

Bullet-Proofing Your Corporation

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Bullet-Proofing Your Corporation

Many small business owners are well aware of the importance and benefits of incorporation. If properly formed and operated, a corporation shields its shareholders from personal liability.

While many small business owners seek legal counsel to assist them with formation of their corporation, they may not understand the benefits of having continuing legal counsel to assist with the operation of their corporation—specifically the importance of maintaining corporate formalities. Failure to draft and maintain documents related to the operation of your corporation may subject the corporation to fines from state agencies, civil liability, and, at worst, the ability of courts to disregard the corporate form and make shareholders personally liable for debts of the corporation.

Though you may believe that your business is a small, private company that does not need to follow the rules for large, public companies, the law does not make exceptions—only subtle distinctions that your attorney can explain to you.

What Is Required?

Upon the formation of your corporation, you must submit Articles of Incorporation to the Secretary of State in your domicile. The Articles of Incorporation must have specific clauses by law. If you have a closely held corporation, you must include additional clauses specified by law. No corporation may issue shares until the Articles are approved by the Commissioner of Corporations. Your corporation must also draft and adopt bylaws, laying out the rules adopted by the corporation for its internal

governance. Annually, a corporation must file a Statement of Information with the Secretary of the State to remain in good standing.

Prior to issuing any stock, even a so-called “private” company may be required to either register the stock with the relevant state corporate agency or request an exemption. Your attorney can assist you with filing for the proper exemption to ensure your stock is properly authorized and issued, even if you—or you and your spouse—are the only shareholders. Your attorney may even be able to properly exempt shares previously issued improperly.

Corporations must also hold shareholder meetings annually and must keep minutes of such meetings. Corporate decisions must be documented and ratified, either by director meetings or by resolutions by directors passed by unanimous written consent. Proper notice must be given for all meetings, as specified in the bylaws. Your attorney can assist you in ensuring you maintain the proper minutes and resolutions for all corporate decisions.

A corporation must maintain proper accounting records and shareholder records. Even a change in the name of one of the shareholders, or (for example) a transfer of title from your personal name to the name of your Revocable Living Trust, must be properly documented in the corporate records book.

Failure to Comply Can Harm You

Failure to comply with the above formalities can subject you to monetary fines, personal liability, or even loss of control over your business.

If you do not annually file the Statement of Information with the state, the Franchise Tax Board may impose fines on your corporation. Failure to file for two consecutive years could lead the Secretary of State to suspend your corporate rights, powers and privileges.

Failure to properly separate the affairs of your corporation and personal affairs may also allow a court to determine that the shareholders of a corporation are personally liable for corporate debts, which would eliminate one of the major benefits of the corporate form. A court may take into account a number of factors before making a determination, among them commingling corporate and personal funds, treatment of corporate assets as personal assets, failure to obtain authority to issue stock or improperly issued stock, failure to maintain minutes or adequate corporate records, and disregard of legal formalities among related entities.

Keeping good records and tight control over the corporation is especially important if you have business partners. Your business partner may take actions on behalf of the corporation that you may not be aware of if you do not maintain strict control over corporate activities by complying with the above rules. The actions taken by partners may lead to corporate or even personal liability. Furthermore, disputes amongst business partners can quickly escalate into very expensive litigation. Many of these disputes arise in corporations where actions taken by directors and/or officers are not properly documented, and one party may take advantage of the lax oversight of corporate affairs.

Maintaining complete corporate records and retaining knowledgeable corporate counsel can save you substantial litigation expenses and fines, and provide invaluable stress relief!

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