

When Your Entity Doesn't Protect You

AND HOW TO PROTECT YOURSELF

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A Few Legal Concepts First

TYPES OF LIABILITY

THE CORPORATE VEIL

Types of Liability

CONTRACT LIABILITY

- ▶ Based on a contract or agreement between two parties
- ▶ “Privity of Contract” – You must have a direct contractual relationship to sue on a contract

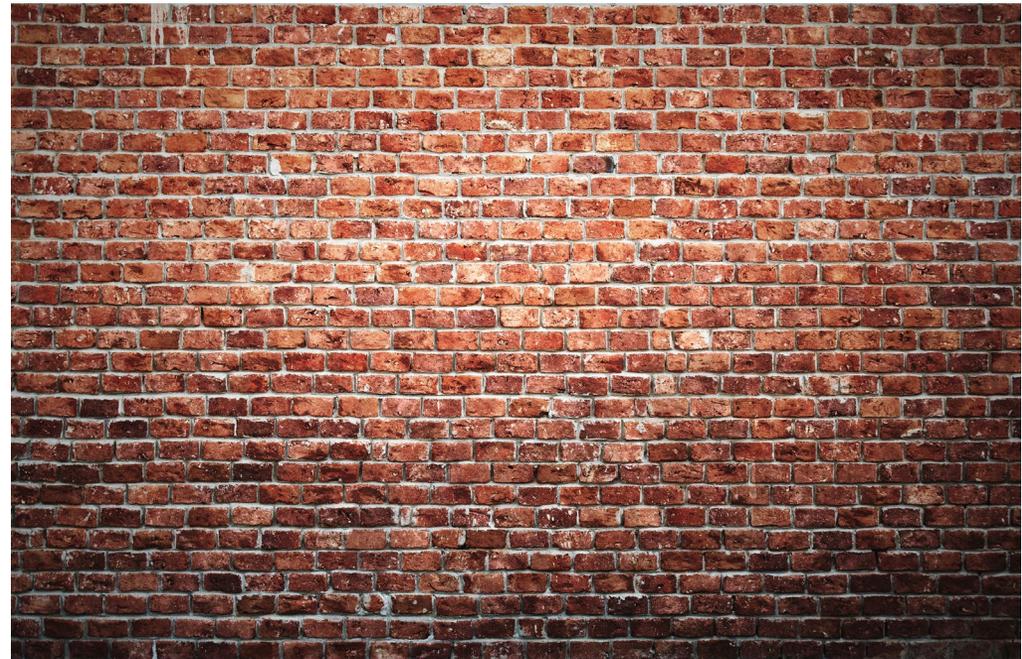
TORT LIABILITY

- ▶ Based on civil law and duties
- ▶ Can be intentional (i.e. defamation), unintentional (i.e. negligence), or “strict” (i.e. product liability)
- ▶ Does not require privity of contract

The Corporate Veil

- ▶ Legal separation of the company from its owners
- ▶ Essentially acts as a shield for the owner's assets from company liabilities

NOTE: Corporate liability protections are available for filing entities such as corporations, limited partnerships, and limited liability companies (LLCs). They are **NOT available for general partnerships where the owners are jointly and severally liable.**



Piercing The Corporate Veil



- ▶ Legal concept where the distinction between the company and the owners is not clear enough, allowing the company liabilities to flow through to the owners (Alter Ego Theory)
- ▶ Actual or constructive fraud is required in Texas. However, courts consider certain factors:
 - ▶ Commingling of corporate assets with personal assets
 - ▶ Failure to follow corporate formalities (i.e. not holding company meetings, not keeping accurate business records)
 - ▶ Insufficiently funding the entity
 - ▶ Using the entity to commit fraud

Legal Options For the Creditor

CHARGING ORDER

FORECLOSURE

FRAUDULENT TRANSFERS

What Can a Creditor Do If They Get a Judgment Against My Company?

LLCs and Limited Partnerships

- ▶ Charging Order
 - ▶ Judge's order enabling creditor to intercept and receive any distributions, payments, or proceeds from a specific entity to the judgement debtor
- ▶ Business Organizations Code Section 101.112
 - ▶ (b)..."The charging order may not be foreclosed upon under this code or any other law."
 - ▶ (c) "A charging order is the exclusive remedy by which a judgement creditor... may satisfy a judgment"
- ▶ Judgement creditor gets paid only if and when distributions from the entity occur.

