

**GAO**

Testimony

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Security and Governmental Affairs, U.S.  
Senate

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# COMPANY FORMATIONS

## Minimal Ownership Information Is Collected and Available

Statement of Yvonne D. Jones, Director  
Financial Markets and Community Investment





Highlights of [GAO-07-196T](#), a testimony to Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

# COMPANY FORMATIONS

## Minimal Ownership Information Is Collected and Available

### Why GAO Did This Study

Companies, which are the basis of most commercial activities in market-based economies, may be used for illicit as well as legitimate purposes. Because companies can be used to hide activities such as money laundering, some states have been criticized for requiring too little information about companies when they are formed, especially concerning owners. This testimony draws on GAO's April 2006 report *Company Formations: Minimal Ownership Information Is Collected and Available* (GAO-06-376), which addressed (1) the information states and other parties collect on companies, (2) law enforcement concerns about the role of companies in illicit activities and the information available on owners, and (3) the implications of collecting more ownership information. GAO surveyed all 50 states and the District of Columbia, reviewed state laws, and interviewed a variety of industry, law enforcement, and other government officials.

### What GAO Recommends

While not making recommendations, GAO observes that any requirement to collect company ownership information must take into consideration (1) the conflicting concerns of states, law enforcement agencies, and other parties about collecting such information and (2) the need to uniformly apply any requirement in all states.

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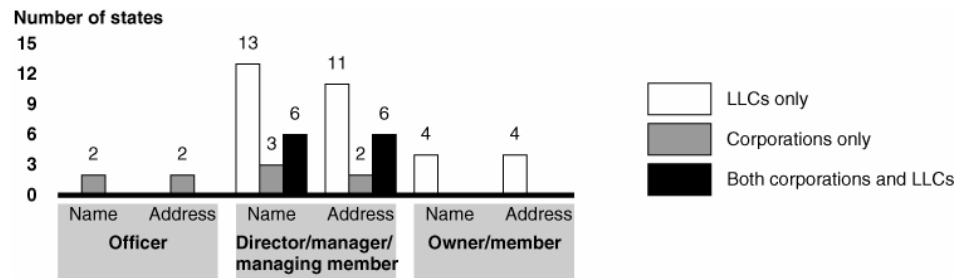
### What GAO Found

Most states do not require ownership information at the time a company is formed or on the annual and biennial reports most corporations and limited liability companies (LLC) must file. Four of the 50 states and the District of Columbia require some information on members (owners) of LLCs (see figure). Some states require companies to list information on directors, officers, or managers, but these persons are not always owners. Nearly all states screen company filings for statutorily required information such as the company's name and an address where official notices can be sent, but no states verify the identities of company officials. Third-party agents may submit formation documents for a company but usually collect only billing and statutorily required information and rarely verify it.

Federal law enforcement officials are concerned that criminals are increasingly using U.S. "shell" companies—companies with generally no operations—to conceal their identities and illicit activities. Though the magnitude of the problem is hard to measure, officials said that such companies are increasingly involved in criminal investigations at home and abroad. The information states collect on companies has been helpful in some cases, as names on the documents can generate additional leads. But some officials said that available information was limited and that they had closed cases because the owners of a company under investigation could not be identified.

State officials and agents said that collecting company ownership information could be problematic. Some noted that collecting such information could increase the cost and time involved in approving company formations. A few states and agents said that they might lose business to other states, countries, or agents that had less stringent requirements. Finally, officials and agents were concerned about compromising individuals' privacy, as information on company filings that had historically been protected would become part of the public record.

**Information Collected on Ownership and Management at Formation**



Source: GAO survey of state officials responsible for company formation.

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing on company formation practices among the states. My testimony, which is based on our April 2006 report to this subcommittee, will provide an overview of the information about the owners of nonpublicly traded companies that is routinely collected and made available by the 50 states and the District of Columbia.<sup>1</sup> As you know, the majority of companies in the United States are legitimate businesses that carry out an array of vital activities and are the backbone of our economy. However, companies can also be used for illicit purposes, such as laundering money or shielding assets from creditors. For example, government and international reports have said that "shell" companies—companies with generally no operations—have become popular tools for facilitating criminal activity because the persons controlling the company are not easily identifiable.<sup>2</sup> State statutes, which have historically governed the company formation process, generally provide for the privacy of the identities of company owners. This privacy may protect owners and their assets in the event of a lawsuit, but it can also be used to conceal the identity of the beneficial owners, or the persons who ultimately own and control a business entity.

In my statement today, I will address three main points. First, I will describe the ownership information that states collect on companies and their efforts to review and verify it. Next, I will discuss the concerns of law enforcement agencies about how companies can be used to hide illicit activity and how information on those companies, or the lack of it, can affect investigations. Finally, I will discuss the implications of requiring that states and others collect information on the owners of companies formed in each state. Our report, and this testimony, is based on extensive audit work that included a survey of officials from all of the states and the District of Columbia, a review of state statutes and company formation forms, and interviews with academics, third-party agents, law firms,

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<sup>1</sup>GAO, *Company Formations: Minimal Information Is Collected and Available*, [GAO-06-376](#) (Washington, D.C.: April 7, 2006).

<sup>2</sup>See U.S. Departments of Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C.: December 2005); and Organization for Economic Co-operation and Development (OECD), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (Paris: 2001).

