



5 STEPS TO AVOID PIERCING THE CORPORATE VEIL



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Typically, you form a legal entity to limit your liability. The thing is, there's more that you have to do than just establishing your company to maintain that protection. If you don't maintain your company as a separate legal entity, you lose the protection you established from having the company in the first place, and it puts your personal assets at risk. We want to keep you protected from this happening, so we've put together a guide for maintaining your liability protection established through forming your company. This is avoiding "piercing the corporate veil."

PIERCING THE CORPORATE VEIL

"Piercing the corporate veil" is a legal phrase that describes the owners of a legal entity losing the limited liability protection that such legal entities (such as a limited liability company, limited liability partnership or corporation) provide. When this happens, the owner's personal assets may be used to satisfy business debts and liabilities. Any business type that provides limited liability to its owners is at risk of piercing the corporate veil, if the owners don't take steps necessary to ensure this protection remains intact. The overarching theme is that to maintain the limited liability protection, you have to follow the minimum amount of corporate formalities that are required by the state of formation to maintain the business as a separate legal entity.

Corporations, limited liability companies (LLC's) and limited liability partnerships (LLP's) exist as separate legal entities from their owners. Because of this, business assets, records and contracts (to name a few) are maintained and entered into under the company, and not the owners and operators. One of the main reasons you're probably considering establishing a company is for the personal asset protection these business types provide. This protection is not guaranteed, and there are obligations that must be fulfilled to maintain its protection.

Corporate Formalities To Avoid Piercing The Corporate Veil

There are an endless number of things you could do to maintain your company as a separate legal entity. Each thing you do establishes evidence that the company is a separate legal entity, and anything you do that mixes business and personal assets and operations could be used as evidence to show that the business is not in fact a separate legal entity.

Here are five steps that you can take for maintaining personal asset protection and avoiding piercing the corporate veil. They include:

1. Completing the necessary corporate formalities.
2. Keeping written documents of all your business actions, routine and non-routine.
3. Keeping business and personal assets separate.
4. Providing adequate business capitalization.
5. Using your company to enter into all company related transactions.

ALL THE DETAILS

Here is a breakdown of each of these steps.

1. COMPLETING THE NECESSARY CORPORATE FORMALITIES.

Corporations, LLCs and LLPs have strict formalities they must follow under the entity's governing documents and under to applicable law.

CORPORATIONS.

Your bylaws are your operating manual and set forth most of the formalities you need to comply with. In addition, you should review or work with an attorney to go over state laws regarding other corporate requirements. These requirements typically include that you create and regularly update bylaws, properly elect a board of directors, properly authorize and issue shares of stock to owners (shareholders) and maintain a stock transfer ledger, hold both an initial and then annual meetings of both directors and shareholders, properly authorize corporate actions under the bylaws and applicable law, undertake any annual filings required by the state of incorporation in a timely manner and pay the necessary filing fees, and pay corporate taxes.

LLCS.

The limited liability company agreement or operating agreement should guide you through complying with most of the necessary formalities - that is your operating manual. In addition, you should review or work with an attorney to go over state laws regarding other required formalities. These requirements typically include that you create and regularly update your operating agreement (or limited liability company agreement - it is called either of these depending on state law), issue membership certificates to owners where required by the operating agreement,

keep a membership transfer ledger or otherwise update the operating agreement when there are changes in ownership as required by the operating agreement, hold both initial and annual meetings of the members (and managers, if your company is managed by a manager) if required by the operating agreement, properly authorize all company actions as required by the operating agreement, properly appoint a manager (if applicable), undertake any annual filings required by the state of formation in a timely manner and pay the necessary filing fees.

LLPS.

The limited liability partnership agreement or operating agreement should guide you through complying with most of the necessary formalities - that is your operating manual. In addition, you should review or work with an attorney to go over state laws regarding other required formalities. These requirements typically include that you create and regularly update an operating agreement (or limited liability partnership agreement - it is called either of these depending on state law), issue partnership interest certificates to owners where required by the operating agreement, keep a partnership interest transfer ledger or otherwise update the operating agreement when there are changes in ownership as required by the operating agreement, hold both initial and annual meetings of the partners if required by the operating agreement, properly authorize all company actions as required by the operating agreement, undertake any annual filings required by the state of formation in a timely manner and pay the necessary filing fees.

2. DOCUMENTING YOUR BUSINESS ACTIONS.

You should document the major business decisions and meetings you hold in accordance with your corporate governance documents. For example, maintain your corporate records by signing and filing contracts your company enters into. The contracts should all be under the name of the company. In addition, document when you hold the initial and annual meetings of directors and shareholders (corporations), members/managers (LLCs) or partners (LLPs) and keep the meeting minutes from each of these meetings in one place. This should also be done for other business decisions as required by your corporate governance documents. In addition, you should keep financial records for at least seven years for tax and audit reasons. You

3. DON'T COMMINGLE BUSINESS AND PERSONAL ASSETS.

Keep business assets separate from the assets of the owner(s) and operator(s). You should have a separate business checking account and business credit card that are only used for business expenses. If there are any expenses you incur personally, those should be properly recorded in your financial documents and reviewed by an accountant. Also, keep assets such as equipment and property separate. This is a very, very important step. So, get a separate bank account for your business ASAP if you don't have one already.

4. ENSURE ADEQUATE BUSINESS CAPITALIZATION.

Your business will need money and the equipment and items necessary both to start and continue operations. There are many ways to do this: through your own money, accepting money from others and making them business owners of the company, or through a business loan. Whatever your approach, without adequate capital, your business will not survive. Keep in mind, this capital needs to be designated to your business and not to you. This is the part where you fund your business. You need to fund it with a sufficient amount to open and operate. Essentially, you cannot spend money you don't have and then not pay for it.

5. MAKE YOUR BUSINESS' STATUS KNOWN.

Everything for the business should be under the business' name. Create business cards that display the name of your business. Make purchases and pay invoices via a business checking account or credit card. Create invoices in the company name to send to your clients. Also, any contracts, leases and/or documents you sign should be in the company name.

Unfortunately, if a judge cannot distinguish between what belongs to the business and what belongs to the owner, and the owners cannot provide proof that corporate formalities have been followed, it may be deemed that you're acting as a sole proprietorship or general partnership rather than a separate legal entity. The judge can then "pierce the corporate veil" and award your personal assets to satisfy the liabilities of your company. To avoid this, it is important to maintain clear distinctions between your personal assets and identity and your business assets and identity.

Contact Us

If you have any questions or would like more advice on this, please feel free to reach out to me at ldifrancesco@deanstreetlaw.com. We hope that this information is helpful! If you need more help, we are happy to provide a free fifteen minute consultation or reach out to me at ldifrancesco@deanstreetlaw.com! You can register for a consultation at www.deanstreetlaw.com. Wishing you all the best!