



“Statutory Frustration” – How Uncle Sam Can Drive Veil Piercing

Highlights

Corporations, LLCs, and limited partnerships are creatures of state law. In other words, every state legislature has documented rules (statutes) that govern the formation and operation of business entities in that state. In addition, courts in each state have produced case law that provides additional guidance on how business entities should be treated in that state.

Together, state statutes and case law provide rules and guidelines that govern corporate veil piercing. They specify how and when a veil may be pierced and business owners held personally liable. These rules and guidelines differ from state to state. However, business owners are also subject to federal laws that can sometimes conflict with state law. In the United States there is a legal doctrine called the “statutory frustration doctrine”. This doctrine, affirmed by the US Supreme Court, holds that a corporate veil cannot “frustrate” federal statutes.

This means that if a business is found to be violating a federal statute, that business’ veil can be pierced under federal law, even when state law would tell a court to respect the corporate entity.

As a practical matter, this gives business owners a whole new field of rules and regulations which they must respect. Tax disputes, divorce proceedings, ERISA violations, worker’s compensation, environmental infractions, discrimination issues, and labor disputes are only a few of the categories of federal statutes that can lead to a veil piercing under the statutory frustration doctrine.

The “Statutory Frustration” Doctrine

The statutory frustration doctrine holds that the fiction of corporate separateness must not be permitted to frustrate the principles or policies of federal statutes. The US Supreme Court announced in *Anderson v. Abbott* that a state “may choose such rules of limitation on the liability of stockholders of her corporations as she desires . . . but no State may endow its corporate structures with the power to place themselves above the Congress of the United States and defeat the federal policy . . . which Congress has announced.” (*Anderson v. Abbott*, 321 U.S. 349)

In practice, the statutory frustration doctrine consistently shows less deference to the concept of limited liability than state corporate law does. Consequently, federal courts can pierce veils in cases where state law would almost certainly leave them intact. In other words, the business owner’s risk of veil piercing is substantially increased.

Federal court cases vary in how aggressively they apply the statutory frustration doctrine. On the aggressive side, federal courts have used statutory frustration to pierce the corporate veil even when the record contains no evidence of actual intent to circumvent the statute. Some cases have held that a corporation’s mere inability to satisfy obligations imposed by federal statute is sufficient to permit a creditor to hold the defaulting corporation’s shareholders personally liable.

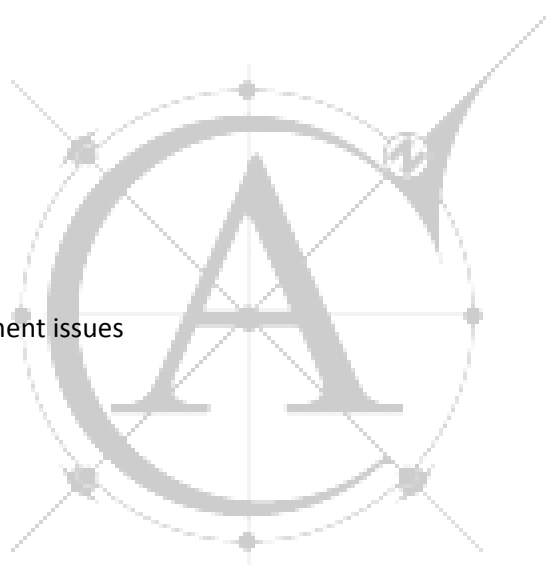
Other federal cases have been more restrictive in their use of statutory frustration. In *US v. Firestone Tire & Rubber Co.*, the court suggested that veil piercing on the basis of statutory frustration is only appropriate where

the corporate form is used to indirectly accomplish what otherwise would be prohibited and illegal (518 F. Supp. 1021, 1039-40).

Federal Statutory Reasons for Veil Piercing

Through our continuing research into statutory and common law causes for veil piercing, we have identified 28 different categories of federal statutes that have been applied to successfully pierce a corporation's veil. Among these are:

- ERISA violations
- Environmental infractions
- Fraud
- Patent violations
- Discrimination
- Securities law
- Estate issues
- Medicare disputes
- Labor disputes
- Bankruptcy
- Divorce proceedings
- Unemployment Garnishment issues
- Tax disputes
- Corporate law
- Social Security law
- Real Property law
- Foreign Subsidiary violations
- Workers Compensation
- FELA
- Constitutional law
- Others . . .



Each of these categories includes multiple statutes or requirements, all of which have already been used to hold shareholders personally liable for the statutory violation.

The Case of United States v. Pisani

In *US v. Anthony J. Pisani, MD*, the Court decided to pierce the corporate veil and hold a physician personally liable for the Medicare debts of his solely held corporation. This case provides a clear example of the doctrine of statutory frustration in action.

Anthony Pisani was president, registered agent, and sole stockholder of a New Jersey corporation doing business as a nursing home. His corporation was a Medicare participant, and received reimbursements for Medicare services provided. Medicare decided that it had overpaid Pisani and sought reimbursement of approximately \$150,000. The corporation was financially unable to repay.

In deciding whether to pierce the corporate veil and hold Pisani individually liable for the Medicare debts, the US District Court ignored New Jersey corporate law. Instead, the court fashioned a federal rule that asked whether the doctor was the alter ego of the provider. The court concluded that applying state law would frustrate specific objectives of the Medicare program.

Without a uniform federal rule, doctors would be able to use corporations with no assets to avoid returning overpayments. Physicians could organize their practice as a corporation under state law, fail to return Medicare overpayments, and yet remain personally immune from any government action. While the government would have access to the corporation's assets, if there were no assets (due to bankruptcy or transfers of assets), then the federal government's ability to recover overpayments would be dependent on a state law analysis of whether it was appropriate to pierce the corporate veil.

The court stated that one of the objectives of Medicare is prompt reimbursement to providers. If the federal government was not able to fashion a federal rule that furthered this objective, it would have to rely on the non-uniform law of different states, some of which would have a much more restrictive test for when to pierce the corporate veil.

If the government was not assured repayment, it would take more precautionary steps that would considerably delay reimbursement and would not encourage providers to treat Medicare patients.

This case was affirmed on appeal and Dr. Pisani was held personally liable for the Medicare overpayments.

Summary & Conclusion

Because state laws differ in how easy it is to pierce a corporate veil, there are those who encourage "jurisdiction shopping" among prospective business owners. For example, Nevada corporations are often promoted as the "best", "most secure" type of business entity, where owners don't need to worry about liability, corporate compliance, or veil piercing. Nevada corporations are better, so the story goes, because of corporate laws that are unique to the state of Nevada.

To a large extent, these claims are negated simply by the existence of federal laws. Regardless of your state's specific rules on corporate governance and veil piercing, federal law can be applied to override state law and pierce the corporate veil.

As always, you're safer if you know and keep the rules. . Please contact your Governance Specialist if you have any questions.

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