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financial institutions, law enforcement, and other state and federal officials.<sup>3</sup>

In summary:

- Most states do not require companies or third-party agents that represent them to provide ownership information at formation or in periodic reports. Similarly, states usually do not require information on company management, such as corporate officers and directors and limited liability company (LLC) managers, in the company formation documents, but most states require this information on periodic reports. Third-party agents that submit formation documents to the state on a company's behalf usually collect only information they need to bill the company for their services and statutorily required information. The information they collect generally does not include information on company owners. States and agents are generally not required to verify any information on company ownership or management or to screen names against criminal watch lists, although almost all state officials reported that they screen filings for the presence of statutorily required information such as the company name and an address where official notices can be sent. With rare exceptions, the agents we spoke with did not request additional information on company owners or verify clients' identity.
- Law enforcement officials we spoke with were concerned about the use of shell companies in the United States that enable individuals to conceal their identities and conduct criminal activity.<sup>4</sup> These officials said that they have also had difficulty investigating U.S. shell companies that were being used for illicit purposes because they could not identify the owners. Quantifying the magnitude of the criminal use of shell companies is difficult, but law enforcement officials told us about investigations, both domestic and international, that have involved such companies and the movement of billions of dollars. The law enforcement officials we interviewed said that they had obtained some company information from

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<sup>3</sup>The survey and a complete tabulation of state-by-state and aggregated results can be viewed at <http://www.gao.gov/cgi-bin/getrpt?GAO-06-377SP>. Third-party agents include company formation agents who help individuals form companies and agents for service of process who receive legal and tax documents on behalf of a company. Agents can be individuals or companies operating in one state or nationally with only a few clients to thousands of clients.

<sup>4</sup>Creating a shell company is not a crime but rather can be a method for hiding criminal activity. When we refer to "shell companies" in this statement, we mean U.S. companies that do not conduct any legitimate activity.

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company formation documents or periodic reports and occasionally from agents during investigations and that this information had generated additional leads. But some officials noted that the information available from the states often did not reveal who owned the company and that cases had been closed because owners could not be traced.

- State officials, agents, and others we interviewed said that collecting company ownership information could be problematic, for several reasons. For example, state officials told us that the costs and time involved in approving company formations could increase, potentially slowing down or derailing business dealings. In addition, a few states and agents said they might lose business to other jurisdictions with less stringent requirements. State officials and agents also expressed concerns about maintaining the privacy of the owners of legitimate businesses that historically had been protected from public scrutiny. State officials, agents, and other experts in the field suggested that internal company records, financial institutions, and the Internal Revenue Service (IRS) could be alternative sources of ownership information for law enforcement investigations, but we found that using these sources could also be problematic.

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## Background

The company formation process is governed and executed at the state level. Formation documents are generally filed with a secretary of state's office and are commonly called articles of incorporation (for corporations) or articles of organization (for LLCs). These documents, which set out the basic terms governing the company's existence, are matters of public record. According to our survey results, in 2004, 869,693 corporations and 1,068,989 LLCs were formed in the United States. See appendix I for information on the numbers of corporations and LLCs formed in each state. Appendix II includes information on states' company formation processing times and fees.

Although specific requirements vary, states require minimal information on formation documents. Generally, the formation documents, or articles, must give the company's name, an address where official notices can be sent, share information (for corporations), and the names and signatures of the persons incorporating. States may also ask for a statement on the purpose of the company and a principal office address on the articles. Most states also require companies to file periodic reports to remain active. These reports are generally filed either annually or biennially.

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Although individuals may submit their own company filing documents, third-party agents may also play a role in the process. Third-party agents include both company formation agents, who file the required documents with a state on behalf of individuals or their representatives, and agents for service of process, who receive legal and tax documents on behalf of a company. Agents can be individuals or companies operating in one state or nationally. They may have only a few clients or thousands of clients. As a result, the incorporator or organizer listed on a company's formation documents may be the agent who is forming the company on behalf of the owners or an individual affiliated with the company being formed.

Businesses may be incorporated or unincorporated. A corporation is a legal entity that exists independently of its shareholders—that is, its owners or investors—and that limits their liability for business debts and obligations and protects their personal assets. Management may include officers—chief executive officers, secretaries, and treasurers—who help direct a corporation's day-to-day operations. LLCs are unincorporated businesses whose members are considered the owners, and either members acting as managers or outside managers hired by the company take responsibility for making decisions. Beneficial owners of corporations or LLCs are the individuals who ultimately own and control the business entity.

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## States and Agents Generally Do Not Collect or Verify Information on Company Ownership and Management

Our survey revealed that most states do not collect information on company ownership (see fig. 1). No state collects ownership information on formation documents for corporations, and only four—Alabama, Arizona, Connecticut, and New Hampshire—request some ownership information on LLCs.<sup>5</sup> Most states require corporations and LLCs to file periodic reports, but these reports generally do not include ownership information. Three states (Alaska, Arizona, and Maine) require in certain cases the name of at least one owner on periodic reports from corporations, and five states require companies to list at least one member on periodic reports from LLCs.<sup>6</sup> However, if an LLC has members that are