Corporations

- ▶ Corporate stock may be seized and sold at public auction

Fraudulent Transfers

Importantly, **protections need to be in place before a lawsuit. After is too late.**

After a lawsuit has been filed, transfers can be deemed fraudulent transfers if undertaken with the intent to defraud, delay, or hinder a creditor. (Tex. Business & Commerce Code Sec. 24.005)

Other Scenarios Allowing Creditors to “See Through” Entity Protection

INACTIVE STATUS

SIGNING CONTRACTS IN
PERSONAL NAME

CORPORATE
DOCUMENTS ALLOW
FOR PERSONAL LIABILITY

PERSONAL GUARANTEES

PROFESSIONAL LIABILITY

Inactive Entity Status. What Does This Mean?



- ▶ Entity status can be forfeited for failure to maintain a registered agent, file a franchise tax report and/or pay franchise tax.
- ▶ Entity can be reinstated (at any time) by
 - ▶ Filing required franchise tax report
 - ▶ Paying all franchise taxes, penalties and interest
 - ▶ And filing an application for reinstatement, along with a tax clearance letter from the Comptroller.
- ▶ Impact of Inactive / Forfeited Status
 - ▶ Forfeited right to transact business in Texas
 - ▶ Cannot maintain any action, suit, or proceeding in any Texas court
 - ▶ Cannot amend its certificate of formation or registration
 - ▶ **Personal liability for managers, directors, and officers**

Failing to Pay Franchise Taxes

- ▶ Franchise tax returns are due by May 15th each year.
- ▶ Starting January 1, 2024, the no tax due threshold was increased to \$2.47M. Businesses are no longer required to file the “No Tax Due Report” if they are under the threshold, but they are still required to file the Public Information Report.
- ▶ Failure to pay the Texas franchise tax results in **personal liability** for the company’s directors and officers, not only for the franchise tax liability, but also **for all company liabilities that arise after the State terminates the company’s existence** for failure to pay franchise tax. Tex. Tax Code Ann. § 171.255(a).
- ▶ If the entity is forfeited and later revived, the liability under 171.255 is not affected by the revival → **If entity is forfeited, need to revive ASAP!!!**

Signing Contracts in Personal Name

- ▶ Don't sign contracts in personal name before the entity is created
- ▶ Make sure it is clear that you are signing the contract in your capacity as a manager or officer of the entity
- ▶ If you sign in your personal name, you could be held personally liable for the contract obligations (you could be sued individually for any breaches of the contract)

Signature Alternatives:

- ▶ James P. Dossey, President, Venture Vault, LLC
- ▶ Signature "Block" (best way)

Venture Vault, LLC

A Texas Limited Liability Company

By: _____

James P. Dossey, President

Sometimes Corporate Documents Can Create Personal Liability for Owners

- ▶ No indemnification of officers, shareholders, managers
- ▶ General Partner for Limited Partnerships has unlimited personal liability for partnership. – **GP needs to be an LLC or Corporation.**
- ▶ Operating Agreement or Partnership Agreement requires capital contributions from members or partners to pay partnership debts or obligations.
- ▶ Operating Agreement or Partnership Agreement requires partner to restore negative capital account balances on dissolution / liquidation.
 - ▶ Example – LLC is sued and has a large judgement against it. LLC needs to dissolve. Requirement to restore negative capital account can create personal **unlimited** liability for owners to pay the judgement.
 - ▶ If owners amend the operating agreement too close to a judgement, this could be seen as a fraudulent transfer

Personal Guarantees

- ▶ Allows creditor to collect against an individual guarantor if the business fails to pay.
- ▶ Typically required for loans and leases; may be included in other contracts to guarantee performance.
- ▶ Typically also apply to assignees, descendants, heirs, spouses, etc. They do not go away when someone dies.
- ▶ **Extreme caution needs to be taken with personal guarantees.**



Professional Liability / Malpractice



Professionals (i.e. lawyers, CPAs, Doctors, Architect, etc.) are held to a higher degree of care than unlicensed people



Personal liability can apply when the professional is shown to have breached their duty to act with reasonable care

How Can I Protect Myself?

MINIMIZE RISK OF
PIERCING THE
CORPORATE VEIL

INSURANCE

STATE OF FORMATION

CONFIDENTIALITY OF
OWNERSHIP

COMPARTMENTALIZING
RISK

How Can I Reduce the Risk of Piercing the Corporate Veil?



