



## **Protecting the Corporate Veil**

When you form an LLC or a corporation, liability protection is one of your most important goals. Observe the simple guidelines listed below to help protect this valuable feature of your company.

### **What is the “Corporate Veil”?**

- The ability of a properly-formed and maintained company to shield its owners from personal liability is sometimes referred to as the "corporate veil." If you are a business owner, this protection of your personal assets is one of the most significant reasons to incorporate or form a limited liability company (LLC).
- When properly managed, the corporate veil provides crucial personal liability protection against creditors, lawsuits, and other disputes. Typically, these claims can only be applied to business assets. An owner's personal liability is restricted to their investment in the company. Personal assets, such as real estate, bank accounts or other investments, are safeguarded from business creditors. In other words, you only risk what you put into the business.

### **Is the Corporate Veil Absolute?**

- No. Under certain circumstances, business creditors may be able to successfully make a claim against a business owner's personal assets (known as "piercing the corporate veil").
- If an owner violates a duty he owes to his company, either on purpose (in bad faith) or by not paying proper attention (negligently), he may be personally liable for any consequences of his actions on behalf of the company to a business creditor.
- Most veil-piercing circumstances occur because a business owner has either failed to abide by the legal requirements for operating a business or because the owner did not clearly separate their personal and business assets.
- While a single act may not lead to piercing the veil, numerous mistakes could be costly, leading to a situation where an owner becomes personally liable for claims against the business.

### **How Can You Make Piercing the Corporate Veil Less Likely?**

- *Separate Personal and Business Assets*
  - If you are the owner of a corporation or an LLC, you are obligated to maintain a legal separation between yourself and your company. If you fail to do this, you risk creditors claiming that your company is merely your "alter ego" – just a shell of your "self." Your personal assets may then become vulnerable to business creditors.
  - Here are some steps to take to separate business and personal assets:
    1. Maintain separate bank accounts for your business and personal finances.
    2. Never use company funds to pay your own personal expenses.
      - If you are entitled to company funds (for example, as wages), follow the appropriate process to transfer the funds from the company to your personal account.
    3. Never use personal funds to pay company expenses.

- If it becomes absolutely necessary for you to provide personal funds to pay employees or other pressing business expenses, document the additional funds as either a loan or an additional investment into the company.
- 4. Always make decisions that are in the company's best interest.
  - An opposite behavior would be taking actions that benefit you personally to the detriment of the company.
  - This duty applies to directors, officers, and controlling shareholders (or members and managers of an LLC), not just owners.
- 5. Maintain adequate business capital.
  - If your business is deliberately undercapitalized (that is it cannot afford to pay for its operational expenses), you may become financially responsible for legal claims against your company.
- To guard against some of the mistakes listed above, companies can sometimes obtain "Errors and Omissions" insurance coverage that would insulate directors and officers from legal action caused by their conduct while representing the company.
- *Observe Corporate Formalities*
  - Every state has certain requirements for corporations and limited liability companies. In Indiana, both corporations and LLCs must:
    - File a Business Entity Report with the Secretary of State every two years.
      - If you do not submit these reports (and pay the required fees) on time, the company can be administratively dissolved. If your company is dissolved, you will lose limited liability protection.
    - Formally notify the Secretary of State whenever the company's Registered Agent, Registered Agent's address, or Principal Office Address changes.
    - File a Certificate of Assumed Business Name with the Secretary of State if using a name other than its official name. (Example: Smith Brothers, Inc., d.b.a. Smith's Restaurant.)
  - Corporations are also subject to other formalities that include holding an organizational meeting to elect officers, adopt bylaws, and issue stock; holding annual meetings of shareholders and keeping minutes of the annual meetings; keeping a ledger that details all shares issued to shareholders, and how much each share is worth; maintaining bylaws that detail the manner in which the company will be operated; keeping records of all payments made, payments received, and all invoices and statements; keeping profit and loss statements and balance sheets every year; and maintaining documentation for business loans and the repayment terms.
  - LLCs have fewer formalities to worry about. However, it is advisable for LLCs to observe many of the same safety measures as corporations to prevent business owners from being held personally liable. Practical guidelines include holding an initial organizational meeting, adopting an operating agreement, maintaining documentation of all business decisions, documenting finances, and encouraging all of its members to have an annual meeting, minutes of which should be recorded and kept.