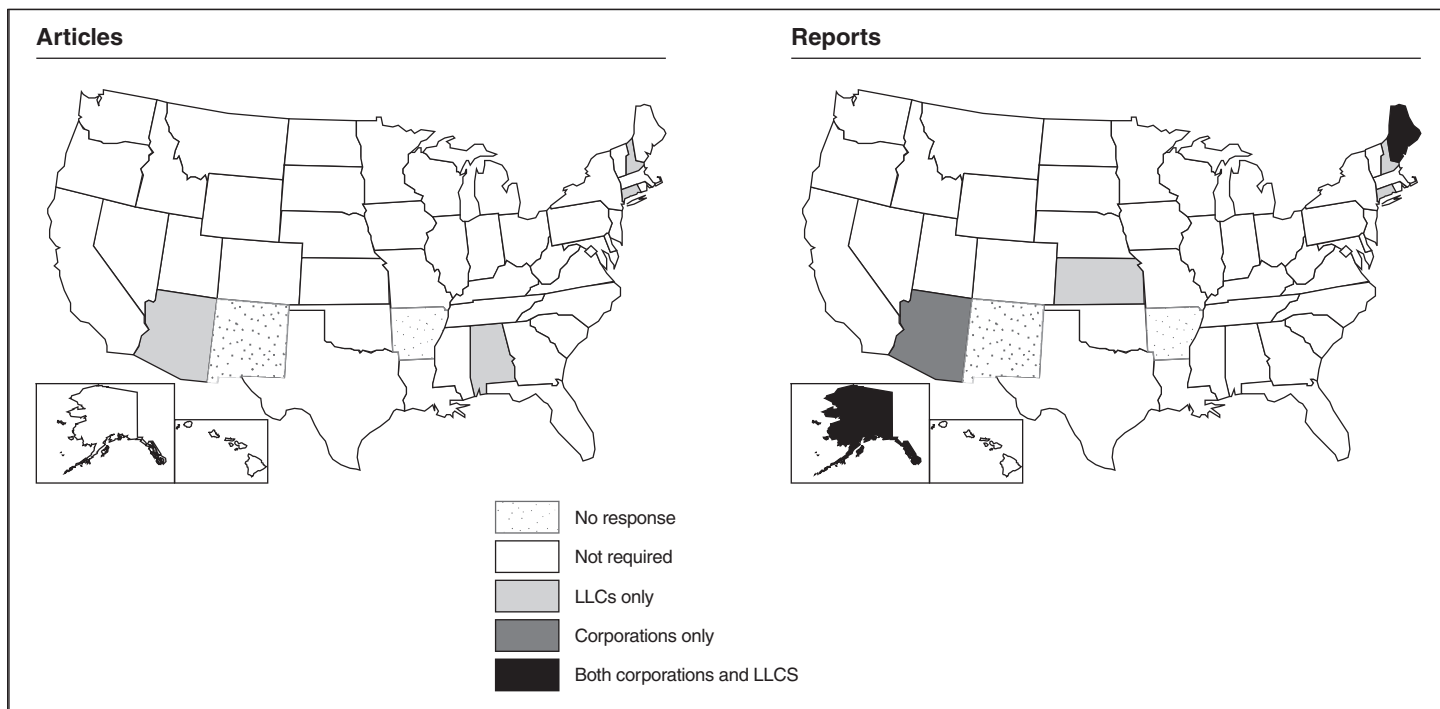
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<sup>5</sup>In response to a question on requirements for LLC member information, a Connecticut official said that either a member's or a manager's name was required on the articles of incorporation. In New Hampshire, a member or manager is required to sign the articles of organization. One state did not respond to the survey question on providing names of owners of corporations, and two states did not respond to the question on the addresses of owners.

<sup>6</sup>The five states are Alaska, Connecticut, Kansas, Maine, and New Hampshire. One state did not respond to this survey question.

acting as managers of the company (managing members), ownership information may be available on the formation documents or periodic reports in states that require manager information to be listed.

**Figure 1: States Requiring Ownership Information in Articles and Periodic Reports**



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Note: Arkansas and New Mexico omitted responses to certain questions on our survey. Arkansas responded that LLC member information is not required on articles or reports. We found from our legal review that Arkansas does not require the address of a corporation's owner on articles or periodic reports. Our legal review also found that New Mexico does not require corporations to list the name or address of an owner on articles or periodic reports. For LLCs, we found that New Mexico does not require member names and addresses on formation documents or periodic reports.

States usually do not require information on company management in the formation documents, but most states require this information on periodic reports (see fig. 2). Less than half of the states require the names and addresses of company management on company formation documents. Two states require some information on officers on company formation documents, and 10 require some information on directors. However, individuals named as directors may be nominee directors who act only as

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instructed by the beneficial owner.<sup>7</sup> For LLCs, 19 states require some information on the managers or managing members on formation documents.<sup>8</sup> Most states require the names and addresses of corporate officers and directors and of managers of LLCs on periodic reports. For corporations, 47 states require some information about the corporate officers, and 38 states require some information on directors on periodic reports. For LLCs, 28 states require some information about managers or managing members on the periodic reports.

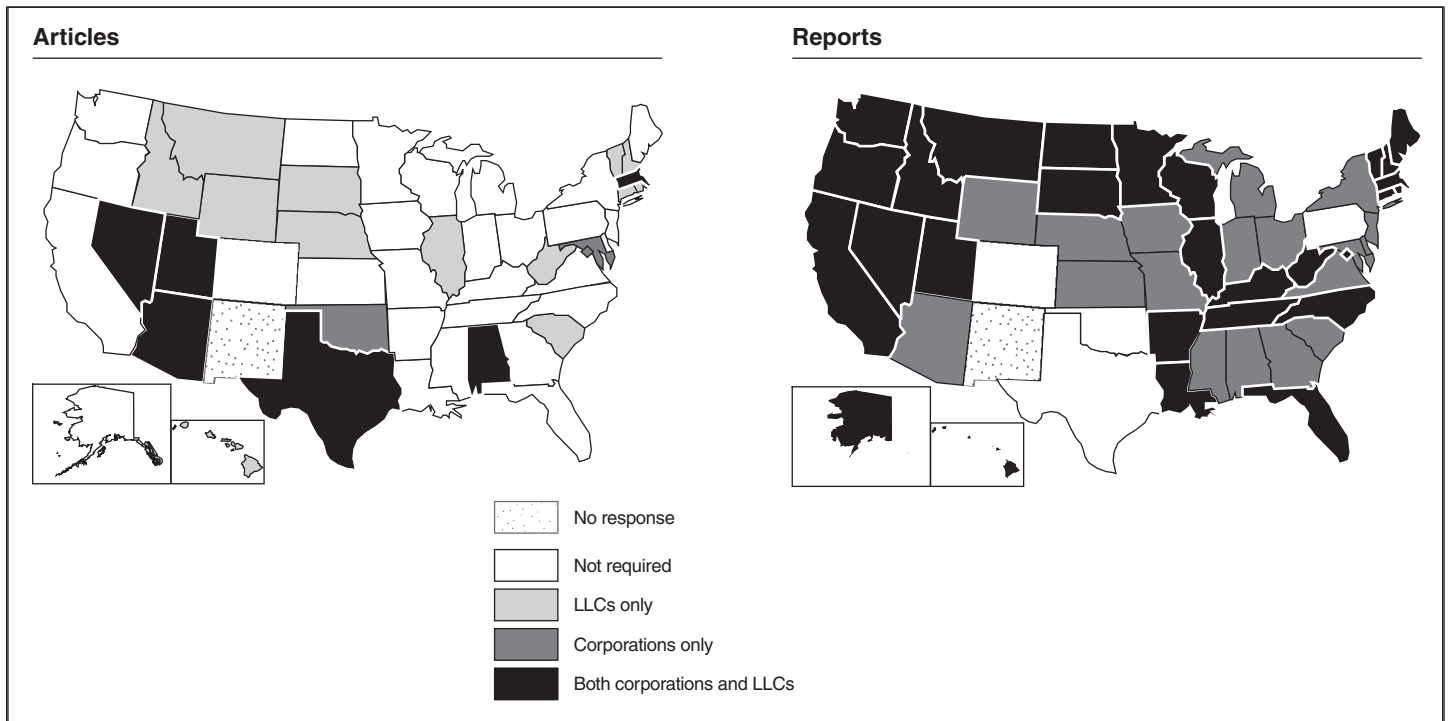
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<sup>7</sup>A nominee director may be an individual who is located where the business was formed and may sign official documents for the business on behalf of the beneficial owner. Typically, the nominee director will have no knowledge of the business affairs or accounts, cannot control or influence the business, and will not act unless instructed to by the beneficial owner.

