Is Your Business Protected?

As a business owner, there's risk involved in building and growing the business. Risk comes in various stages of the business lifecycle, but lawsuits and bankruptcy are two of the risks that never seem to go away. However, there are effective ways business owners can protect their personal assets. Your CPA and Avantax Planning Partners can help business owners explore options that make sense for their business and needs.

Select the Proper Business Structure

Creating a business structure to protect personal assets may be the single most important step to take. The two simplest forms of business structure provide the least protection for personal assets: sole proprietorships and general partnerships. These business structures are easy to form but they offer no limit on personal liability. The general partnership, potentially, has even greater risk as the bad acts of one partner could translate into liability for the other partners.

Typical business structures that people may use to provide protection from personal liability may include:

- Limited Partnership – A limited partner is typically only liable for the amount that he or she invested. A limited partner's personal assets typically cannot be subjected to claims against the business. A general partner, however, has full liability for debts and claims against the partnership.
- Limited Liability Companies – These could be limited liability companies or partnerships (LLCs or LLPs). The business is responsible for its own debts and liabilities, but if the business cannot pay what it owes, the owners' personal assets are typically protected.
- Limited Liability Limited Partnership – This entity offers some liability protection for the general partner. It is a more recent modification of the limited partnership. Slightly more than half of the states allow formation of LLLPs.
- Corporations – S Corps and C Corps both provide asset protection to the owners.

These options should be explored with your attorney, and you may also want to consult a tax consultant (as each entity type may have different tax consequences) to decide if any of these options are right for you or your business.

A few words of caution with respect to corporations, LPs and LLCs, if the business owner doesn't keep business entity affairs separate from personal affairs, the separate entity could be considered a sham. This is an important discussion between business owners and their attorney to ensure proper governance for the entity that is utilized. Creditors may be able to go after personal assets for satisfaction of debts or judgments if the entity is considered a sham. The following strategies, along with others that may be suggested by your attorney, may be helpful:

1. Follow the rules of incorporation. Keep up with the applicable corporate documents, such as the by-laws and meeting minutes. Make sure the company stays current on annual filings with the state.
2. Avoid co-mingling of personal and business funds. The business checking account should not be used as a personal checking account. Lawyers seeing this may file suit based on the "alter ego doctrine," where the company is not really a separate entity, it is an alter ego of the owner.[1] This could subject the owner to personal liability. Should the owner need money, he or she should take a distribution rather than write a check from the business account.
3. Keep appropriate levels of cash in the business. Underfunding or pulling too much cash out of the business may give the appearance of trying to defraud creditors.

Purchase Insurance Coverage

Businesses may be able protect themselves from liabilities by buying the right kinds of insurance. This strategy should be reviewed between a business owner, their attorney and accounting professional, and a professional from Avantax Planning Partners. If there is adequate insurance on the business, claimants and creditors may be less likely to pursue claims of personal liability. Different types of insurance that may be considered are as follows:

- Errors and Omissions (E&O) Insurance – Professional service providers like financial advisors, lawyers, engineers, accountants and so on can protect their businesses from civil liability for negligence, misrepresentation, violation of good faith and fair dealing.
- Malpractice Insurance – This is required for medical doctors.
- Commercial Liability Insurance – Provides coverage for injuries sustained on business premises.
- Worker's Compensation – Provides protection for workers who get injured on the job.

Avantax can also help business owners explore coverage at the personal level. This coverage provides back-up if homeowners or auto coverages do not fully cover a claim.

Contribute to Qualified Retirement Accounts

Assets in retirement accounts covered by ERISA such as 401(k), 403(b), SEP, SIMPLE, employee stock ownership, cash balance, and profit-sharing plans typically have unlimited protection in case of bankruptcy. Individual IRAs and Roth IRAs do not have ERISA bankruptcy protection, but they are protected from creditors to a certain extent. These accounts have the advantage of tax-deferred or tax-free growth.

Transfer Assets to Heirs

Business owners can consider transferring or gifting assets to irrevocable trusts for the benefit of one's heirs. This puts the assets out of reach of creditors because the business owner is no longer the owner, and trusts can provide creditor protection for the beneficiaries. It also removes the assets from the estate for estate tax purposes. These strategies involve consulting with your attorney and planning team.

Put Money into Your Home

A homestead bankruptcy exemption can protect some or all the home's value from creditors. The exemption varies by state. It can be as low as $0 or $15,000, or an unlimited amount as in several states. Typically, no creditors except for a mortgage holder, taxing agency, or mechanic's lien (liens placed by those who provided home improvement services, for example) may seize more of the equity than the homestead laws allow.[2] If the homestead is in a state that has a high level of protection, consider paying down the mortgage to allow more equity to be protected. Similarly, in high protection states, putting more money into your home purchase offers more protection for that money.

The information provided is not intended to be legal advice. You should consult your attorney and tax consultant before making any decisions.

1 "Liability Protection," ***Companies Incorporated, 2019 Companiesinc.com*****;**
https://companiesinc.com/start-a-business/liability-protection/

2 "Homestead Exemptions by State and Territory," Asset Protection Planners;
https://www.assetprotectionplanners.com/planning/homestead-exemptions-by-state/