Personal Assets and Business Risk

Time. Money. Energy. Brainpower. More money. It takes a lot to own and operate a business. As natural risk-takers, most business owners are prepared to lose investments in time and money if their business takes a hit. Unfortunately, exposure to loss and liability may cost you even more than your business assets—and that's a possibility even the most experienced business owners find hard to accept. If you are personally liable for your business debt, creditors may be able to take your personal property to pay off these debts. That means your savings, car or even your home could potentially be seized to cover your business debts. Fortunately, there are security measures available, such as asset protection plans and insurance. Each can help you prevent business risk by providing a comprehensive way to safeguard your assets. By understanding your business liability and the best way to protect against potential claims, you can help defend your assets from creditors.

When determining the best way to protect your assets, consider the following:

- **What am I liable for?**
- **Possible business risks**
- **Asset protection plans**
- **Insurance**
- **Additional ways to minimize liability**

What am I liable for?

Before protecting yourself against business risk, you have to determine your personal liability risk. While your business will always be subject to debt, that doesn't always mean your personal assets can be used to pay that debt. There are two types of claims that can be made against you: internal claims and external claims. Internal claims are limited to pursuing your business's assets, while external claims can extend to your personal assets as well. Your liability depends largely on the type of business entity you own, as well as the nature of your business and your assets.

Certain types of entities, industries and assets are generally more liable than others.

- **Liability by entity**: Sole proprietorships and partnerships are much more open to liability than corporations are and limited liability companies (LLCs) because sole proprietorships and partnerships treat personal and business finances as the same. That makes you personally liable for any debts or lawsuits that your business assumes. If your business goes into debt or is hit with an expensive lawsuit, you may lose your assets as a result. Partnerships can be especially worrisome in terms

Busine LLC
4225 Executive Square, Suite 600
La Jolla, CA 92037

858.255.4274
www.businewealth.com

of liability because you are liable not only for your own actions, but also for the actions of your partner(s). Alternatively, corporations and LLCs provide limited liability to owners, meaning that your personal assets are insulated from liability even if your business gets into trouble. It is referred to as "limited liability" because this cannot protect you from certain kinds of personal liability. For example, if a doctor mistreats a patient, he or she can be sued for malpractice even if part of a corporation or LLC. The same kind of personal liability affects dentists, lawyers, accountants and psychiatrists.

- **Liability by industry**: Businesses in certain industries are more susceptible to liability than others, simply due to the nature of day-to-day operations. Examples include medical or legal practices, contracting companies (that risk injury or damage to property when working on people's homes), companies with delivery drivers (who run an increased risk of accident), home cleaners (who frequently work with chemicals) and many more. If you think your business falls under this category, you will likely want to explore extended insurance coverage.
- **Liability by assets**: Assets known as "dangerous assets" create a large liability risk. These include commercial property, machinery and equipment, motor vehicles, rental real estate or any other type of asset that has a high degree of inherent liability. On the other hand, "safe assets" would be those that don't incorporate a lot of risk, such as personal savings accounts, stocks or bonds. If a large amount of your business assets are considered "dangerous," it will make you more susceptible to business risk overall.

Possible business risks

It can be hard to imagine a creditor appearing out of nowhere to seize your personal assets, but business risk may be closer than you think. All of the following can result in a claim against you:

- A client or worker slips or has an accident on your business property
- You or an employee damages someone else's property while working
- You take out a business loan and are unable to repay it
- You are sued for malpractice
- One of your employees files a sexual harassment or wrongful discharge suit against you
- Your product malfunctions, leading to a lawsuit
- You default on a mortgage or equipment payment
- You fail to pay a supplier on time

These are just some common scenarios that open you up to business risk, but there are many more. Make sure you're prepared to handle business risk by coming up with strategies to minimize your liability.

Asset protection plans

One way to protect yourself from business risk is to set up an asset protection plan with your attorney. Asset protection plans provide a way to deter claims and help prevent the seizure of your personal assets through the setup of various legal documents and entities. Typically, these plans combine corporations or partnerships as a way to keep risk inside the business itself as well as trusts to shelter personal assets. It's a good idea to start asset protection plans sooner rather than later, as the longer they are in place, the stronger they will be.