<sup>8</sup>One state did not respond to this survey question.



**Figure 2: States Requiring Management Names or Addresses in Articles and Periodic Reports**



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Note: New Mexico responded on our survey that information on corporate officers is required on reports and information on directors is required for both articles and reports, but did not respond to the questions about the names and addresses of LLC managers/managing members. We found in our legal review that New Mexico does not require this information on LLC filings.

In addition to states, third-party agents may also have an opportunity to collect ownership or management information when a company is formed. Third-party agents we spoke with generally said that beyond contact information for billing the company and for forwarding legal and tax documents, they collect only the information states require for company formation documents or periodic reports. Several agents told us that they rarely collected information on ownership because the states do not require it. Further, one agent said it was not necessary to doing the job. In general, agents said that they also collected only the management information that states required. However, if they were serving as the incorporator, agents would need to collect the names of managers in order to officially pass on the authority to conduct business to the new company principals. A few agents said that even when they collected information on company ownership and management, they might not keep records of it, in part because company documents filed with the state are part of the public

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record. One agent said that he did not need to bear the additional cost of storing such information.

According to our survey, states do not verify the identities of the individuals listed on the formation documents or screen names using federal criminal records or watch lists. Nearly all of the states reported that they review filings for the required information, fees, and availability of the proposed company name. Many states also reported that they review filings to ensure compliance with state laws, and a few states reported that they direct staff to look for suspicious activity or fraud in company filings.<sup>9</sup> However, most states reported they did not have the investigative authority to take action if they identified suspicious information. For example, if something appeared especially unusual, two state officials said that they referred the issue to state or local law enforcement or the Department of Homeland Security. While states do not verify the identities of individuals listed on company formation documents, 10 states reported having the authority to assess penalties for providing false information on their company formation documents. One state official provided an example of a case in which state law enforcement officials charged two individuals with, among other things, perjury for providing false information about an agent on articles of incorporation.

In addition, our survey shows that states do not require agents to verify the information collected from their clients. Most states have basic requirements for agents for service of process, but overall states exercise limited oversight of agents. Most states indicated on our survey that agents for service of process must meet certain requirements, such as having a physical address in the state or being a state resident. However, a couple of states have registration requirements for agents operating within their boundaries. Under a law that was enacted after some agents gave false addresses for their offices, Wyoming requires agents serving more than five corporations to register with the state annually. California law requires any corporation serving as an agent for service of process to file a certificate with the Secretary of State's office and to list the California address where process can be served and the name of each employee authorized to accept process. Delaware has a contractual relationship with approximately 40 agents that allows them, for a fee and under set

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<sup>9</sup>We do not have information on the extent of this legal review in all of the states that responded that they conduct such a review.

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guidelines, access to the state's database to enter or find company information.

Agents we interviewed said that since states do not require them to, they generally do not verify or screen names against watch lists or require picture identification of company officials. One agent said that his firm generally relied on the information that it received and in general did not feel a need to question the information. However, we found a few exceptions. One agent collected a federal tax identification number (TIN), company ownership information, and individual identification and citizenship status from clients from unfamiliar countries. Another agent we interviewed required detailed information on company principals, certified copies of their passports, proof of address, and a reference letter from a bank from certain international clients. A few agents said that they used the Office of Foreign Assets Control (OFAC) list to screen names on formation documents or on other documents required for other services provided by their company.<sup>10</sup>

The agents said they took these additional steps for different reasons. One agent wanted to protect the agency, while other agents said that the Delaware Secretary of State encouraged using the OFAC list to screen names. One agent felt the additional requirements were not burdensome. However, some agents found the OFAC list difficult to use and saw using it as a potentially costly endeavor. OFAC officials told us that they had also heard similar concerns from agents.

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<sup>10</sup>OFAC is an office within the U.S. Department of the Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals, as well as a master list of "Specially Designated Nationals and Blocked Persons" (SDN) that includes numerous foreign agents and front organizations, terrorists, terrorist organizations, and narcotics traffickers. All U.S. persons, both individuals and entities, are responsible for ensuring they do not do business with a person or entity listed on the SDN list. Undertaking any type of business or financial transaction with a person or entity on this list is illegal under federal law.

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## Lack of Ownership Information Can Obstruct Law Enforcement Investigations

Law enforcement officials and others have indicated that shell companies have become popular tools for facilitating criminal activity, particularly laundering money. A December 2005 report issued by several federal agencies, including the Departments of Homeland Security, Justice, and the Treasury, analyzed the role shell companies may play in laundering money in the United States. Shell companies can aid criminals in conducting illegal activities by providing an appearance of legitimacy and may provide access to the U.S. financial system through correspondent bank accounts.<sup>11</sup> For example, the Financial Crimes Enforcement Network (FinCEN) found in a December 2005 enforcement action that the New York branch of ABM AMRO, a banking institution, did not have an adequate anti-money laundering program and had failed to monitor approximately 20,000 funds transfers—with an aggregate value of approximately \$3.2 billion—involving the accounts of U.S. shell companies and institutions in Russia or other former republics of the Soviet Union. But determining the extent of the criminal use of U.S. shell companies is difficult. Shell companies are not tracked by law enforcement agencies because simply forming them is not a crime. However, law enforcement officials told us that information they had seen suggested that U.S. shell companies were increasingly being used for illicit activities. For example, FinCEN officials told us they had seen many suspicious activity reports (SAR) filed by financial institutions that potentially implicated U.S. shell companies. One report cited hundreds of SARs filed between April 1996 and January 2006 that involved shell companies and resulted in almost \$4 billion in activity.<sup>12</sup>

