have to comply. Most other compliance statutes regulate only certain kinds of industries or activities.

Filing and reporting requirements – Having to file documents or reports with a state or federal agency is a common compliance requirement. A failure to comply can lead to consequences ranging from small fines to the company being involuntarily dissolved.

III. Compliance Requirements of State Corporation and LLC Statutes

Corporation and LLC statutes are considered “enabling” acts – that is, statutes which give management a choice of actions to take, as opposed to “regulatory” acts – which require entities to take certain actions. Nevertheless, corporation and LLC statutes do contain compliance requirements, including those detailed below.

1. The Annual Report Filing Requirement

A. Requirement in General - Corporations and LLCs are generally required to file an information report with the business entity filing office of their formation state and of every foreign state in which they are qualified to do business.

This is typically referred to as an Annual Report requirement because in most cases the information report must be filed every year and the document filed is called an Annual Report. However, there are a few states where the filing is not due annually and where the form is called something other than an Annual Report.

B. Report’s Contents - The information required to be set forth in an Annual Report differs from state to state but generally includes the following:

1. The business entity’s legal name
2. In the case of a foreign business entity, the fictitious name it qualified under, if any
3. The principal office address in the state, if any
4. The principal office address wherever located
5. The registered agent’s name
6. The registered office address
7. The names and business addresses of directors and officers (for a corporation) or managers and members (for an LLC)

C. Filing Requirements - Some Annual Reports are due on a fixed date. Other states have a due date based on the business entity's anniversary of formation or qualification. In many states the Annual Report may be delivered to the filing office in paper form or electronically. However, a growing number of states will only accept Annual Reports that are filed electronically.

D. Penalties for Non-compliance - Penalties are imposed for a failure to comply with the Annual Report requirement. If the report is not filed by the due date a late fee will be charged. A delinquent business entity also falls out of good standing. This means the state will not issue a certificate of good standing or file documents for the business entity.

Continued non-compliance can result in administrative dissolution or revocation. An administratively dissolved corporation or LLC is prohibited from conducting any business other than that necessary to wind up and liquidate. The effect of administrative revocation is that the corporation or LLC loses the authority to transact business in a foreign state. Furthermore, doing business while administratively dissolved or revoked can bring about additional penalties and personal liability for those acting on the entity's behalf.

2. The Registered Agent Requirement

A. Requirement in General - In order to facilitate service of process on domestic and qualified foreign corporations and LLCs the states require the appointment and maintenance of a registered agent and registered office.

This requirement has two parts: (1) the corporation or LLC must have an agent, located in the state, who is authorized to receive process on its behalf, and (2) the corporation or LLC must notify the filing office if its registered agent or registered office changes.

B. Penalties for Non-compliance - A penalty for failing to comply that is found in many statutes is administrative dissolution or revocation. For example, the Model Business Corporation Act (MBCA) provides that the Secretary of State may proceed to administratively dissolve a domestic corporation or revoke a foreign corporation that is

without a registered agent or office for 60 days or more or that does not notify the Secretary of State within 60 days that its registered agent or office has been changed.

3. Qualification Requirement for Foreign Corporations and LLCs

- A. Requirement in General** - Every state's corporation law and LLC act requires foreign corporations and LLCs to qualify before doing business in the state.

Few laws define the phrase "doing business in the state". Most statutes do, however, contain a list of activities that do not constitute doing business, which generally includes maintaining or defending a proceeding; carrying on activities concerning internal affairs; maintaining bank accounts; conducting an isolated transaction, and transacting business in interstate commerce.

While these statutory provisions provide some guidance, the determination of whether a corporation or LLC is doing business in a state sufficient to require qualification will generally require an analysis not only of the governing statute, but of case law. Whether a foreign corporation or LLC must qualify is decided on a case-by-case basis.

- B. Qualification Procedure** - Corporations and LLCs become qualified to do business in a foreign state by filing a document, generally called an application for certificate of authority, with the state filing office. A certificate of existence from the home state generally has to accompany the application.
- C. Penalties for Non-compliance** - Corporations and LLCs transacting business in a foreign state may not maintain a proceeding in any court of that state until they have qualified. Many states also impose monetary penalties on foreign corporations and LLCs that do business before qualifying. These penalties vary significantly from state to state and can range from a few hundred dollars per year to several thousand dollars per year. Some states penalize individuals who act on behalf of the unauthorized entities.

