

How Companies Lose Their Corporate Shield

Business Owners Must Follow The 33 Minimum Rules to Protect Their Personal Assets

By Charles B. Brown

The Corporate Form Protects Owners Against Liability

As the owner of a business, you need to incorporate your business to shield your personal assets from the creditors of your business. This is an absolute given. Thereafter, during the life of the company, the company must follow certain legal rules or you as the owner could become liable for the debts of the company. Therefore, the modern corporate form is not an impenetrable suit of armor.

In addition, when financial difficulties arise, other questions often arise such as when can you transfer company assets or when can you dissolve the company.

How to Prevent Someone from Going after Your Personal Assets

Your company creditors can treat you, the owner, as personally responsible for corporation debts if you fail to follow the rules. This is known as “*piercing the corporate veil*.” The astute businessperson should know how piercing the corporate veil can occur and how to avoid it.

You must treat the corporation as a distinct entity. Businesses must follow certain minimal formalities and not use the corporation for personal purposes. To prevent you from becoming personally liable for your business’s debts, follow the 33 important guidelines attached to this article.

In one instance, a corporation’s veil was pierced when the owner and sole director and sole shareholder used the corporation’s assets to pay his personal debts. He also did not elect any other directors, issue stock or hold even one director’s meeting.

He deposited corporate funds in his personal bank account, which he used to pay for personal expenses such as car payments and his daughter’s high school tuition. In this situation, the Court allowed the company’s creditors to go after the owner’s personal assets. He was ruined.

Detrimental Factors

The following activities are considered negative factors and have persuaded courts that the corporate form should be disregarded. In these situations, the owners became personally liable:

- The shareholders invested little in the corporation compared to the debt incurred by the corporation.
- The corporation incurred debts far in excess of its reasonably projected ability to repay the debt.
- The owners incurred a debt for the personal benefit of the shareholders and the debt was not reasonable remuneration to the owners.

Please keep in mind that an overall determination as to whether a corporation has correctly followed the minimum legal operational requirements is a delicate balance of each of the factors in this article. No one factor is decisive and each factor can have different weight depending on the overall circumstances and law. Each case is different and the results depend on the interaction of each factor with all the other factors.



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The law requires corporations to follow minimal rules or the corporation may then no longer be able to shield the owners’ personal assets.

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How Can You Transfer Company Assets?

As the President of your company, you have wide latitude to manage the affairs, assets, and debts of the company, provided you comply with the company charter (Articles of Incorporation), bylaws, minutes, loan covenants, binding agreements, and the law. Before you take significant action such as selling assets or otherwise diminishing the company's value, you should review these guiding documents.

If you are the sole owner of the business, you may transfer company assets to yourself if you pay arm's-length value to the corporation for the asset. However, you must keep a record of the transaction and the company must report receipt of income in accordance with tax laws. If you transfer a significant asset to a third-party, it must also be for arm's-length value. This means that the price needs to be reasonably near market value. Where a market is unevenly or thinly traded, or it is difficult to compare used products sold at similar prices (such as used equipment), your valuation will be more likely to be upheld by the IRS or the Courts.

On the other hand, if you transfer an asset to yourself or to a third party when the company is facing significant financial problems or if the transfer of the assets renders the corporation unable to pay its debts, this may be deemed a "fraudulent conveyance." The creditors would claim in this situation that this conveyance prevented the company from being able to pay its other debts. As a

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The corporations laws of the 50 states provide that a corporation may dissolve at any time. However, these laws also require that the corporation pay all its debts first, or if the corporation is unable to pay its debts, to so notify the corporation's creditors.

result, your creditors may sue you personally for the debts of the corporation. Be sure that you are aware of these requirements.

Can You Just Dissolve the Corporation?

The corporations laws of the 50 states provide that a corporation may dissolve at any time. However, these laws also require that the corporation pay all its debts first, or if the corporation is unable to pay its debts, to so notify the corporation's creditors. Therefore, be sure to reserve for the corporation's debts before shuttering your business.

Conclusion

While the modern corporate form is one of the most useful tools to protect personal assets from business debts, the prudent businessperson must take certain steps to preserve that shield. If the guidelines of this article are not followed, your corporation's protections might be "pierced." There are many examples of businesspeople that lost this protection and lost most or all of their personal assets. Be sure to incorporate and to follow the rules relating to transferring assets and dissolving the business. Do not be at risk for losing your personal assets due to business losses and debts.

We would be happy to answer any questions you may have about this area.

This article does not constitute the giving of legal advice. Please seek legal counsel who can assess your individual legal situation in compliance with the law.

About CorpLaw Associates LLC

CorpLaw Associates LLC is a law firm of experienced business attorneys who deeply understand their clients' businesses and who use best practices to achieve their clients' business goals. The firm provides full support for businesses. For clients who need on-site legal help, CorpLaw is one of only a few firms that specialize in this model. Their mailing address is CorpLaw Associates LLC, 400 Central Avenue, Suite 150, Northfield, Illinois 60093. They can be contacted at 847.784.1300 or at firm@corplaw.com. Their web address is www.corplaw.com.

About Charles Brown

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33 Rules to Protect Your Personal Assets

1. Form the company correctly
2. Do not conduct business until the Articles are filed
3. Adequately initially capitalize the company in light of its purposes
4. File the company's Annual Report each year
5. Issue stock after forming the company
6. Only issue stock to true owners
7. Elect directors to a board of directors
8. Prepare proper minutes of important decisions and note the rationale of the decision including the views of the directors
9. Conduct annual meetings of shareholders
10. Conduct annual meetings of directors (or by unanimous written consent in some states)
11. Maintain all necessary accounting and expense records
12. Keep corporate funds and personal funds separate (do not "commingle" these funds)
13. Qualify the company appropriately in other states where you do business
14. Know the financial condition of the business
15. Operate the corporation for business, not personal, purposes
16. Maintain a legal purpose and objective for the corporation
17. Do not pay personal debts from the company's bank account
18. Each officer must actually provide services to the company
19. Follow the bylaws, Articles, minutes, loan agreements, and binding agreements
20. Pay dividends
21. Document loans to the shareholders by preparing formal promissory notes
22. Carry reasonable levels of insurance relative to the inherent risks of the business
23. Operate the company with the purpose of making a profit
24. Sign contracts by noting your title in the signature space; do not sign in your personal capacity
25. Do not say you will be personally responsible
26. Do not overlap multiple businesses with the same officers, employees, and office space
27. Do not divert company money for personal use
28. Do not misrepresent to people the identities of shareholders or officers
29. Do not mistate whether you are an LLC if you are a corporation, and vice versa
30. Use the company's correct, full legal name in business cards, letterhead, bank checks, contracts, and papers. This name will include "corporation," "company," "Inc.," "Ltd.," "LLC," or other corporate entity identifier
31. Do not include improper entities as shareholders in an S corporation
32. Register your d/b/a (doing business as) assumed names with the State
33. Do not transfer company assets to owners or relatives' entities except for fair market value

Failing to follow each of these requirements could contribute to a court invalidating your company's legal shield.