

How Business Owners Can Protect Their Personal Assets

By Ryan D. Strohmeier

You recently started a construction company that builds custom homes. Everything was proceeding nicely, until you discovered that one of your first projects was improperly designed by the property owner's architects, and you unfortunately had the privilege of having built the house. The aggrieved owner is furious and threatens suit against every member of the construction industry who ever passed within a mile of the house. If you end up being sued, the most you can lose would be your new company, which has built up little going concern value anyway, but you can't lose your personal assets like your own house and investments, right?

If your attorney organized you in one of the limited liability legal formats, if you signed the construction contract properly, and if you followed the legal formalities, your liability is likely limited to the amount you invested in your business venture, and your personal assets are protected. Unfortunately, that is not always the case.

Protection from individual liability is available if your business is structured as a corporation (either a subchapter C or subchapter S corporation for tax purposes), a limited liability company, or a limited liability partnership. Most, if not all, businesses with active operations should be in one of these three forms.

Under the laws of most states, the existence of your business as a corporation starts when your Secretary of State issues you a certificate of incorporation or organization. Unfortunately, many start-up business owners think that is all there is to it, and they do nothing more about refining the legal aspects of their business structure. In Illinois, one can start a corporation or limited liability company by filling out a simple two-page form, and submitting it online for less than \$1,000. A lawyer is not needed to obtain this documentation. Our experience shows us that many owners of new companies do only this, and simply assume that they are alright.

If simply obtaining paperwork from the Secretary of State is all that you have done, then you may be exposing yourself to individual liability for all the debts and obligations of your corporation anyway. Lawyers and courts have coined a colorful term for when a court decides to ignore the limited liability protections from operating through a company, when the business is, in reality, a mere alter-ego of the individual owners: "piercing the corporate veil". In such a case, the court will not treat the company as a separate person from its owners for the purposes of legal liability, which allows a plaintiff to bring its lawsuit against the individual owners themselves. To put it simply, this means you can end up losing your house, car, and personal investments, even though you sent the organization papers with your check and received a certificate from the Secretary of State.

Successfully piercing the corporate veil is relatively rare, and it involves a judgment call by the court hearing the case. Still, the possibility of a catastrophic result is not worth leaving it up to chance. There are a number of factors to best avoid losing limited liability protection.

Observe Legal Formalities. The first factor is whether you have observed all of the appropriate legal formalities. For example, has your corporation issued an actual stock certificate, printed out with your name as the shareholder, and properly signed? You may have been treating yourself and your partners as stockholders, but you may need to issue the physical stock certificates themselves.

Stockholders elect the board of directors, and the board adopts the corporate bylaws, and elects the officers. Have you done that? This can be done with a formal meeting, documented by minutes prepared by the corporate secretary, or by simple unanimous written consents of the shareholders and directors. Do you need this if you are the sole shareholder and director? Yes. It is important to put this in writing even if you are “agreeing with yourself”, because you don’t have another person to verify that the meeting was held.

The corporation laws of all states require that you hold an annual meeting of shareholders and directors, in which the shareholders elect the directors as necessary and the directors elect the officers. Before you make any substantial decision for the corporation, that decision should be approved by your board of directors. What is “substantial” depends on the corporation. Usually, a business loan or real estate lease would be considered substantial, whereas decisions on day-to-day operations are typically not.

Always Sign Properly. A proper signature for a legal entity like a corporation, limited liability company, or limited liability partnership consists of three things:

1. *The full legal name of the entity* (if a corporation, include “corporation”, “company”, “incorporated”, “limited” or an abbreviation; if a limited liability company, include “limited liability company” or an abbreviation; and if a limited liability partnership, include “limited liability partnership” or an abbreviation)
2. *Your signature or the signature of an authorized officer*
3. *Your title in the organization* (President, CEO, etc.)

This seems obvious, but you would be surprised at the number of ways that business people do this incorrectly. Suppose you sign “John Doe, President”, but without mentioning the name of your corporation. Is your corporation bound, or does this make you individually liable? Some judges have ruled that the corporation only is bound, and others have ruled that the individual alone is liable. This is a simple point, so don’t miss

it. You sign your name on behalf of your business many times each day. Always include the three elements: the name of your business, your signature, and your title.

Pay Your Annual Fees: Each state has annual fees to maintain your corporation. If you don't pay the fees, your Secretary of State usually has the right to dissolve your corporation after further notice to you. This notice consists of an innocent-looking form which you ignore at your peril.

Use Separate Accounts. Do not intermingle the corporation's money and your money. You need a separate bank account for your corporation, with a separate tax identification number. Do not pay your household expenses from the corporate bank account. Do not deposit checks payable to the corporation in your personal account.

Adequately Finance Your Company. The third test is inadequate capitalization or financing. This test is generally not applied much today, since you can form a corporation in most states with stated capital of as little as \$1,000.

You may think of your business as you, and that you are your business. The law does not. A corporation or limited liability company is a separate "legal person" from you, and this is very much for your benefit. So long as you keep the company separate, and fulfill its legal requirements, you can enjoy the privileges of limited liability for its debts and obligations, and focus on running your business.

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