4. Post-Qualification Filings

Qualified foreign corporations and LLCs are required to notify the state filing offices of certain changes affecting the entity. For example, if the corporation or LLC changes its name in its home jurisdiction, it will be required to notify the foreign state. This is generally done by filing an application for an amended certificate of authority or a statement of change of name, along with proof that the change was made in the home state.

Corporation and LLC statutes will also frequently require the filing of documents to notify the state if the foreign entity was merged out of existence, converted to another entity type, or dissolved in its home state.

A failure to file a required document may subject the foreign corporation or LLC to a statutory fine.

5. Transactional Filing Requirements

The successful completion of formations, qualifications, name changes, mergers, dissolutions, and other transactions requires compliance with statutes, regulations, and administrative policies dealing with the preparation and filing of documents with the state filing office.

Non-compliance can result in delaying a transaction, unanticipated tax or reporting requirements, and even monetary penalties being imposed.

One of the keys to ensuring compliance with transactional filing requirements is to be prepared. A useful exercise is to ask the following questions and obtain the answers before attempting to make a filing.

1. What is the proper filing office?
2. What is the name of the document to be filed?
3. What is the required content of the document?
4. Who can sign the document?
5. Are supporting documents required?
6. What are the filing fees?

7. What methods of delivery may be used?
8. Is the filing entity in good standing?
9. What are the filing office's administrative policies?
10. Does the filing have to be made by a certain date?

6. Franchise Tax Requirement

In many states, corporations and LLCs must pay a special privilege tax levied upon their right to do business as a corporation or LLC. This kind of tax is generally referred to as a franchise tax.

However, the exact name of the tax may be something different - such as a license tax, excise tax, or registration fee. A franchise tax differs from an income tax in that the entity does not have to earn an income or even do business in the state. It only has to be formed or qualified to do business as a corporation or LLC under the state's law.

A failure to pay the franchise tax generally has the same consequences as a failure to file an Annual Report. There are late fees, a loss of good standing, and eventually administrative dissolution or revocation.

IV. Compliance Requirements Regarding Internal Governance

Corporations and LLCs also have to comply with requirements regarding how the entity is governed. These requirements may be imposed by the governing statute or the internal documents.

Corporations are subject to more of these statutory requirements than LLCs. LLCs tend to have to deal with more self-imposed compliance requirements than corporations. Below are some of these requirements.

1. Record Keeping and Inspections

Domestic corporations and LLCs are generally required by their governing statutes to maintain certain books and records. While there are differences from state to state, statutorily mandated records generally include (1) organizational documents such as a corporation's articles of incorporation and bylaws and an LLC's articles of organization and operating agreement; (2) a list of corporate shareholders and LLC members; and (3) copies of recently filed tax returns, annual reports, or financial statements.

Most of the statutes require the corporation or LLC to allow shareholders and members to inspect the maintained documents. Upon a failure to comply the shareholder or LLC can go to court, and if the court grants the inspection, the corporation or LLC may have to pay the shareholder's or member's costs.

2. Meeting Requirements

Every state corporation act requires a corporation to hold an annual shareholders' meeting. A corporation is required to notify shareholders of the date, time, and place of each annual meeting. An annual meeting may be ordered by the court if the corporation fails to comply with this statutory requirement. LLCs are generally not required by statute to hold an annual members' meeting.

However, an LLC may require meetings to be held in its operating agreement. The operating agreement may also impose penalties if the LLC fails to comply.

3. Indemnification

Most corporations and LLCs will pay the expenses and liabilities incurred by their managing officials who are sued for actions taken in their official capacity.

Every state corporation law provides for statutory indemnification. These provisions generally require a corporation to indemnify directors or officers who are wholly successful in defending themselves.

Some, although not all, LLC laws also have a provision requiring indemnification. However, even in the absence of a statutory provision the LLC can require indemnification in the operating agreement.

4. Dissenter's Rights

Every corporation statute provides shareholders with dissenter's rights. This obligates the corporation to pay shareholders the fair value of their shares in the event of certain mergers, amendments, and other corporate actions that the dissenting shareholders oppose and that result in a fundamental change in their shares. There is also a statutory procedure that the corporation and shareholders must follow.

Some LLC acts address dissenter's rights as well. However, even in the absence of a statutory provision the LLC can give this right to its members in its operating agreement and set forth the procedure for the LLC and members to follow.

