

You and Your Business: Why Keeping Them Separate Matters

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Agenda

- How Can I Structure My Business?
- Why Should I Form an Entity?
- What if I Don't Keep My Business Separate?
- How Do I Keep My Business Separate?

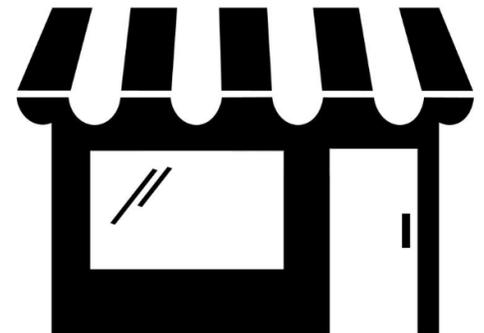
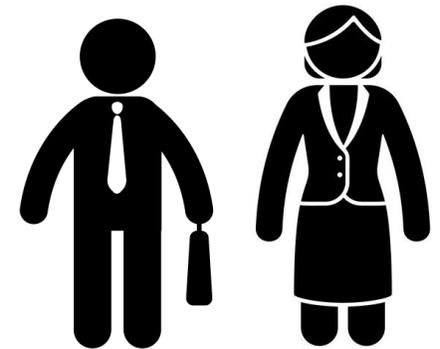
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How Can I Structure My Business?

- Sole proprietorship
 - Simplest form; no legal entity required
 - May operate under trade name, but business and owner legally the same
- Partnership
 - Same as a sole proprietorship, but with more than one owner
- Limited liability company (“LLC”)
 - Separate legal entity for the business
 - Flexible as to ownership, management, tax treatment; few formalities
- Corporation
 - Separate legal entity for the business
 - Requires compliance with certain corporate formalities

Why Should I Form an Entity?

- Key consideration: **limited liability** nature of a legal entity
- Who is liable for debts, judgments and claims of the business?
 - Sole proprietorship or partnership: **owners/partners**
 - Owners/partners have unlimited personal liability for the debts, judgments and claims of the business
 - LLC or corporation: **the business**
 - Members/shareholders are generally not personally liable for debts, judgments or claims of the business
 - Liability is generally limited to the amount of their investment in the business



What If I Don't Keep My Business Separate?

- If someone sues, they will sue the business and possibly owner
- Courts are generally reluctant to disregard a separate legal entity and hold individual owners personally liable
- However, personal liability may be imposed to protect innocent third parties from fraud or injustice

What If I Don't Keep My Business Separate?

- Courts conduct a fact-specific inquiry into multiple factors in deciding whether to “pierce the corporate veil”
 - Examines whether the business was operated as its own business unit, separate and distinct from the owner’s personal affairs
 - Many jurisdictions apply the same analysis to LLCs
- Some of the factors courts will consider include:
 - Failure to observe corporate formalities
 - Lack of corporate records
 - Commingling of funds
 - Diversion of assets

What If I Don't Keep My Business Separate?

- Brooks v. Becker, Virginia (2005)
 - Becker Interiors, project manager, hired Stephen Brooks, subcontractor for home renovation, but failed to pay Brooks \$55,000 for work performed
 - Brooks sued Becker Interiors, a corporation, and won, but the corporation had no assets, so Brooks sued Ronald Becker, the owner
 - The court held that Brooks could recover against Ronald Becker personally, finding he had “treated the corporation’s funds as his personal piggy bank”
 - Used \$100,000 of the corporations funds to renovate his personal residence
 - Used \$185,000 to pay his own personal credit card bills
 - Sold the corporation’s vehicles for \$74,000 and deposited the funds in his personal account
 - Took an income tax refund check payable to the corporation and deposited it in his account
 - Commingled his personal funds with the corporation’s funds
 - “[S]eparate personalities of the corporation and the individual no longer exist”

What If I Don't Keep My Business Separate?

- Peters v. Guy, Maryland (2018)
 - Esther Guy was the sole owner of Early Healthcare Giver, Inc., which was sued by a former employee for failure to pay overtime
 - The court awarded the employee \$18,600, but Guy caused the corporation to become defunct and withdrew all funds
 - The court held that the employee could recover directly against Guy, finding that Guy:
 - “Never held a meeting of the board”, “never issued any stock” and “maintained no bylaws or other formal rules to govern” the corporation
 - “Kept no record of money she withdrew from corporate accounts for herself, which she did whenever she pleased”
 - She “routinely siphoned off corporate assets for her personal use” and charged personal expenses to corporate accounts (causing the IRS to assess additional taxes)

What If I Don't Keep My Business Separate?

- Krauss v. Apex Custom Homes, LLC, Virginia (2019)
 - Paul and Holly Krauss entered into a contract with Apex, owned by Scott Prendergast, for construction of a single-family home
 - Krauss sued Apex for breach of contract related to defective work, and sought to pierce the corporate veil and recover from Prendergast directly
 - The court denied their claim, finding that:
 - Alex had an LLC operating agreement and Prendergast abided by its terms
 - Apex maintained a bank account separate from Prendergast's personal account
 - Apex kept detailed ledgers and financial records, which showed to the court "the ordinary, routine, and proper expenses of a small business"

What If I Don't Keep My Business Separate?

- Other reasons to keep your business separate:
 - **Tax Purposes**
 - Keeping accurate, separate records helps support deductions, avoid issues in audit
 - Helps demonstrate that the business is a business, not a hobby
 - **Business Credit**
 - Difficult to apply for financing if can't provide financial information for the business
 - **Professional Image**
 - Makes business look more professional and established to have separate accounts

How Do I Keep My Business Separate?

- Consider forming a separate legal entity for your business
 - Only way to get limited liability protection; clear indicator of separation
- Take actions and sign documents in the business's name
 - Appoint yourself as an officer of the entity (e.g., President)

WRONG:

This Lease Agreement, dated as of
November 1, 2020, is by and between
John Smith and Landlord, LLC...

Signed:

John Smith
John Smith

RIGHT:

This Lease Agreement, dated as of
November 1, 2020, is by and between
Small Business LLC and Landlord, LLC...

Signed:

SMALL BUSINESS LLC

John Smith

Name: John Smith
Title: President

How Do I Keep My Business Separate?

- Open separate bank account for business in business's name
- Apply for and use credits cards / checks in business's name
- Track personal vs. business expenses, keep separate receipts
 - Consider using a dedicated accounting system/software
- Document money/assets you put into or take out of the business
 - Transactions between the business and owners should be arm's-length
- Educate your partners, employees, family members, etc.
- If you make a mistake, correct it

How Else Can I Protect Myself?

- Business insurance
- Create form contracts with favorable provisions
- Contractual indemnification provisions and limitations on liability

Questions?