

Business Planning

Asset protection strategies help protect small businesses and their owners.

By Eva Stark, JD, LL.M.



In today's economy, it is not uncommon for an individual's "gig" or "side hustle" to grow into a full-time business opportunity. Something that starts out as a part-time activity or just a hobby may quickly blossom into a profitable business.

Where a business activity is conducted, limiting liability from that activity is an important consideration. In the absence of planning, an accident, or a dispute with a customer, supplier or an employee, can not only wipe out business profits but also put the business owner's personal assets at risk. Fortunately, proper planning may limit exposure and avoid a nightmare scenario.

CONDUCTING BUSINESS IN A LIMITED LIABILITY ENTITY

One of the first lines of defense from business liabilities is to conduct any business activity in a limited liability

entity. A limited liability entity—such as a corporation, a limited liability company (LLC), a limited partnership (LP), limited liability partnership (LLP), limited liability limited partnership (LLLLP) or similar entity—can create a "firewall" between the business owner's business activity and personal assets.

The specific business activity, management structure, expected growth potential and tax considerations will determine what entity type makes the most sense under the circumstances.

ASSESSING THE NEED FOR MULTIPLE ENTITIES

Just as an entity may create a firewall between business activities and a business owner's personal assets, segregating different business lines and business assets into separate entities may create firewalls between such activities and assets as well. For

example, a manufacturer that owns its warehouses and transports its products may be taking on unnecessary risk if all assets are owned and all activities are conducted inside a single limited liability entity. A single trucking accident and a judgment against the company could put all of the company's assets at risk (warehouses, manufacturing equipment, bank accounts, etc.). However, if the company is divided into several entities (a manufacturing company, a transportation company and a real estate holding company, for example) it may be possible to isolate the liability within the transportation company.

To set up such separation, three entities would typically be created and the entities would execute contracts (e.g., rental agreements and contracts for transportation services) with one another. The manufacturing company could lease the warehouses from the real

estate holding company and hire the transportation company to transport its goods. Proper documentation (contracts, governing documents), capitalization, insurance and governance can help ensure that courts will respect such segregation of one entity from another and from the business owner's personal assets.

LIMITING LIABILITY THROUGH CONTRACT

Written contracts with clients, suppliers, lenders, etc. may help avoid disputes over pricing, payment terms, or quality expectations, and spell out each party's obligations to limit surprises.

Where a dispute does arise, a contract may often limit damages to amounts paid under the contract or provide for liquidated damages (e.g., a set dollar amount). State law varies widely when it comes to the ability to limit liability and damages through contract, so having contracts drafted and reviewed by a competent business attorney is key.

INSURANCE

Carrying adequate insurance is also key to protecting assets of the business and the personal assets of the business owner. Without sufficient insurance to satisfy liabilities, a creditor will be tempted to explore strategies for accessing a business owner's personal assets. Additionally, a business that is poorly capitalized (given the

specific business activity involved) or a business's failure to carry adequate insurance may bolster a creditor's argument for piercing the corporate veil.

Generally, where the corporate veil is pierced, the court or creditor may ignore the firewall between the business and the business owner's personal assets, exposing such personal assets to creditors. For example, a business owner who runs a "transportation company" that leases its trucks from the owner, owns no other assets, and carries no insurance would likely not be respected by a court as a separate entity and a liability from a trucking accident involving the business would likely not be isolated within the business.

PERSONAL ASSET PROTECTION

In addition to limiting business liabilities, business owners should consider positioning personal assets for creditor protection. Various state and federal laws protect certain types of assets from creditors. These "exempt" assets may include home equity, qualified plan balances, individual retirement accounts, annuities, life insurance death benefits and cash values, as well as some miscellaneous assets (e.g., a personal vehicle, burial plot, gun, livestock, etc.).

What is exempt and the degree to which it may be exempt varies greatly by state. For example, certain states protect an unlimited amount of life insurance cash

values as well as death benefits both from the creditors of the insured and the beneficiary.

Other states may limit the protection of cash values to a specific dollar amount and may limit the protection of death benefits based on the relationship of the beneficiary to the insured or other factors.

In addition to taking advantage of exemptions, a business owner may be able to enhance creditor protection of personal assets by placing both exempt and nonexempt assets in a trust for the benefit of the business owner's spouse or children.

An increasing number of jurisdictions also allow protection for certain self-settled trusts (trust created by an individual for the individual's own benefit). Successful asset protection planning requires planning ahead and having a trust in place before the liability exists.

Having a part-time gig or hobby blossom into a great business opportunity can be very exciting. When this happens, it makes sense to take steps to minimize risk both for the business owner as well as for the business itself.

The right professionals (attorneys, financial advisors, accountants) can help spot opportunities to ensure that the business, and the business owner's balance sheet, continue to grow.



About the author:

Eva Stark, JD, LL.M., joined The Nautilus Group in 2014 to assist with the development of estate and business plans and perform advanced tax research. Eva graduated *summa cum laude* with a BS in economics and finance from The University of Texas at Dallas. She earned her JD, with honors, from Southern Methodist University, where she served as a student attorney and chief counsel at the SMU Federal Taxpayers Clinic. She received her LL.M. in taxation from Georgetown University Law Center. Prior to joining Nautilus, Eva worked in private practice in tax controversy, business law, and litigation.

This material includes a discussion of one or more tax related topics. This tax related discussion was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purposes of avoiding any IRS penalties that may be imposed upon the taxpayer. The cash value in a life insurance policy is accessed through withdrawals and policy loans, which accrue interest at the current rate. Loans and withdrawals will decrease the cash surrender value and death benefit. These materials are prepared by The Nautilus Group®, a service of New York Life Insurance Company, and are made available to all Nautilus Group member agents and, as a courtesy, to select agents of New York Life Insurance Company. Nautilus, New York Life Insurance Company, its employees or agents are not in the business of providing tax, legal or accounting advice. Individuals should consult with their own tax, legal or accounting advisors before implementing any planning strategies. SMRU 5016479 Exp 1/31/2029