

ESSENTIAL
COMPLIANCE
INSIGHTS

Statutory Recordkeeping and Inspection Requirements for Corporations and LLCs

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, in many states, is the requirement that the entity maintain a statutorily prescribed set of records related to that entity.

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, some states may also require that foreign entities maintain records of ownership. Although not the subject of this white paper, it is important to be aware of any rules for foreign states where the entity is qualified to do business as well as for the home state

► 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 extensive recordkeeping requirements.

For example, a number of states require 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 and amount of contributions, 2) the articles of organization and all amendments; 3) the operating agreement and all amendments; 4)

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the three most recent annual financial statements; and 5) the three most recent federal, state and local tax returns.

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.

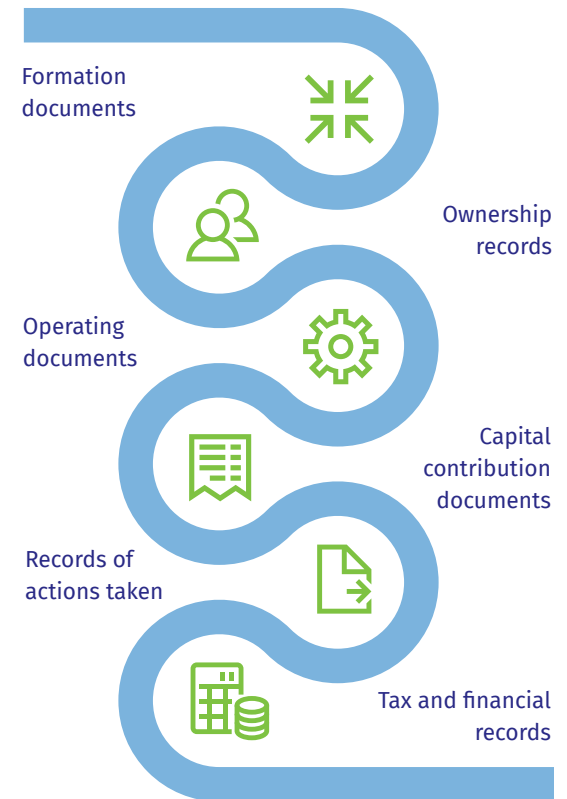
> WHAT RECORDS MUST BE KEPT?

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

- **Formation 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.
- **Ownership records.** 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. LLCs are generally not required by statute to keep records of actions taken by members or managers.
- **Tax and financial records.** These include the three most recent annual financial statements and the three most recent federal, state and local tax returns.

Statutorily mandated records

Requirements generally include:



- **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, accounting records often have to be maintained. The most recent annual report or financial statement sent to shareholders may also be required..

The place where required records must be kept also varies greatly depending upon the state. In general, basic records, such the formation or organizational document must be kept at the entity's principal place of business. Some states, however, do not specify where records must be kept.

Practice Pointer



In the age of digital information, most 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.

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> 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.

Limited Liability Companies. Many states provide that an LLC must allow a member to inspect the records the statute requires them to maintain. Other states, while not specifically requiring the LLC to maintain records, provide that upon request the LLC must provide the member with certain specified 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. Corporation statutes take various approaches. In some, the inspection statute is similar to the LLC statute. A shareholder can make a written request to examine the statutorily required documents provided there is a proper purpose for making the 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.) In others, the basic documents, such as a copy of the articles of incorporation or bylaws, minutes, or the names and address of directors and officers can be inspected upon notice. Other documents, however, such as accounting records, require a proper purpose as well. Some states also require that the shareholder seeking the inspection of certain records have a minimum percentage of shares or have held their shares for a specific period of time.

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.

Some types of statutorily required records must be made available for inspection by the entity's owners



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.

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. The definition of a “writing” can differ depending upon the statute. For example, it may include electronic communications.

The request should contain: the requestor’s full name and address; the requestor’s ownership 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 – if a proper purpose is required by statute or the governing documents.

- **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.

Although not required by statute, 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.

Documentation of inspection requests should cover:



CONCLUSION

Statutory entities are generally 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.

This document is for general information purposes and is not intended to be and should not be taken as legal advice.



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