



# Newsletter

August 2000

## Professional Legal Assistors

5525 Canoga Avenue  
Suite 304

Woodland Hills, CA 91367-6648

(818)347-0101 / (800)621-7008

fax (818)347-1823 / (888)232-9022

Email: [dottie@biz-usa.com](mailto:dottie@biz-usa.com)

Visit us at: **OUR NEW WEBSITE**

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Our office will be closed for the following holidays:

September 4<sup>th</sup> – Labor Day

November 23<sup>rd</sup> & 24<sup>th</sup> – Thanksgiving

December 25<sup>th</sup> – Christmas Day

Our next newsletter will be mailed out the beginning of January 2001.

Remember if you have an article that you would like to contribute to our newsletter just fax it to us for our review. We must receive the article no later than December 15<sup>th</sup> for our January newsletter. ♦

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## NEVADA CORPORATIONS – BEARER SHARES

Nevada is the only state that allows corporations to issue stock to the “bearer,” which is very much like writing a check to “cash”. The person who controls the bearer certificates, or has the shares in their possession, technically has the power to redeem those shares as the beneficial owner. As a negotiable instrument, it may be difficult to determine how many times the stock has changed hands since it was first issued.

The use of “bearer shares” to own and control a Nevada corporation has been touted in seminars, newspaper advertising, and promotional brochures. Bearer shares are generally considered to be an attractive solution for individuals who desire to own or control assets of business activities, while maintaining a high degree of financial privacy. It is true that privacy can be accomplished through bearer share ownership, however there are many issued which are broadly misunderstood regarding the use of bearer shares.



## HOW BEARER SHARES ARE ALLOWED

Most states base their corporate law extensively on the Revised Model Business Corporation Act as developed by the Committee on Corporate Laws of the American Bar Association. It should surprise no one then that there are amazing similarities in the Corporation Codes of the various

states. However, because the Model Act has been refined and modified over time, and because of the stubborn independence of the various states not to conform entirely to the Model Act, each state has developed its own eccentricities that set it apart from the others.

In Nevada's case, one area in which it separates its Corporation Code from the Model Act is in the information required on the stock certificate of a corporation. Under the Model Act, for instance, a stock certificate is required to contain: 1) the name of the issuing corporation and the state under which it is organized; 2) the name of the person to whom the stock is issued; and 3) the number and class of shares and the designation of the series, if any, the certificate represents.

The Nevada Revised Statutes (NRS) reads differently, and by omission of the language of the Model Act, creates an opportunity to issue shares of a Nevada corporation to "The Bearer". NRS 78.235(1) reads in part as follows: "*every stockholder is entitled to have a certificate, signed by officers or agents designated by the corporation for the purpose, certifying the number of shares owned by him in the corporation.*"

In other words Nevada law, specifically, only requires two things: 1) the name of the corporation, and; 2) the number of shares represented by the certificate (according to an attorney with the Nevada Attorney General's office assigned to the Nevada Secretary of State's office). Nevada, is the only state with this language. Since the name of the shareholder is not specifically required on the certificate, there has been broad use and acceptance of bearer shares in the State of Nevada for many years.

Even so, officials with Nevada agencies such as the Attorney General's office, the Securities Division and Corporation Division of the Secretary of State's office, are reluctant to take an official position one way or the other on bearer shares. There are no Attorney General's opinions on this issue, and surprisingly, there is absolutely no case law on the subject. The most positive affirmation I have received on the viability of bearer shares came from Mr. John Cunningham, an attorney with the Securities Division, who confirmed that bearer shares

could be used as long as the corporation was not required to qualify for a public offering.

## WHY BEARER SHARES ARE USED

There are two clear reasons why a corporation would issue bearer shares. First, as a tool to achieve total privacy in corporate ownership due to the fact that true ownership is extremely difficult to determine. Secondly, as a vehicle to provide for convenient transfer of ownership interests. Let's discuss these individually.

## PRIVACY

There are only two tangible sources of information on ownership of a Nevada corporation: the stock certificate, and the stock ledger. The stock ledger has its own legal requirements under Nevada law. The ledger must contain, in alphabetical order, the names of the stockholders, their residence address, and the number of shares owned by each. This list must be revised annually, and would be a significant document for a legal adversary to obtain.

However, Nevada law provides a statutory barrier to getting and using information on the stock ledger that includes its own penalties. As discussed above, NRS 78.257 provides that any stockholder who owns at least 15% of the issued shares of a corporation has a right to inspect all books and records upon five days notice, but must bear the costs of such an inspection. But subsection 3 of that statute states that,

*"Any stockholder or other person exercising (these rights) who uses or attempts to use information, documents, records or other data obtained from the corporation, for any purpose not related to the stockholder's interest in the corporation as a stockholder, is guilty of a gross misdemeanor."* (Emphasis added)

In other words, the penalty for using corporate information for any other purpose than to have a stockholder defend or demonstrate his or her interest in the corporation is up to one year in the county jail and up to a \$2,000 fine. Clearly, a non-shareholder in a Nevada corporation has no legal right or authority whatsoever to view the stock ledger. However, the burden of proof; in the cases of *Roney v. Buckland*, 4, Nev 619 (1868), falls on the corporation to prove improper motivation for such a request.

