



STEPHEN P. KATZ

A Little Corporate Housekeeping Can Help Avoid a Big Mess

Now that tax season is over, and we've finally caught a breath after filing our tax returns in a timely fashion, it is a good time to consider some corporate housekeeping tips that will help keep intact the limitation of liability that corporate entities provide to their shareholders. While not necessarily the first item on the agenda of an executive team's hectic schedule, the failure to perform simple corporate housekeeping and follow certain corporate formalities can have a serious negative impact on the ability of a corporation to shield its shareholders from liabilities. Creditors can use the failure to follow corporate formalities as grounds to "pierce the corporate veil" and look to the assets of the shareholders of the corporation to satisfy the debts of the corporation.

To avoid this negative outcome and to better maintain the limited liability of the shareholders of corporations, here are some corporate housekeeping tips that can help avoid having your corporate veil pierced:

[Director and Shareholder Meetings](#)

The Corporation should have annual director and shareholder meetings, and keep minutes of those meetings in an official minute book. Moreover, decisions made outside of the ordinary course of business, should be approved by the Board (and in certain cases, the shareholders), and records of meetings or written consents approving those decisions should also be kept with the minutes.

[Organize Company Records](#)

The minute books of the corporation should be updated frequently and contain minutes of all director and shareholder meetings.

[Review the Bylaws](#)

The directors should review the bylaws of the corporation to ensure that it is operating in compliance. A review of the bylaws will also be helpful to determine if changes to the bylaws are necessary in light of new facts and circumstances.

[Elect New Officers and Directors and Remove Inactive Ones](#)

Directors and officers who do not contribute nor are involved in the corporation should be removed and replaced with individuals who will be actively participating in the affairs of the corporation. Resolutions to that effect should be prepared and filed in the corporate minute book.

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Review Capitalization

The corporation should be capitalized in a sufficient manner to keep it running. Courts will consider whether a corporation is undercapitalized when making a determination to pierce the corporate veil.

Make Sure Agreements are 'Arm's Length' and Documented

If the corporation has any agreements, especially with affiliates, those agreements should be at arm's length and reduced to writing. For example, if a shareholder is providing services or assets to the corporation, the services or assets should be provided for arm's length consideration and pursuant to a written agreement. The absence of such documentation may point toward a commingling of assets and/or an alter ego status of the corporation, both of which the courts consider when making a determination to pierce the corporate veil.

Review Banking and Accounting Records

It is very important that a corporation's funds are not commingled with funds of shareholders or affiliated entities. A review of banking and accounting records should be performed to ensure there is no commingling of this sort. Furthermore, where funds are transferred between affiliates and shareholders, a legitimate business reason for such a transfer should be documented.

The corporate housekeeping tips provided above are not intended to be an exhaustive list of actions you should take to avoid piercing the corporate veil. Courts will consider many other factors in making a determination to pierce a corporate veil (including, for example, the presence or absence of fraud, insolvency at the time a debt is incurred, lack of corporate assets, payment of excessive dividends, functioning as a facade or an alter ego of the shareholders and improper use of corporate assets); however, these tips offer an overview of the basic steps you can take to help maintain protection from the liability that corporate entities provide to their shareholders.

Please feel free to contact Stephen Katz, Chairman of our Corporate Law Services group, if you would like to discuss how P&A can help you with your corporate housekeeping.

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