What Businesses Need to Know about Piercing the Veil

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If you are one of the fortunate business owners to have survived the pandemic and the historic economic downturn that it created, you are probably just happy to have come this far. Often business owners will tell me that they were too busy just trying to keep the business running to worry about corporate record keeping and follow corporate formalities. However, ignoring corporate formalities can have serious negative consequences, including the potential that you will be sued personally. In the legal world, this is called "piercing the corporate veil" and is a method whereby the courts will look through the shield of the corporate or limited liability company entity and hold the owner personally liable.

Owners must take steps to show that the business exists separately from them. Below are some concrete actions you can take to protect yourself:

1. **Undertaking necessary formalities.** Corporations must follow the strict formalities set forth in the laws of their states regarding governance, election of officers and directors and other matters. While limited liability companies generally are not subject to the same requirements that apply to corporations, they still must adhere to the state laws.
2. **Recordkeeping.** A corporation should adopt by-laws, issue stock to the owners, maintain a stock ledger, and hold annual meetings to appoint directors and elect officers. Limited liability companies should have an operating agreement that addresses the governance and operation of the entity, for example, whether the company is run by its members or by one or more "managers" and establishing procedures for admission of new members and/or sale or transfer of membership interests.
3. **File Annual Reports.** File all annual filings required by the state of incorporation or formation in a timely manner and pay the necessary filing fees.
4. **Document your business actions.** Any major business decisions or meetings of the owners, directors, officers or managers should be memorialized in writing in either as meeting minutes or written consents (for actions taken without a meeting).
5. **Don't comingle business and personal assets.** Keep business assets separate from the assets of the owner(s). The business should have its own checking and other bank accounts and credit card that are separate from the owners to ensure proper record-keeping. Even if you operate the business out of a home office, effort should be made to keep business and personal assets physically separate as well.
6. **Adequate business capitalization.** Ensure that the business is sufficiently funded (capitalized) to own its furniture, equipment and other tangible assets and to maintain its operations. If a loan from the owner is necessary to fund the organization, such loan must be in writing and signed by the business entity. The business should also maintain adequate property and casualty insurance coverage for its tangible property and commercial liability insurance for its operations not only because it is prudent to do but also to demonstrate that the entity has made adequate provision for payment of potential liabilities.

7. **The corporate or LLC status should be clearly stated.** A customer should be able to distinguish you from your company. Some ways to do this are: make sure contracts and invoices to clients are in the company's name; create business cards that display the name of the company, and make purchases and pay invoices via a business checking account or credit card.

If the pandemic has provided you with extra time in your busy schedule, now is a great time to conduct an audit to ensure that you (the business owner) are following company formalities to shield you from personal liability.

If you have questions regarding how to protect you from personal liability from your business, please contact Mariel Giletto, corporate shareholder at Flaster Greenberg.