During investigations of suspicious activity, law enforcement officials may obtain some company information from agents or states, either from state's Internet sites or by requesting copies of filings. According to some law enforcement officials we spoke with, information on the forms, such as the names and addresses of officers and directors, might provide productive leads, even without explicit ownership information. Law enforcement officials also sometimes obtain additional company information, such as contact addresses and methods of payment, from

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<sup>11</sup>A correspondent account is an account that a foreign bank opens at a U.S. bank to gain access to the U.S. financial system and to avoid bearing the costs of licensing, staffing, and operating its own offices in the United States. Many of the largest international banks serve as correspondents for thousands of other banks.

<sup>12</sup>See U.S. Departments of Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C.: December 2005).

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agents, although one state law enforcement official said the agents might tell their clients about the investigation. In some cases, the actual owners may include their personal information on official documents. For example, in an IRS case a man in Texas used numerous identities and corporations formed in Delaware, Nevada, and Texas to sell or license a new software program to investment groups. He received about \$12.5 million from investors but never delivered the product to any of the groups. The man used the corporations to hide his identity, provide a legitimate face to his fraudulent activities, and open bank accounts to launder the investors' money. IRS investigators found from state documents that he had incorporated the companies himself and often included his coconspirators as officers or directors. The man was sentenced to 40 years in prison.

In other cases, law enforcement officials may have evidence of a crime but may not be able to connect an individual to the criminal action without ownership information. For example, an Arizona law enforcement official who was helping to investigate an environmental spill that caused \$800,000 in damage said that investigators could not prove who was responsible for the damage because the suspect had created a complicated corporate structure involving multiple company formations.<sup>13</sup> This case was not prosecuted because investigators could not identify critical ownership information. Most of the officials we interviewed said they had also worked on cases that reached dead ends because of the lack of ownership information.

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<sup>13</sup>Dispersing assets among as many different types of entities and jurisdictions as possible is also a way to protect assets. The goal of this approach is to create complex structures that, in effect, provide multiple protective trenches around assets, making it challenging and burdensome to pursue. See GAO, *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations*, [GAO-05-658](#) (Washington, D.C.: Aug. 17, 2005).

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## More Company Ownership Information Could Be Useful to Law Enforcement, but Concerns Exist about Collecting It

States and agents recognized the positive impacts of collecting ownership information when companies are formed. As previously noted, law enforcement investigations could benefit by knowing who owns and controls a company. In addition, a few state officials said that they could be more responsive to consumer demands for this information if it were on file. One agent suggested that requiring agents to collect more ownership information could discourage dishonest individuals from using agents and could reduce the number of unscrupulous individuals in the industry.

However, state officials and agents we surveyed and interviewed indicated that collecting and verifying ownership information could have negative effects. These could include:

- Increased time, costs, and workloads for state offices and agents: Many states reported that the time needed to review and approve company formations would increase and said that states would incur costs for modifying forms and data systems. Further, officials said that states did not have the resources and staff did not have the skills to verify the information submitted on formation documents.<sup>14</sup>
- Derailed business dealings: A few state and some private sector officials noted that an increase in the time and costs involved in forming a company might reduce the number of companies formed, particularly small businesses. One state official commented that such requirements would create a burden for honest business people but would not deter criminals.
- Lost state revenue: Some state officials and others we interviewed felt that if all state information requirements were not uniform, the states with the most stringent requirements could lose business to other states or even countries, reducing state revenues.
- Lost business for agents: Individuals might be more likely to form their own companies and serve as their own agents. Agents also indicated that it might be difficult to collect and verify information on company owners because they often were in contact only with law firms and not company officials during the formation process.

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<sup>14</sup>State officials and others also noted that individuals could easily provide false names if ownership information were required without being verified.

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In addition, some state officials noted that any change in requirements for obtaining or verifying information, or the fees charged for company formation, would require state legislatures to pass new legislation and grant company formation offices new authority. Further, state and private sector officials pointed out that ownership information collected at formation or on periodic reports might not be complete or up to date because it could change frequently. Finally, as noted, some states do not require periodic reports, and law enforcement officials noted that a shell company being used for illicit purposes might not file required periodic reports in any case.<sup>15</sup> Law enforcement officials told us that many companies under investigation for suspected criminal activities had been dissolved by the states in which they were formed for failing to submit periodic reports. In addition, since a company can be owned by another company, the name provided may not be that of an individual, but another company.

We also found that state officials, agents, and other industry experts felt that the need to access information on companies must be weighed against privacy issues. Company owners may want to maintain their privacy, in part because state statutes have traditionally permitted this privacy in part to avoid lawsuits against them in their personal capacity. Some business owners may also seek to protect personal assets through corporations and LLCs. One state law enforcement official also noted that if more information were easily available, criminals and con artists could take advantage of it and target companies for scams. Although business owners might be more willing to provide ownership information if it would not be disclosed in the public record, some state officials we interviewed said that since all information filed with their office is a matter of public record, keeping some information private would require new legislative authority. The officials added that storing new information would be a challenge because their data systems were not set up to maintain confidential information. However, a few states described procedures in which certain information could be redacted from the public record or from online databases.

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<sup>15</sup>Our review of state statutes indicated that 14 states do not require periodic reports for LLCs and that 3 did not require them for corporations. In 3 states (Alabama, New Jersey, and Oklahoma), the annual report is submitted to a different office, such as the department of revenue, than the office that handles formation filings. In addition, biennial reports were required to be filed by corporations in 7 states and by LLCs in 5 states.

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In our review, state officials, agents, and other experts in the field identified three other potential sources of company ownership information, but each of these sources also has drawbacks.

