

Status as a Legal Entity

Practice Tips for Observing the Corporate Formalities

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The corporation is a legal entity or “person,” separate from its officers, directors, shareholders and employees. One advantage of doing business in the corporate form is to prevent the corporation’s obligations from becoming the obligations of its officers, directors and shareholders by a third party attempting to “pierce the corporate veil.” This paper identifies a few items that, although basic, are often skipped by officers, directors and shareholders of a corporation. The discussion contained herein would apply equally to a limited liability company and its members and managers.

It is essential that the separate existence of the corporation be continually recognized and respected, and that any business be done by the corporation acting in its status as a legal person, not by the individuals involved. The corporation should use its full corporate name on its letterhead, contracts, website, and business cards. When the name of any officer or any employee is signed to a letter, contract, or check for the corporation or printed on a business card, the agency capacity of the officer or employee should be clearly indicated. Individuals should sign letters or agreements clearly indicating their position, such as Jane Doe, President, ABC Corporation.

Material agreements of the corporation should be approved by formal action (and written into minutes of meetings) of the Board of Directors. Examples of material agreements are:

- stock option plans
- stock purchase or subscription agreements with investors
- loan documents or line of credit agreements/funding agreements through a bank



- employment agreements
- office leases
 - buy-sell agreements

In addition, significant transactions should be reflected in Board minutes. Examples of significant transactions are: declaring dividends and distributions; issuing additional stock; paying bonuses to executive officers or directors; granting stock options.

The issuance of additional stock or grant of stock options impacts the ownership percentages of all shareholders. Ironically, this last item is one of the most often forgotten items to document, resulting in an ownership structure in which it is hard to identify owners and percentages.

All bank accounts should be established in the corporation’s name and signature cards should be executed by the appropriate responsible corporate officials in their corporate capacities and on behalf of the corporation. Any assets transferred to the corporation become its property and must be treated as such. Insurance policies for fidelity bonds, liability coverage and property coverage should be obtained in the corporation’s name.

All assets should be held in the proper corporate name, including the following:

- bank accounts
- real property
- equipment and vehicles
- trademark and trade name filings
- software
- insurance policies on principals of the corporation

The actions by the corporation’s Board of Directors (and/or shareholders) must be evidenced by resolutions adopted by the Board of Directors or by the shareholders, as the case may be. Executed consent minutes or minutes of meetings where action is taken should be kept in the corporate minute book.

For instance, a shareholder who takes money or property from his or her corporation must realize that the only way that property can legally be transferred from a corporation to its shareholders is as: (1) a dividend (taxable to the shareholder and not providing a deduction to the corporation); (2) as wages or salary; or (3) as a loan. Likewise, cash or property made available to the corporation by its shareholders will either be considered a contribution to capital or a loan. This scenario, again, is one of the least documented items, resulting in an inability to accurately reflect transactions in corporate records and in the corporation’s tax returns.

Keeping proper records and documenting action of the Board of Directors and shareholders are important to limit the ability of third parties attempting to “pierce the corporate veil.” In addition, if the company attempts to obtain any type of financing, or is a party to any merger or acquisition, the other parties will need to conduct “due diligence” on the corporation by reviewing all of its records. Therefore keeping accurate records minimizes what might otherwise be another hurdle in obtaining financing or engaging in an M&A transaction.

If you have questions regarding your corporate records, or would like assistance in conducting an audit of your records, please contact me.