With those protections in place, the only other tangible source of ownership information is found on the stock certificate itself. A bearer certificate, even if obtained, could only be considered circumstantial.

Individuals who attempt to use bearer shares should exercise extreme caution to avoid the potential for civil or criminal liability. When in the discovery phase of litigation, there is no guarantee that the court will not require full disclosure of stock ownership. In a criminal case a grand jury may do likewise, although materials submitted to a grand jury are confidential unless presented in support of a criminal indictment.

Examples of individuals who might use bearer shares include:

- Persons contractually obliged not to compete in a particular business. Such persons may establish a Nevada corporation issuing bearer shares to enter into that market, recognizing the possibility of civil litigation if their employer or former employer learns of their indirect involvement.
- Persons engaged in contested divorce or family support proceedings. Once a court of proper jurisdiction establishes alimony or child support requirements, the person making such payments might wish to establish a Nevada corporation issuing bearer shares to avoid addition support appeals from future income.
- Persons who wish to maintain a low profile in their business dealings. Many wealthy and prominent people want to avoid having their names associated with high-profile investments. Bearer shares are an ideal form of ownership for such individuals.
- Persons who wish (or may need) to remain anonymous to close a business deal. When personal relationships could otherwise jeopardize profitable business dealings, it may be possible to use a corporation with bearer ownership to close the deal.

## TRANSFER OF OWNERSHIP

Most of the confusion surrounding bearer shares has to deal with the issue of transfer of ownership. A bearer instrument is negotiated differently than an instrument made payable to order. If an instrument is made payable to the order of John Doe, it is negotiated by delivery with any necessary endorsement. If an instrument is made payable to bearer, it is negotiated by delivery. It is commonly believed that bearer shares allow you to transfer ownership of a Nevada corporation in complete privacy, without any adverse impact. Three important facts must be established on this topic:

### **1. A stock certificate is not stock itself.**

The stockholder may own the stock with or without the stock certificate. The Nevada Attorney General has published a formal opinion on this subject (AGO38). The certificate is merely a piece of paper that indicates ownership. Because Nevada does not require corporations to issue certificates at all, it would be foolish to assume that possession of the certificate equals ownership of the shares.

### **2. The Nevada Revised Statute (78.240) specifically state that shares of stock are personal property.**

So, all rules, regulations, and applicable taxes, that would otherwise apply to transfers of personal property will also apply to transfers of bearer shares. Bearer share certificates, like personal property, may be stolen, borrowed, obtained under false pretenses, lost, copied, sold, inherited, bought, willed, etc. My car is personal property also. On occasion, I have lent my car to a friend. Simply because he was in possession of my car during that time did not mean he was the owner.

### **3. Nevada case law requires a transfer of stock to be registered upon the corporation's books before the transfer is valid against the corporation.**

This is done to protect corporate officers in determining ownership of and the right to vote corporate shares. (61 Nev. 431, 132 P.2d 605. (1942)).

So, can bearer shares be used to transfer ownership of a Nevada corporation? Absolutely. But the new owner must register his ownership with the corporation before the corporation can grant ownership

rights, including dividends. And, the transfer may trigger other things, like federal gift and estate or capital gains taxes.

### HOW TO ISSUE BEARER SHARES

If a corporation chooses to issue bearer shares, the following formula can be effective:

**Step One.** Set up a Nevada corporation.

**Step Two.** Hire nominee officers and directors who have no personal contact with the shareholders, but receive all instructions through your corporate attorney. This way the testimony of officers and directors relative to their personal knowledge of corporate ownership is limited.

**Step Three.** In the organizational meeting of the corporation, the nominee officers and directors issue stock certificates to "bearer" in increments provided in instructions from the attorney. In the stock ledger, the transaction is recorded with the stock being issued "in care of" the attorney.

**Step Four.** The stock certificates and stock ledger are forwarded to the office of the attorney. The certificates are held in a file in the attorney's office. The stock ledger may also be held in the attorney's office, or may be transferred to any location in the world. The attorney should provide the corporation's Resident Agent with the name and mailing address of the individual who holds and maintains the stock ledger.

**Step Five.** All instructions from the shareholders to the corporate officers and directors are communicated

by the attorney. All communications between the shareholders and the attorney represent privileged information.

As a defense against revealing corporate ownership in civil litigation, this can be a very effective strategy. Nevertheless, it may not be absolutely bullet-proof. When a civil case is in the discovery phase there is no guarantee that the court will not require the attorney to provide information over his objections. It is not as likely that this information would be allowed in the trial itself, but you may be defeated in your attempt to preserve absolute privacy.

**As you can see, if it is total financial privacy you are after, Nevada is the only state to consider for incorporating. If you know what the law allows you to do, and how to structure your affairs, it can be virtually impossible to uncover the ownership in a Nevada corporation.**

### INFORMATION SHARING – THE IRS

Nevada has repeatedly denied the access of the Internal Revenue Service to corporate records, and is the only state that does not comply with IRS requests for information. As recently as July of 1991, Nevada's Governor ordered the directors of the State Department of Taxation and other agencies to seal state records from the Internal Revenue Service. Every state in the United States, with the singular exception of Nevada, has an information sharing agreement with the Internal Revenue Service.

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