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Business Owners: Safeguard Your Assets from Unnecessary Risks

We all know that risk is a part of business. There will always be factors beyond the owner's control, such as interest rates, prices, and competitors. For some businesses, even the weather can throw an unforeseen and uncontrollable wrench into the smooth and profitable operation of the business.

But many other risks exist, beyond the financial and operational hazards that businesses must navigate each day. Most businesses, whether owners realize it or not, face the ongoing risk of a lawsuit, either resulting from an injury incurred during business operations or from a disgruntled customer or competitor. Product or professional liability can subject businesses to legal claims that can jeopardize the assets upon which the business depends. Disputes over the repayment of business debt can trigger the type of lawsuit that sends some firms into bankruptcy. Moreover, the improper structuring of assets and ownership can allow problems at the business to jeopardize personal assets, placing them at risk, as well.

Clearly, an asset protection plan is a vital component of any business's overall operational strategy. While it is probably impossible to eliminate all risk, properly designed asset-protection tactics can significantly reduce the vulnerability of business and personal assets to claims that can arise in the course of operations.

It is important at the outset to recognize the most common types of business assets. *Dangerous assets*are those that, by their nature and use, present risks of liability. An example of a dangerous asset is the heavy equipment used by construction companies. Such equipment poses a risk every time it is used. Someone could be injured, or the improper use of the equipment could cause damage to property. Rental property can also be considered a dangerous asset. Someone could slip on a step and break a leg, or someone could be electrocuted by a malfunctioning circuit. *Safe assets*, on the other hand, pose little or no likelihood of harm or injury. Bank accounts and investments are examples of safe assets; their use and maintenance cannot hurt anyone.

One principle of effective asset protection is to keep ownership of dangerous assets and safe assets separated, to the degree possible. The owner of an incorporated business, for example, might choose to have the corporation own all dangerous assets and maintain personal ownership of most or all of the safe assets. As long as proper separation is maintained between corporate and personal assets, it would be much more difficult for a plaintiff or a creditor to make a successful claim against the personal assets. It is very important, however, to maintain that separation. Failure to do so could create the opportunity for plaintiffs and creditors to "pierce the corporate veil," making the legal argument that the corporation is really just a proxy for the individual.

The form of business organization is another aspect of asset protection. As suggested above, many businesses operate as corporations, precisely because of the protections afforded to the owners of the corporation. A legally organized corporation is owned by its shareholders, and each shareholder's personal liability is limited to the value of his or her individual shares. Creditors of the corporation who pursue claims against the company are limited to assets owned by the corporation; the personal assets of the corporation's owners are not susceptible to seizure.

Within the larger category of corporations, there are a number of subcategories. "C" corporations, which include the largest companies in America, are taxed as entities unto themselves. The company is treated as a separate individual with regard to the income it generates, and it also has legal existence in terms of liability. For example, plaintiffs may file suits against the corporation, and creditors may look to the assets of the corporation for satisfaction of claims. "S" corporations, on the other hand, pass the income they generate to the shareholders; the shareholders, not the corporation, pay tax on that income. These are

typically much smaller businesses with a limited number of shareholders, but their corporate structure still provides many of the protective benefits of “C” corporations. Limited liability companies (LLCs), like corporations, have their own legal existence, and the owners of an LLC cannot be held personally responsible for the debts or liabilities of the company. Income generated by an LLC, like that of an S corporation, is passed through to the owners. The chief difference—and, in some cases, a disadvantage—of an LLC is that, like a partnership, it cannot survive the death of one of the owners. Corporations, on the other hand, can exist in perpetuity.

Other forms of business organization, such as partnerships or sole proprietorships, do not offer a high degree of protection for personal assets. In a general partnership, for example, each partner is liable for the actions of all the other partners, even if one partner acts without the knowledge or consent of the others. For this reason, general partnerships are one of the least effective forms of organization, from an asset-protection perspective. Similarly, with a sole proprietorship, the owner and the business are essentially one and the same. Any liabilities or debts incurred by the business are the responsibility of the owner.

Trusts are another useful tool for protecting assets. They involve three entities: the *grantor*(the person or organization that creates and places assets in the trust), the *beneficiary*(the person or organization that receives or benefits from the assets in the trust), and the *trustee*(the person or organization that secures and manages the assets in the trust). A trust may be either *revocable*(the grantor may amend or revoke part or all of the trust) or *irrevocable*(the grantor may make no changes whatever to the trust). Of the two types, the irrevocable trust offers the greater protection for assets in the trust, simply because the law holds that grantors cannot be sued for assets over which they no longer have any control. An irrevocable trust can be a very effective tool for protecting assets that are intended for the future use of minor children, for example.

Finally, certain types of assets enjoy greater protection from claims because of their purpose. Retirement accounts, for example—such as IRAs, 401(k) plans, and pension plans—are typically shielded from the claims of creditors in bankruptcy cases. For some individuals, this can constitute a strong incentive to make maximum annual contributions to such accounts, because the assets within them enjoy an extra measure of protection from legal claims.

The key to any asset protection plan, of course, is timely implementation. The longer your plan is in place, the more likely it is to survive a legal challenge or claim. On the other hand, if you wait until you are sued or liable to the claim of a creditor, any attempt to shield assets is likely to be seen as no more than a fraudulent transfer.

If you are seriously concerned about minimizing risks to your business and personal assets, you should work with a qualified legal professional to develop a strategy that is tailored to your unique situation. This is one more situation where some careful planning now can avoid

significant heartache and stress later.

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