Five ways to protect personal assets
Tom Taulli

Even if business owners aren't worried about their ability to repay creditors, they should still put protections in place, says Tom Taulli.

A few years ago, you took out a $300,000 loan for your business because you anticipated continued growth. But the economy soon fell apart, and so did your business. You can no longer pay back the loan, and the lender has filed a lawsuit against your company and you personally, threatening to seize your home, car, and cash in the bank.

This is a common scenario for owners of small businesses, even those structured as corporations or limited liability companies, because they are not always as protected as they might think against determined creditors. In fact, a 2007 report from the U.S. Chamber Institute for Legal Reform, a nonprofit sponsored by the lobbying group, estimated 2005 tort liability costs were $98 billion for small businesses (defined as those with annual revenue of less than $10 million). Keep in mind the report found owners paid $20 billion out of pocket, as opposed to through insurance.

While this probably isn't too surprising, you may be personally exposed to plenty of other circumstances beyond nonpayment of loans—including nonpayment to suppliers, tax liabilities, malpractice, default on equipment financing, default on mortgages, negligent acts, fraud, legal action from employees (such as from sexual harassment or wrongful discharge), and liabilities for environmental damage.

Scary, huh? Well, you can take steps now to deal with the risks by engaging in asset protection. While the perception is this is just for wealthy individuals, small business owners can also benefit. Here are my suggestions of what you should consider doing now. Note, this is a broad overview. You should hire a specialist in asset protection for more advice.

1. Inventory everything. Make a complete list of your assets and debts. It's a good idea to do this on a regular basis (say, every six months or so). Remember to think broadly. For example, do you own a vacation home or have retirement assets? Do you hold stock in another company? These can have lots of value and may wind up being taken away in litigation.

2. Research exemptions and protective entities. A few of your assets may be exempt from creditor actions because of federal or state laws. These typically include your personal residence, your pension or retirement fund, and your life insurance policy. These should be the only ones in your name, according to Hillel Presser, a partner at the asset protection law firm Presser & Goldstein in Deerfield Beach, Fla. As for all other assets, consider setting up so-called protective entities, such as domestic trusts and offshore trusts. "You can layer the protection by using multiple entities. You can go even further and equity-strip the assets. This means taking loans against the assets or refinancing them. This makes the asset less attractive to creditors," says Presser.

3. Avoid personal guarantees. A personal guarantee is when you pledge to be personally responsible for a debt. The result is that you essentially lose the protection of your company's corporation status. True, a bank will likely require a personal guarantee (this is the case of loans guaranteed by the Small Business Administration). If so, try to minimize the impact. One approach is to put a time limit on it (say, for one year) or to specify a particular asset as collateral. Some suppliers will try to get a personal guarantee. Don't do it. Find another supplier.

4. Be wary of the contracts you sign. While your company's corporate structure may provide some protection, it may not be enough if there's a tort action or claim for fraud. In such cases, you may have personal liability. This is why it's important to provide liability protection in your contracts. This includes capping damages and even disallowing certain types of damages. Also, make sure you sign contracts on behalf of your company—not in your name, to avoid the chance the contract could later be considered a personal guarantee.

5. Buy insurance. While asset protection can be extremely helpful in avoiding personal liability, a creditor may still be determined to go after your assets. That's why it is important to have insurance protection. Liability insurance covers damages for personal injuries and property damages that other people cause (such as your employees). Property insurance covers your company's assets. You may even consider an umbrella policy to cover exposure that goes beyond property insurance. As should be no surprise, carriers try to avoid paying claims. To get the best coverage, it's a good idea to have an attorney look at the policy.

Which leads me to repeat: For any kind of asset protection, it's smart to get the advice of a qualified attorney or tax expert. You'll likely be dealing with complicated questions.

And the costs? Putting together a basic asset protection plan generally ranges from $2,000 to $10,000, at least for small businesses with revenues below $1 million and an owner with a net worth of less than $500,000. And the earlier you start, the better. The costs will be much lower, and the overall protection should be greater.

As you know, running a business is quite risky regardless of the economic environment. Even top companies fail. Spend the time now to look at your potential liability exposures and see how asset protection will help lower your risks.

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