Asset protection plans often use irrevocable trusts to protect personal assets. Unlike revocable trusts, irrevocable trusts are trusts that you don't control and cannot revoke, so the money within the trust likely will not be considered yours from a legal standpoint. This makes the money unreachable by creditors, providing you with some form of asset protection.

Asset protection trusts are a special type of irrevocable trust that is only legal in certain states. They allow for the distribution of money from a trust, even though the trust would be considered outside the grantor's estate. Because they are not legal nationwide, many of these types of trusts are found in offshore accounts. Asset protection trusts are complex and expensive, and should not be attempted without the help of a legal professional. There are also many risks involved, and if you're found to have created an asset protection trust fraudulently, creditors may still have access to the funds within it.

Above all, asset protection plans should be considered sooner rather than later. If you try to transfer funds outside of your estate after a claim or liability arises, a judge may be able to void the transfer and seize your assets anyway. It's important to remember that asset protection plans are just that—plans. Although they attempt to hide and shelter your wealth, there's always the chance that creditors will "find" this wealth anyway. Asset protection plans should always be supplemented with insurance.

Insurance

Insurance can protect you if you don't have an asset protection plan or your asset protection plan fails. It can provide coverage for a variety of business risks, depending on what type of policy you choose. It's important to meet with your insurance agent on a regular basis to ensure that you have the right policies for your situation. Consider the following options for insuring your business:

- **General liability insurance**: Provides coverage for legal ramifications due to injuries, accidents and property damage caused by either you or one of your employees.
- **Product liability insurance**: Provides coverage against financial loss due to a product defect.
- **Professional liability insurance**: Provides coverage against malpractice, errors and/or negligence for professionals who provide a service (doctors, lawyers, accountants, etc.)
- **Commercial property insurance**: Provides coverage against loss and damage of company property due to events such as fire, wind/hail storms, vandalism, etc.

Additional ways to minimize liability

Beyond asset protection plans and insurance, there are many things you can do to minimize your business risk, including the following:

- **Keep business and personal finances completely separate.** If you run a corporation or LLC and fail to keep a formal separation between your business and personal finances, a creditor can try to hold you personally responsible for business debts. This is known as "piercing the corporate veil," and it happens when a court determines that you have not observed the formalities imposed on corporations and LLCs by state law. This could include making important business decisions without recording them in the minutes of a meeting or paying business expenses out of a personal checkbook.
- **Show a clean business record.** By being diligent in your recordkeeping and fee paying and showing a clean history of business practices, you will have an easier time proving that any claim made against you was an isolated accident rather than the result of poor business practices. For example, if you keep records that you pay someone to regularly shovel and de-ice the sidewalks on your business property, if someone slips and falls on a sidewalk he or she will be less likely to win a lawsuit against you.
- **Avoid personal guarantees.** A personal guarantee is when you pledge to be personally responsible for a debt. It makes you liable for debt if your business is unable to pay it. However, some loans and leases will require a personal guarantee to help banks or lenders avoid risk, as small businesses are often considered risky partners. If you do have to sign a personal guarantee, try to negotiate for limitations, such as limiting the guarantee to the first two or three years of the loan or limiting it to your own interest in the company if you share interest with partners.
- **Be honest when applying for credit.** If you misrepresent any facts when applying for a credit card or loan on behalf of your business, you could be held personally responsible for liability, even if you run a corporation or LLC.
- **Make sure contracts include liability protection.** A contract you sign on behalf of your business (and you should always sign on behalf of your company, not in your own name) should contain some form of liability protection, such as a cap on damages.
- **Be wary of business credit cards.** Although it may seem as though a business card would automatically qualify as business debt, most small business credit cards offer "joint and several" liability, which means that you share responsibility with your company for any debt that the card carries. Be aware of this when making large purchases using a business card.