First, company ownership information may be available in internal company documents. According to our review of state statutes, internal company documents, such as lists of shareholders for corporations, are required in all states for corporations.<sup>16</sup> Also, according to industry experts, LLCs usually prepare and maintain operating agreements as well.<sup>17</sup> These documents are generally not public records, but law enforcement officials can subpoena them to obtain ownership information. However, accessing these lists may be problematic, and the documents themselves might not be accurate and might not reveal the true beneficial owners of a company. In some cases, the documents may not even exist. For example, law enforcement officials said that shell companies may not prepare these documents and that U.S. officials may not have access to them if the company is located in another country. In addition, the shareholder list could include nominee shareholders and may not reflect any changes in shareholders.<sup>18</sup> In states that allow bearer shares, companies may not even list the names of the shareholders.<sup>19</sup> Finally, law enforcement officials may not want to request these documents in order to avoid tipping off a company about an investigation.

Second, we were told that financial institutions may have ownership information on some companies. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001 established minimum standards for financial institutions to follow when verifying the identity of

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<sup>16</sup>Delaware, Kansas, and Oklahoma statutes do not expressly state that a corporation is required to maintain a list of shareholders, but shareholders must be able to extract information on shareholders from corporate documents maintained by the corporation.

<sup>17</sup>Some states may not require written operating agreements. If there is no operating agreement, the LLC follows default provisions of the LLC act of the state where the company was formed.

<sup>18</sup>With publicly traded shares, nominees (e.g., shares registered in the names of stockbrokers) are commonly and legitimately used to facilitate the clearance and settlement of trades. Nominee shareholders can also be used in privately held companies to shield beneficial ownership information.

<sup>19</sup>According to the U.S. Money Laundering Threat Assessment, Nevada and Wyoming allow the use of bearer shares, which accord ownership of a company to the person who possesses the share certificate.



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their customers. For customers that are companies, this information includes the name of the company, its physical address (for instance, its principal place of business), and an identifying number such as the tax identification number.<sup>20</sup> In addition, financial institutions must also develop risk-based procedures for verifying the identity of each customer.<sup>21</sup> However, according to financial services industry representatives, conducting due diligence on a company absorbs time and resources, could be an added burden to an industry that is already subject to numerous regulations, and may result in losing a customer. Industry representatives also noted that ownership information might change after the account was opened and that not all companies open bank or brokerage accounts. Finally, correspondent accounts could create opportunities to hide the identities of the account holders from the banks themselves.

Finally, the Internal Revenue Service was mentioned as another potential source of company ownership information for law enforcement, but IRS officials pointed to several limitations with their agency's data. First, IRS may not have information on all companies formed. For example, not all companies are required to submit tax forms that include company ownership information. Second, IRS officials reported that the ownership information the agency collects might not be complete or up to date and the owner listed could be another company. Third, law enforcement officials could have difficulty accessing IRS taxpayer information, since access by federal and state law enforcement agencies outside of IRS investigations is restricted by law. IRS officials commented that collecting additional ownership and management information on IRS documents would provide IRS investigators with more detail, but their ability to collect and verify such information would depend on the availability of resources.

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<sup>20</sup>Pub. L. No. 107-56, 115 Stat. 272 (Oct. 26, 2001). Section 326 of the USA PATRIOT ACT directs Treasury and the federal financial regulators to adopt customer identification program requirements for all "financial institutions," which is defined broadly to encompass a variety of entities, including, among others, (1) banks that are subject to regulation by one of the federal banking regulators, as well as credit unions that are not federally insured, private banks, and trust companies; (2) securities broker dealers; (3) futures commission merchants and introducing brokers; and (4) mutual funds. See 31 U.S.C. § 5312; 31 C.F.R. part 103.

<sup>21</sup>See GAO, *USA PATRIOT ACT: Additional Guidance Could Improve Implementation of Regulations Related to Customer Identification and Information Sharing Procedures*, [GAO-05-412](#) (Washington, D.C.: May 6, 2005).

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## Concluding Remarks

In preparing our April 2006 report, we encountered a variety of legitimate concerns about the merits of collecting ownership information on companies formed in the United States. On the one hand, federal law enforcement agencies were concerned about the existing lack of information, because criminals can easily use shell companies to mask the identities of those engaged in illegal activities. From a law enforcement perspective, having more information on company ownership would make using shell companies for illicit activities harder, give investigators more information to use in pursuing the actual owners, and could improve the integrity of the company formation process in the United States. On the other hand, states and agents were concerned about increased costs, potential revenue losses, and owners' privacy if information requirements were increased. Collecting more information and approving applications would require more time and resources, possibly reducing the number of business startups and could be considered a threat to the current system, which values the protection of privacy and individuals' personal assets. Any requirement that states, agents, or both collect more ownership information would need to balance these conflicting concerns and be uniformly applied in all U.S. jurisdictions. Otherwise, those wanting to set up shell companies for illicit activities could simply move to the jurisdiction that presented the fewest obstacles, undermining the intent of the requirement.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other members of the committee may have at this time.

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## Staff Contacts and Acknowledgments

For further information regarding this testimony, please contact me at (202) 512-8678 or [jonesy@gao.gov](mailto:jonesy@gao.gov). Individuals making contributions to this testimony include Kay Kuhlman, Assistant Director; Emily Chalmers; Jennifer DuBord; Marc Molino; Jill Naamane; and Linda Rego.

