**8802. How might the losses that may be incurred during operation of a business impact choice of entity decisions?**

For many business owners, the opportunity to limit personal liability may be the most attractive feature of the corporate form. This can be an advantage and even a necessity for a business that faces substantial liability for the actions of its agents, the hazardous nature of its business, or the liability exposure of its products. Also, any venture has an inherent risk of loss, especially in the early years. Shareholders in a corporation (as well as members of a limited liability company and limited partners in a limited partnership) are not liable for the corporation’s actions beyond the amount of their capital contribution to the corporation. However, there are still important considerations that must be noted, because limited liability is not absolute.

First, the corporation and its shareholders must follow strict state law requirements relating to shareholder meetings, election of a board of directors, directors’ meetings, and other matters of internal governance required by the corporation’s articles of incorporation and the state of incorporation’s laws. These are not mere formalities—a corporation which fails to follow these rules may lose its status as a corporation and limited liability in a process known as “piercing the corporate veil.” However, many states have close corporation statutes relaxing these rules and giving shareholders in a closely held corporation greater freedom to determine their own internal governance.

Second, a shareholder’s limited liability may be illusory for bank financing, because most lending institutions demand that stockholders personally guarantee close corporation indebtedness.

Finally, potential incorporators who wish to do business under an umbrella of limited liability can find other ways to do so without incorporating. One way to do so may be to set up a limited partnership with an existing corporation or S corporation as the general partner.