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Alter Ego: When Individuals May Be Liable for Corporate Debts

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Nevada encourages business ventures and entrepreneurship by allowing individuals to form corporations as a shield against personal liability. Generally, individuals are considered separate from the corporations they control. So, if a corporation fails to pay a debt, the corporation itself is liable, and not its individual owners or operators.

But the individual protection offered by a corporation is not unlimited. Under the doctrine of “alter ego” (also known as “piercing the corporate veil”), individuals may be liable for the actions of their corporations in certain circumstances. The general question is whether the individual—usually a shareholder, officer, or director—abused the corporate form such that it would be unfair to shield that individual from personal liability. While there are no rigid requirements for the alter ego doctrine, considerations include whether (a) the individual commingled his or her personal funds with the corporation, (b) the corporation was underfunded, (c) the individual treated the corporation's funds as his or her own, or (d) corporate formalities were observed.

Example: Joe Badman started a web-design company in the form of a limited liability company (LLC) in which he was the sole member and manager. Having procured funding for the LLC from Big Bank, Badman uses those funds to pay off his student loans and purchase a “company RV,” which he uses for a long-desired road trip to all 62 National Parks. The LLC never holds meetings and, unsurprisingly, is unable to pay back its loan to Big Bank. In these circumstances, Badman could be held personally responsible for the LLC's debt to Big Bank under the Alter Ego doctrine.

Conversely, corporations may also be held liable for an individual's debts, which is known as “reverse piercing.” The considerations are largely the same as alter ego and turn on whether the individual has abused the corporate form so that the individual and corporation's assets are difficult to distinguish.

In sum, while Nevada protects the separation between individuals and corporations for the purpose of avoiding personal liability, that protection is not endless and can be pierced where the corporate form is abused.

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