

Smart Business ~ Don't Lose Everything & The Kitchen Sink!

Everywhere we turn, dark clouds are all around us. The stock market is down. Real estate values are down. Layoffs are up. But, it could be even worse!

A 2008 survey of corporate law departments shows increased expectations for litigation. Unfortunately, people often look to hold others accountable for their difficulties. Which is why lawsuits tend to rise as the economy sinks. So, what can you do to protect yourself?

Consider placing your business or rental property in a limited liability entity. Let's say you own a corner market. If you own it directly, then someone who is injured on the premises could collect against all your assets, including assets not involved in the business. This could include things like your personal investments, savings you've set aside for your children's education and even future inheritances. Let's say your business has assets of \$500,000, you have investment and savings accounts worth \$500,000 and a future inheritance from your parents worth \$500,000. The entire \$1.5 million could be in jeopardy.

However, if your business were owned by a corporation or a Limited Liability Company (LLC), the injured person could only collect against the \$500,000 of assets in your business, regardless of the amount of the damages awarded to the injured party. Your other personal assets would be safe.

We can't stop there though. Many clients believe that if their business is in a S Corporation, then their business is also protected from the business owner's personal liabilities. Unfortunately, this is not the case. If you are a business owner with a corporation, you own that corporation by holding shares. Your personal creditor can seize those shares and therefore your business just as a personal creditor could seize your Exxon or GE shares.

There are relatively few types of assets that are statutorily protected from claims of creditors. One such asset is a membership interest in a LLC. With a LLC, the business is owned by way of membership interest which is essentially the same thing as stock but with an extremely important difference. If a creditor seeks to enforce a personal judgment against the business owner's interest in a LLC, that creditor will only be entitled to a charging order remedy, NOT seizure of the business owner's membership interest in the LLC. A charging order remedy means the judgment creditor will only be able to attach any distributions that come out of the LLC. These distributions are made at the discretion of the business owner as managing member and the courts generally will not have the authority to order that distributions be made. Therefore, in order to more fully protect the business, and likely the business owner's livelihood, the business should be placed inside a LLC.

Many readers may be rightfully concerned that their business interests are held in a S corporation and are not fully afforded the asset protection benefits of a LLC. Thankfully, the Internal Revenue Service and Florida statutes allow a change in structure whereas the S corporation can be turned into a LLC with no tax consequences as long as certain conditions are met. After converting to a LLC, the business can still elect the tax advantages available to S corporations if recommended.

Additionally, consider liability insurance. If someone sues you, that is your first line of defense. There is separate liability coverage for your home and your auto. In addition, you may need a separate policy for a rental property or any business-related liability, like malpractice insurance

for a doctor. In addition to these separate liability policies, consider an “umbrella” policy which provides coverage on top of the underlying coverage. If you had a premises liability policy for your corner market, that policy would protect you up to the policy limit, let’s say \$300,000. This would pay first. Then your umbrella coverage would add its limit, let’s say \$1 million, on top of that. So, you would be protected for the first \$1.3 million of court award against you. However, that would still leave some exposure to liability above the \$1.3 million, if you did not have a limited liability entity.

Therefore, protect yourself, your business and your family!