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PIERCING THE CORPORATE VEIL: HOW TO AVOID PERSONAL LIABILITY

When choosing the right business entity, one of the vital factors to consider is how much personal liability you are willing to assume. Corporations are seen as separate legal entities, meaning that, as the business owner, you are not generally personally responsible for the company's debts or legal obligations solely by virtue of being a shareholder.

However, there are exceptions to this rule. Sometimes, business owners can be held personally liable for their company's debts or legal issues through a legal process known as "piercing the corporate veil." This could put personal assets—like your home, car, and bank accounts—at risk if a creditor or individual sues you personally for the business's problems, separate from circumstances where you voluntarily assume liability (e.g. guaranty corporate debt) or engage in conduct beyond that of an ordinary shareholder.

So, how is the corporate veil pierced, and what steps can you take to shield yourself and your business? Here, we will break down the essentials of the corporate veil and offer tips on safeguarding your assets from personal liability.

What is the "Corporate Veil"?

The term "corporate veil" refers to the limited legal protection you obtain when you create a corporate entity. By running your business as a corporation instead of a sole proprietorship, you generally protect yourself from personal liability for the business's actions or debts. In essence, the corporate veil ensures that the business and its owner are treated as distinct legal entities.

How Is the Corporate Veil Pierced?

A court may pierce the corporate veil if it finds that the separation between you and your business isn't sufficient. This means a creditor or affected party might be able to sue you personally for the business's actions. When this happens, the corporate veil protection is lifted, and your personal property could be at risk.

To pierce the corporate veil, a party must prove that the business and its owner are so intertwined that the business is essentially an extension of the owner. This is known as the "alter ego" theory. In North Carolina, the creditor or injured party must show that the owner had so much control over the business that it lacked a "separate mind, will, or existence."

Courts in North Carolina generally prefer to uphold the liability protections for business owners. Therefore, a party seeking to pierce the corporate veil must allege and prove serious misconduct by the business and business owner to expose the business owner to personal liability.

Courts will analyze various factors to determine if a business is genuinely independent from its owner, such as:

- Whether the company was properly capitalized
- If corporate formalities were observed by directors, shareholders, officers, and managers
- The financial stability of the business
- Whether the business was divided into multiple “shell” entities
- If personal funds were siphoned from the business to pay for individual expenses or debts
- Whether the business maintained regular and proper corporate records.

How Can You Avoid Personal Liability?

It is crucial to run your business fairly and lawfully to keep your liability shield intact. Below are some key practices:

- **Keep Finances Separate:** Ensure your business and personal finances are apart. Avoid using business funds for personal expenses.
- **Follow Corporate Rules:** Adhere to corporate bylaws, pay taxes, and meet all formal requirements. This applies to LLCs and other entities as well.
- **Maintain Accurate Records:** Document business decisions and meetings and keep these records secure for at least seven years. Make sure all documentation is accurate and up-to-date. Separate these records from personal records.
- **Properly Fund Your Business:** Whether through personal investment, loans, or investors, ensure you have enough capital to cover initial costs and ongoing operations.
- **Clearly Convey Your Business Status:** Make it clear that your business is a separate entity. Use the correct business name on invoices, contracts, and business cards.

JAH Can Help

The experienced corporate attorneys at Johnston Allison Hord can help you navigate the complexities of piercing the corporate veil and safeguard personal assets from business liabilities. Our team offers expert guidance on maintaining proper corporate formalities, capitalization, and record-keeping to

ensure your business remains a distinct legal entity. If you or your company needs legal counsel, complete our [General Contact Form here](#).

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