5. Ratification of Defective Acts

Delaware's corporation law sets forth a procedure under which a corporation may ratify an overissue of stock, an election of directors, or another corporate act or transaction that, due to a lack of

compliance with the corporation law, certificate of incorporation, bylaws or other agreement or plan, is void or voidable. In order to ratify the corporate act the board of directors must adopt a resolution. That resolution will have to be approved by the stockholders if the corporate act being ratified required stockholder approval. If the act being ratified would have required a filing with the Secretary of State, the corporation will have to file a certificate of validation with the Secretary of State. Some other states have enacted provisions based on the Delaware law as well.

V. Compliance Requirements Imposed on Specific Types of Corporations or LLCs

Compliance provisions found in the state corporation and LLC acts generally apply to all corporations and LLCs formed or qualified under the act regardless of their purpose or activities. However, there are a number of compliance requirements that are imposed upon specific types of companies. Insurance companies, for example, may be required to file documents with the state insurance department. This may be in addition to, or instead of, the statutory filings required with the corporation department. A registered agent may be required, or the insurance company may have to appoint the insurance commissioner as its process agent and file a document providing a forwarding address where the commissioner can send process served on it on the insurance company's behalf.

Benefit corporations are another example. A benefit corporation is a for-profit corporation that has, as one of its purposes, the creation of a material positive impact on society and the environment. Although a benefit corporation is incorporated in the same manner as any for-profit corporation it is subject to some special compliance requirements. For example, under the Model Benefit Corporation Act, a benefit corporation must send each shareholder an annual benefit report, post its most recent benefit report on the public portion of its website, and deliver a copy of the benefit report to the Secretary of State.

VI. Other State Laws Requiring Compliance with Filing or Reporting Obligations

There are many state statutes – other than the corporation and LLC acts – that impose compliance requirements. Below is a look at a few of these statutes. Each one requires the filing of documents with a state agency and imposes penalties for non-compliance.

1. Assumed Name Statutes

- A. Requirement in General** - When a corporation or LLC does business under an assumed name that means it is using a name other than the one set forth in its formation document. Most states have statutory provisions governing the use of assumed names. Some assumed name provisions are found in the state's business entity statutes. Others are found in the state's laws dealing with consumer protection or unfair trade practices. In general, these statutes require business entities doing business under an assumed name to make a public filing.
- B. Filing Procedures** - The assumed name filing procedures vary by state. Some require the assumed name document to be filed with a state agency such as the Secretary of State. Others require filings to be made on the county level. There are also states that require a filing with the state office, followed by a recording of the document with the county.
- C. Penalties for Non-compliance** - Most assumed name statutes impose monetary penalties on entities that do business under an assumed name without making the required filing. In addition, some assumed name statutes provide that a non-complaint business entity may not maintain a suit until it complies.

2. Unclaimed Property Laws

A. Requirement in General - Every state has an unclaimed property statute. Unclaimed property (also called abandoned property) is property that has been unclaimed by its owner for a statutorily set period of time called the dormancy period. Unclaimed property includes stocks, bonds, dividends, cash, uncashed checks, life insurance benefits, and other items.

Most of the state statutes are based on one of the versions of the Uniform Unclaimed Property Act. Nevertheless the statutes vary from state to state.

B. Reporting Requirement – The statutes require holders of unclaimed property to file a report with the appropriate state agency. In general, the report must be filed annually. The report lists information such as the property, the name and address of the owner, the date the property was created, and the date of last contact with the owner.

C. Penalties for Non-compliance - All unclaimed property statutes provide for the assessment of interest and monetary penalties for the failure to report and escheat unclaimed property to the state.

3. State Securities (Blue Sky) Laws

A. Requirement in General - Every state has its own securities laws and rules. State securities laws are commonly known as “blue sky laws”. Each state has a securities commission that administers the law.

Most state securities laws are based on the Uniform Securities Act. Nevertheless, the laws still vary from state to state.

B. Registration Requirement - The blue sky laws require a security to be registered before it is offered or sold in a state, unless it is otherwise exempt. Every state has a number of exemptions. For example, securities associated with certain issuers - such as the government, banks, insurance companies, or employee benefit plans - are often exempt.

Also exempt from state registration are “federal covered securities”, which include securities listed on designated national stock exchanges, IPOs, securities issued by mutual funds, and securities sold to “qualified” purchasers. However, the states can require issuers to file notices of offers and sales and to collect fees for these filings.

