

THE C & D NEWSLETTER



CITRON & DEUTSCH
A LAW CORPORATION

Published by:
RICHARD K. CITRON
DAVID R. DEUTSCH
MICHELLE LeCOLST-JOHNSTON
Attorneys

PIERCING THE CORPORATE VEIL

One of the principal reasons for conducting a business as a corporation is to ensure that the owners of the business are not personally liable for the debts of the business. However, the courts will "pierce the corporate veil" and hold the shareholders personally liable for corporate obligations when the corporation is merely the alter ego of the shareholders.

There are two basic requirements which must be established before the corporate entity will be disregarded by the courts. First, there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist. Second, an inequitable result must follow if the acts are treated as those of the corporation alone. Whether the two requirements are satisfied is a matter of fact, and will depend on the circumstances in each case. The mere fact that all of the common stock of the corporation is owned or controlled by one person is not enough to destroy the corporate existence; however, it is not necessary to prove fraud to pierce the corporate veil.

Courts have allowed creditors to pierce the corporate veil if any of the following is present:

1. A failure to adequately capitalize the corporation.
2. Commingling of funds and other assets.
3. The unauthorized diversion of corporate funds or assets to other than corporate uses.
4. The treatment by an individual of the assets of the corporation as his own.
5. The failure to issue stock in the corporation.
6. The failure to maintain minutes or adequate corporate records.
7. The disregard of legal formalities.

It is important to maintain the formalities necessary to establish the separate identity of the corporation. Therefore, the corporation must hold and document meetings of the board of directors and shareholders, and must strictly maintain separate accounting and bank records. It is critically important for the corporation to be adequately capitalized; that is, for the corporation to have sufficient capital to conduct its business. Finally, any transactions between the corporation and its controlling persons, such as salary, loans, or sales of equipment, should be completely documented and the terms of the transaction should be the same as if arms-length negotiations were involved.

This complimentary newsletter is intended to provide general information. Because of the complexities and constant changes in the law, it is important to seek professional advice before acting on any of the matters covered herein.