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WHAT CAN I DO TO PROTECT BUSINESS AND PERSONAL ASSETS FROM THE REACH OF CREDITORS?

Contributed by Peterson • Dymond • Reagor, LLP, a Rocky Mountain Chapter IEC Industry Partner

It takes long hours and hard work to create a successful business or a comfortable nest egg. What has taken years to build, however, can be threatened by one bad year or, even worse, one wrong decision. If your debts become too numerous or too large, creditors may begin searching for your assets like sharks at a feeding frenzy. Shielding your assets in those circumstances can only be achieved with careful advance planning. This article discusses three elements that you should consider in crafting an asset protection game plan: (1) business planning; (2) estate planning; and (3) insurance protection.

1. Business Planning

From a business planning perspective, one of the essentials for an asset protection plan is the creation of a separate entity to operate the business. There are many business forms to choose from including corporations, limited liability companies and limited partnership associations. Each of these entities is designed to shield the shareholder, member or manager from personal liability for the debts and other obligations the business may incur. In contrast, one who operates his or her business merely as a sole proprietorship, general partnership or joint venture, will be held personally liable for the debts and obligations of the business.

Another component of an asset protection plan requires deciding who will own the “business” related assets. Typically, these assets include the office building, real estate, automobiles, tools, office equipment and even office furniture. You may be able to shield these assets from the reach of business creditors if the assets are owned by others and simply leased to the business. The “others” could include the individual shareholders or even a separate entity created by the shareholders for the sole purpose of owning and leasing the particular asset.

One should also consider whether the nature of the business lends itself to being separated into distinct operating units. For example, residential work can be performed by one business entity while commercial work is performed by another. Additionally, a separate business entity may be formed solely for the purpose of performing work on a specific project. Segregating the work in this manner may help to “contain” or minimize the potential negative impact of a risky business venture.

2. Estate Planning

Even the best business planning for asset protection cannot provide insulation from creditors in all circumstances. You can still be personally liable for documents that have been signed in an individual capacity, such as promissory notes, indemnity agreements or personal guarantees. Personal liability may also arise from claims that come from your own negligent conduct, such as an auto accident caused by your failure to use a turn signal. For this reason, estate planning can play a critical role in crafting an overall asset protection plan.

One of the goals of estate planning is to protect your personal assets from the reach of creditors. Assets in this context typically include real estate, stocks, bonds or cash. Shielding personal assets from creditors is primarily achieved by transferring ownership of the assets to another. They can be transferred to a spouse or a child. The assets can also be transferred to an irrevocable trust account or placed into a Family Limited Partnership. The latter can provide excellent asset protection, while at the same time providing a method for transferring ownership of a business to one's children.

3. Insurance Protection

Insurance can serve as another component of an overall asset protection plan. There are many types of insurance policies, each covering specific events or liabilities. For example, there is commercial general liability insurance, personal auto liability insurance, homeowner's insurance and errors and omissions coverage. There are at least two factors to having effective insurance protection: (1) sufficient coverage; and (2) sufficient amount. Without having insurance policies to cover the most likely risks that you and your business face, or having the policies for amounts to cover the most likely liabilities that would be sustained, the insurance coverage you obtain may not provide sufficient protection against potential claims or losses.

4. The Importance of Advance Planning

The importance of timely and properly undertaking asset protection planning can not be emphasized enough. The time to prepare and implement a plan is *before* the debt, liability or claim arises. Insurance policies typically do not cover pre-existing claims, and a transfer of assets after the fact is often rendered void as an attempt to defraud creditors. One must also properly execute the asset protection plan. Failing to do so can result in lack of control over or loss of the asset, unwanted tax consequences, or even the loss of protection from creditors that was sought by creating the plan.

This article has given you a general and over-simplified review of some asset protection planning considerations. What would be appropriate for any particular person or business, however, depends on the particular situation of each individual or business entity. Always consult with a qualified attorney concerning asset protection, and address these concerns before substantial liabilities are incurred, or costly claims arise.

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