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# Appendix I: The Number of Corporations and LLCs Formed in the United States

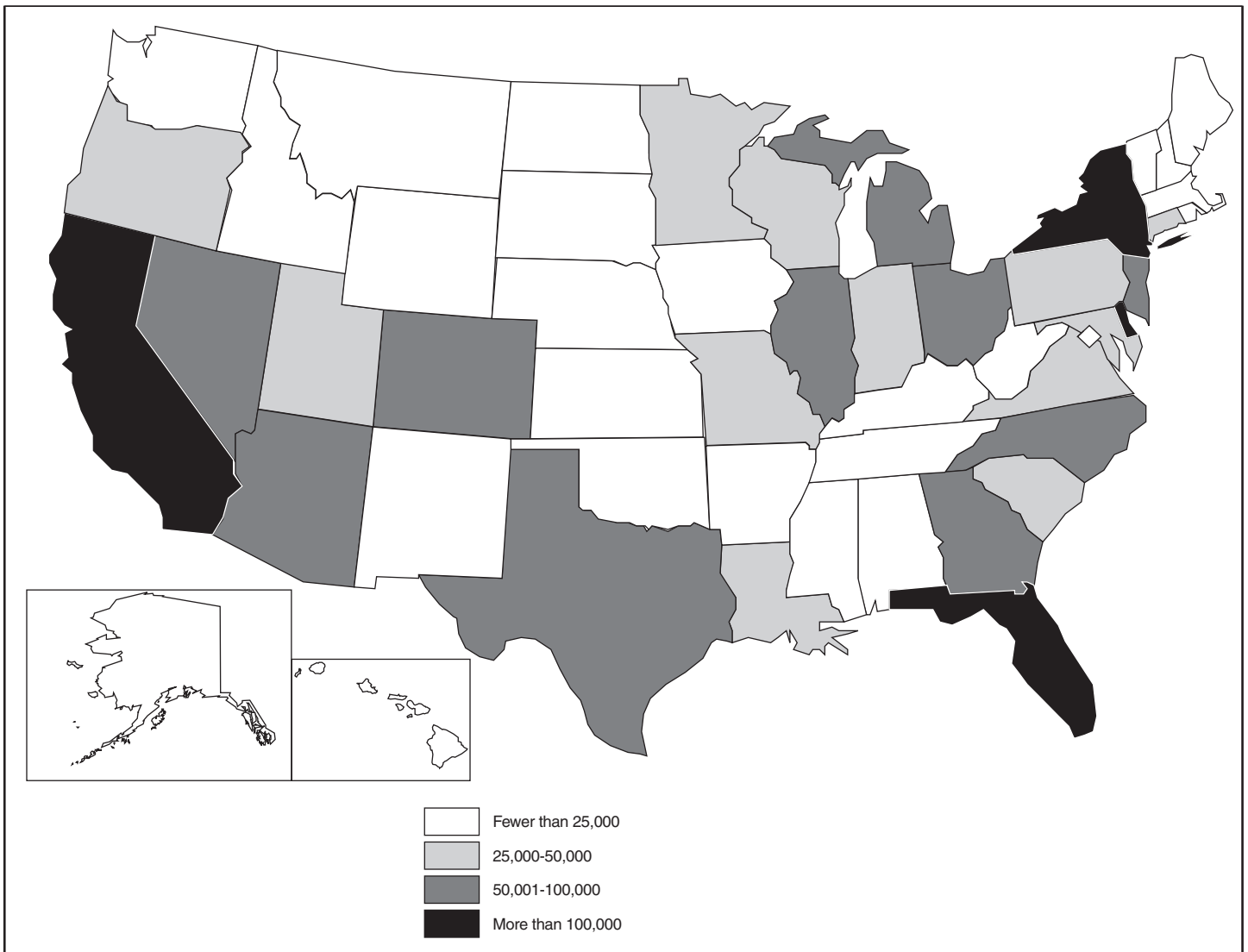
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Historically, the corporation has been the dominant business form, but recently the limited liability company (LLC) has become increasingly popular. According to our survey, 8,908,519 corporations and 3,781,875 LLCs were on file nationwide in 2004. That same year, a total of 869,693 corporations and 1,068,989 LLCs were formed. Figure 3 shows the number of corporations and LLCs formed in each state in 2004. Five states—California, Delaware, Florida, New York, and Texas—were responsible for 415,011 (47.7 percent) of the corporations and 310,904 (29.1 percent) of the LLCs. Florida was the top formation state for both corporations (170,207 formed) and LLCs (100,070) in 2004. New York had the largest number of corporations on file in 2004 (862,647) and Delaware the largest number of LLCs (273,252). Data from the International Association of Commercial Administrators (IACA) show that from 2001 to 2004, the number of LLCs formed increased rapidly—by 92.3 percent—although the number of corporations formed increased only 3.6 percent.<sup>1</sup>

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<sup>1</sup>IACA is a professional association for government administrators of business organization and secured transaction record systems at the state, provincial, and national level in any jurisdiction. The IACA data include domestic, foreign, and professional companies. Domestic companies are those doing business in the same state in which they are incorporated or formed. Foreign companies do business in a state, but they are incorporated or formed in another jurisdiction, either in another U.S. state or a foreign country. Professional corporations may include professional services, such as those performed by doctors, dentists and attorneys. Combining figures for these different types of companies overestimates the number of companies formed under the state statutes examined in this report, which covers only domestic companies. Some states did not report data to IACA.

Figure 3: Domestic Corporations and LLCs Formed in U.S. States in 2004



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

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# Appendix II: Company Formation and Reporting Documents Can Be Submitted in a Variety of Ways