✓ Ensuring that all the corporate documents are valid and updated (and executed)



✓ Keep up to date accounting and corporate records



✓ Hold regular meetings and document with corporate resolutions and meeting minutes

✓ Every entity should have a bank account with some amount of money in it to ensure adequate capitalization

✓ Entity bank account should be separate from personal account, and no personal expenses should be paid from the entity account



✓ Do not let the entity fall into invalid status

✓ Do not sign contracts or other agreements in personal name; ensure your capacity to sign is clear by noting your title or position in the company

✓ File all corporate filings and tax returns on time

✓ Use management service agreements, leases, etc. to maintain separation between subsidiaries or affiliates

Consider Liability Insurance

- ▶ The entity protects your personal assets from liability, but it does not protect your business assets. Business insurance can help protect the business assets.
 - ▶ If the business is severely impacted by a loss, the owner may need to contribute funds to support the business.
 - ▶ Without insurance, the owner may not be legally liable for a liability, but practically they still have to pay the liability to keep the business afloat.
- ▶ Professionals can be held personally liable for malpractice. Most lawyers, doctors, CPAs and other professionals carry professional liability insurance (i.e. Errors and Omissions) to cover these risks.



Does the State of Formation Matter?

- ▶ Traditionally, Delaware, Wyoming, and Nevada have been popular for entity formations
- ▶ Delaware is known as the “motherhood” of corporate and business law
- ▶ Practically, however, very little difference exists between the state laws.
- ▶ Many big businesses are moving out of Delaware to Texas (Tesla and SpaceX)
- ▶ To do business in Texas, you still must register in Texas as a foreign entity which negates any perceived advantage of a different state.



Confidentiality of Ownership

- ▶ Ownership of entities are not public information in Texas. However, the governing authority is on file with the Secretary of State.



- ▶ Where possible, it is best to keep the “clues of ownership” of an entity confidential.

- ▶ Use a trust or a non-Texas entity as the governing authority for the entity.
- ▶ Do not use your personal address as the business address (but it can't be a PO box)



- ▶ Use a third party as the registered agent
- ▶ Own real estate in an entity or trust, not in your personal name

Compartmentalize Risk



Identify source of risk and what type of risk



Separate assets from source of risk

Separate operations from assets (operating company and holding company)

For professionals, separate assets from their person (because they are the risk)

Within a holding company, legally separate assets from each other (i.e. Series LLC)



Establish legal autonomy of each subsidiary or affiliate

Master Service Agreements (“MSA”)

Lease between operating and holding companies

Separate bank accounts, corporate documents, etc.

Thank You

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A Safe Place for Business.

Venture Vault is a one-stop-shop online portal for business entity protection and compliance.

The screenshot displays the 'MOSSEY' web application interface. The main section is titled 'Entities' and includes a 'Create a New Entity' button, an 'Entity Search' section with a search input and a dropdown menu, and an 'Active Entity Roster' showing several entity cards with profile icons and state abbreviations (TX, CO, FL).

An 'Entity Representatives' modal is open, listing the following representatives:

Representative Name	Role
Tawny Davidson	Owner
Jefferson Merrick	Representative
Terrence O'Toole	Representative
Eckhart Bellringer	Representative

A detailed form for entity information is also visible, containing the following fields:

Field	Value
Entity Name	John Peppercom
Entity Type	C Corporation
EIN	192503520058
Registered Agent Name	Jake Johnny
Registered Agent Address	142415 Pine Lane, Houston TX 77080
Principal Office Address	142415 Pine Lane, Houston TX 77080
State of Incorporation	Texas
State File Number	123502015
Web File Number (TX Comptroller Only)	123502015
Contact Address	142415 Pine Lane, Houston TX 77080
Contact Email	1234@hotmail.com
Contact Phone	713-668-9874
Attorney Name	Jim Van Jones
Attorney Address	142415 Johnny Cakes Lane, Houston TX 77080
Attorney Email	134@gmail.com
Attorney Phone	33-333-5555
CPA Name	Jackie Doe
CPA Address	11211 Joe Joe Freeway, Nevada Utah 1234
CPA Email	123@netzero.net
CPA Phone	222-242-2222
Entity Ownership / Management	Texas
Assumed Names	Mister Esquire
Assumed Names	Dan Joseph, John Doe, Dave Smith, California Henley
Annual Minutes Drafted	1
Annual Minutes Executed	2



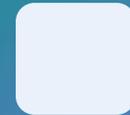
VENTURE
V A U L T



Monitor your entity status in real-time.



Generate your annual minutes.



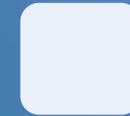
Ultra-secure document storage.



Act as your registered agent.



File your CTA information with FinCEN.



// Coming Soon //
File your Public Information Report with Comptroller