The registration of securities that are neither exempt nor federally covered is commonly made on a form entitled “Uniform Application to Register Securities” (Form U-1). The registration is accompanied by a “Uniform Consent to Service of Process” (Form U-2). This form appoints the state securities commissioner as the applicant’s attorney for service of process and requires the applicant to set forth the name and address of a person upon whom notices and litigation documents served on the securities commissioner may be forwarded.

- C. Penalties for Non-compliance** - The statutes impose penalties for violations of the law. These include cease and desist orders, administrative and civil fines, and criminal penalties.

4. State Charitable Solicitation Laws

- A. Requirement in General** - Most states regulate the in-state fundraising activities of nonprofit organizations. They do so through statutes called charitable solicitation laws.

Generally, any nonprofit organization soliciting charitable contributions within the state’s borders must comply with the charitable solicitation statute. Certain organizations are exempt. This varies by state but generally includes religious organizations, hospitals, and colleges.

- B. Registration Requirement** – The states with charitable solicitation laws require nonprofit organizations to register with the state before their first solicitation of donations. This registration provides the state with information about the organization’s finances and governance.

In most states there is a choice of what to file. The organization can file the form produced by the state or it can file the Unified Registration Statement or URS. The states also impose annual financial reporting obligations.

C. Penalties for Non-compliance – The penalties for non-compliance can include late fees and civil and criminal penalties that may be imposed on the organization, and, in some cases, its officers or directors. Other penalties can include a cancellation of registration, a loss of tax exemption, and an injunction against further solicitations.

VII. Federal Statutory Compliance Requirements

There are many federal statutes imposing compliance requirements on corporations and LLCs. Federal laws that impose reporting requirements include the Securities Act of 1933, the Securities Exchange Act of 1934, and the Hart-Scott-Rodino Act.

1. Securities Laws Reporting Requirements

A. Required Filings - The sale of securities is subject to the provisions of the federal securities laws. A major purpose of the securities laws is to require companies that are offering to sell securities to the public to disclose material business and financial information that will allow investors to make informed decisions. In order to fulfill this purpose, the securities laws require the filing of a number of forms, reports and statements. These include the following:

- (1) Form S-1. The Securities Act of 1933 requires issuers to file a registration statement with the SEC before offering their securities to the public, unless they qualify for an exemption. Form S-1 is the basic registration form.
- (2) Form 10. All companies whose securities are registered on a national securities exchange, (and certain other companies with substantial assets and a class of equity securities held by a significant number of persons) must register those securities pursuant to Sec. 12 of the Securities Exchange Act of 1934. Form 10 is the form generally used for the registration of securities.
- (3) Form 10-K. The registration under Sec. 12 of the 1934 Act establishes a public file containing material business and financial information. Reporting companies are obligated to keep this information up-to-date by filing periodic reports. Form 10-K is the annual report that most companies file with the SEC.

(4) Form 10-Q. This is a report filed quarterly by most reporting companies. It includes financial statements and provides a continuing view of the company's financial position.

(5) Form 8-K. This is the "current report" used to report the occurrence of any material events or changes that are of importance to investors not previously reported.

B. Penalties for Non-compliance – Under both the 1933 Act and the 1934 Act the failure to file required reports subjects the issuer to civil and criminal penalties.

2. Pre-Merger Notification Filing under the Hart-Scott-Rodino Act

A. Reporting Requirement - The Hart-Scott-Rodino Antitrust Improvement Act of 1976 requires entities involved in certain proposed mergers or acquisitions of voting securities, non-corporate interests, or assets to file a Notification and Report Form with the Federal Trade Commission and the Department of Justice. The transaction may not be consummated for a designated period of time after giving notice.

Whether a merger or acquisition will be subject to a pre-notification filing depends upon the value of the acquisition and the size of the parties. There are thresholds that must be met that involve the aggregate amount of voting securities, non-corporate interests, or assets that will be acquired (the size-of-transaction test) and the sales and assets of the parties (the size-of-person test). The thresholds are adjusted annually.

B. What is Filed? - The document that must be filed is called a "Notification and Report Form for Certain Mergers and Acquisitions". Supporting documents must be submitted as well, such as balance sheets, copies of documents filed with the SEC, and other information and disclosures related to the parties' industries, products, and business.

C. Penalties for Non-compliance - The Act provides that any person, or any officer, director or partner thereof is liable for a monetary penalty for each day the person is in violation of the Act. The enforcement agencies may also seek other relief such as the divestiture of assets or voting securities obtained in violation of the Act.

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