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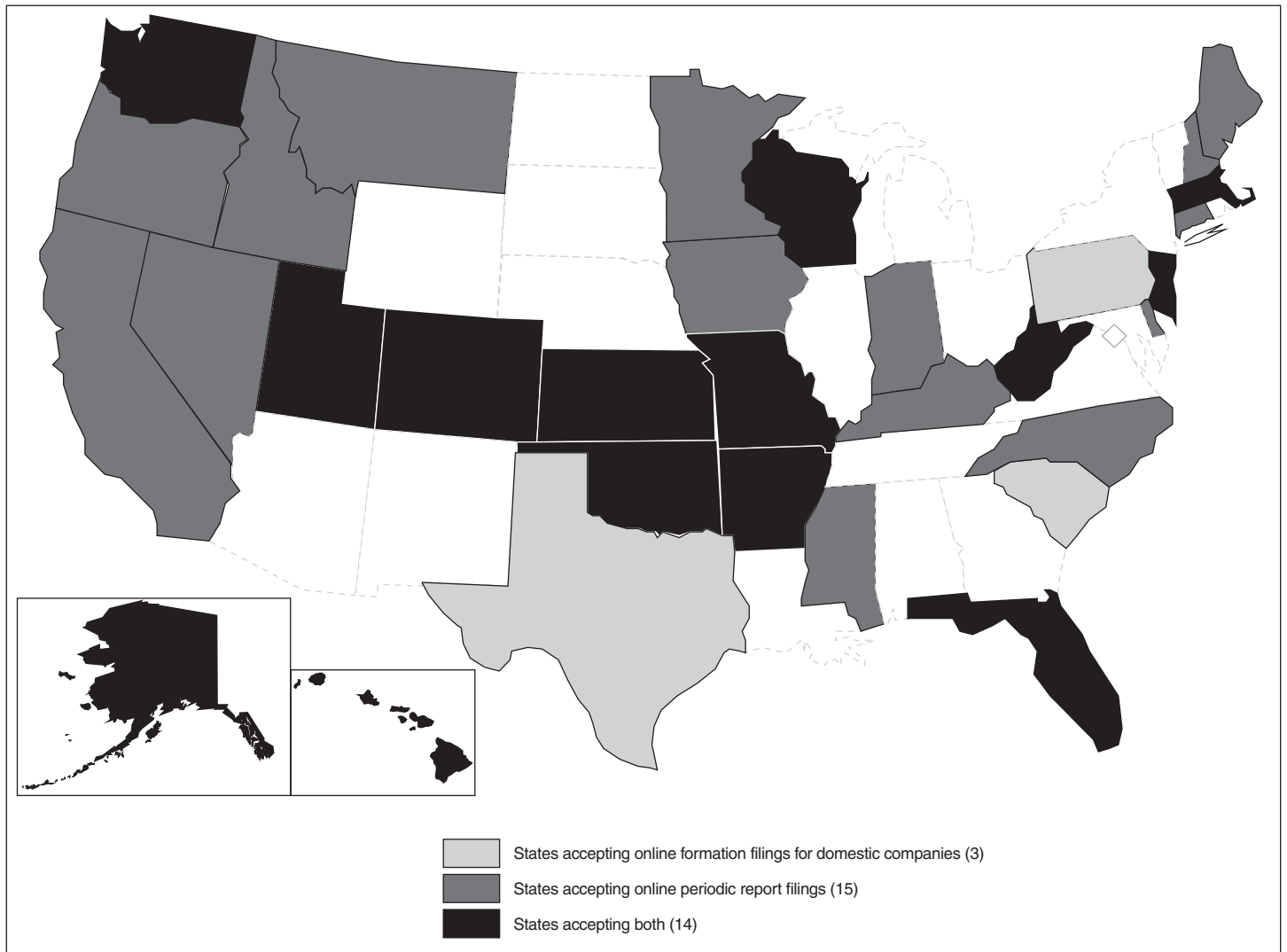
Company formation and reporting documents can be submitted in person or by mail, and many states also accept filings by fax. Review and approval times can depend on how documents are submitted. For example, a District of Columbia official told us that a formation document submitted in person could be approved in 15 minutes, but a document that was mailed might not be approved for 10 to 15 days. Most states reported that documents submitted in person or by mail were approved within 1 to 5 business days, although a few reported that the process took more than 10 days. Officials in Arizona, for example, told us that it typically took the office 60 days to approve formation documents because of the volume of filings the office received.

In 36 states, company formation documents, reporting documents, or both can be submitted through electronic filing (fig. 4 shows the states that provide a Web site for filing formation documents or periodic reports).<sup>1</sup> In addition, some officials indicated that they would like or were planning to offer electronic filing in the future.

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<sup>1</sup>Electronic filing includes the ability to file a document through a Web site, e-mail, or fax. Five states reported that they offer e-mail filing for company formation documents, and 4 states reported that they offer e-mail filing for periodic reports. In addition, 27 states reported that they accept formation or periodic report filings by fax.

**Figure 4: States That Provide a Web Site for Filing Formation or Periodic Report Filings**



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

As shown in table 1, in many cases states charge the same or nearly the same fee for forming a corporation or an LLC. In others, such as Illinois, the fee is substantially different for the two business forms. We found that in two states, Nebraska and New Mexico, the fee for forming a corporation may fall into a range. In these cases, the actual fee charged depends on the number of shares the new corporation will have. The median company formation fee is \$95, and fees for filing periodic reports range from \$5 to \$500.

**Table 1: State Company Formation Fees as of November 2005**

<b>State</b>	<b>LLCs</b>	<b>Corporations</b>
Alabama	\$75	\$40
Alaska	250	250
Arizona	50	60
Arkansas	50	50
California	70	100
Colorado	125	125
Connecticut	60	150
Delaware	90	50
District of Columbia	150	89
Florida	125	79
Georgia	100	100
Hawaii	50	50
Idaho	100	100
Illinois	500	150
Indiana	90	90
Iowa	50	50
Kansas	165	90
Kentucky	40	40
Louisiana	75	60
Maine	175	145
Maryland	100	100
Massachusetts	500	275
Michigan	50	60
Minnesota	135	135
Mississippi	50	50
Missouri	105	58
Montana	70	70
Nebraska	100	60-300
Nevada	75	75
New Hampshire	100	50
New Jersey	125	125
New Mexico	50	100-1,000
New York	200	125
North Carolina	125	125
North Dakota	125	80

<b>State</b>	<b>LLCs</b>	<b>Corporations</b>
Ohio	125	125
Oklahoma	100	50
Oregon	50	50
Pennsylvania	125	125
Rhode Island	150	230
South Carolina	110	135
South Dakota	125	125
Tennessee	300	100
Texas	200	300
Utah	52	52
Vermont	75	75
Virginia	100	25
Washington	175	175
West Virginia	100	50
Wisconsin	170	100
Wyoming	100	100

Source: GAO analysis of state Web sites.

Thirty states reported offering expedited service for an additional fee. Of those, most responded that with expedited service, filings were approved either the same day or the day after an application was filed. Two states reported having several expedited service options. Nevada offers 24-hour expedited service for an additional \$125 above the normal filing fees, 2-hour service for an extra \$500, and 1-hour, or “while you wait,” service for an extra \$1,000. Delaware offers same day service for \$100, next-day service for \$50, 2-hour service for \$500, and 1-hour service for \$1,000.



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