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"Tip of the Month"

PIERCING THE CORPORATE VEIL

Do Your Business Practices Jeopardize the Liability Shield?

One of the benefits of forming a corporation or limited liability company (LLC) is shielding the shareholders or members of the company from personal liability. A corporation shields the assets of an individual or parent company in the event the corporation is sued in a tort or contract claim. However, this shield can sometimes be pierced to enable a plaintiff to reach the assets of an individual or a parent company. Although discussed here for corporations, piercing the veil also applies to LLCs.

As a general rule, an individual shareholder, director, officer, or parent company is not liable for the actions of the corporation. Corporations are creatures of statute created with the intent of fostering entrepreneurship by providing a liability shield. The legal benefits of a corporation come with certain obligations. When those obligations are not sufficiently met, courts will disregard the corporate entity (i.e., "pierce the veil") and hold the individual shareholder, officer, director, or parent company responsible for obligations of the corporation.

Piercing the corporate veil requires proof of three elements, which are discussed here for an individual as an example. First, the individual does not honor the separate identity of the corporation. A common example here is that the individual comingles corporate and personal funds. Paying for personal expenses with corporate funds, failing to have separate bank accounts for the individual and the corporation, and failing to maintain a clear distinction between the individual's finances and the finances of the corporation are acts that likely establish the first element.

A second element is that the individual has a controlling interest in the corporation. The individual may own a majority or 100% of the stock in the corporation. As such, the individual has dominating control over the operation of the corporation.

Third, and very important, the individual uses the corporation to commit a fraud or injustice. It is not sufficient by itself that a corporation is insolvent. When the individual pays out excessive salary or distributions, intentionally underfunds the corporation relative to its obligations, or makes fraudulent transfers, these acts support the element of fraud or injustice that is necessary to pierce the corporate veil.

Another common mistake that allows piercing of the veil is when the business owner fails to identify the business as a separate entity, such as by including "Inc.", "Corp.", "Ltd.", or "LLC" in the company name. The business owner should also always sign in a representative capacity, indicating, for example, "President" or "Manager" with his/her signature.

If you are unsure about whether your company's business practices place your personal assets at risk, contact the attorneys at Mesmer & Deleault by calling (603) 668-1971 or by email at *mailbox@biz-patlaw.com*.

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