

## **Behind the Counter**

### **Protecting yourself from business creditors**

Going into business for yourself requires a huge investment and substantial risk. Each business tries to mitigate the risks by having proper policies and procedures in place, by following safety procedures, by instituting quality control procedures and having enough of and the correct insurance such as errors and omissions insurance and business liability insurance. Sometimes insurance is not enough to protect against civil litigation. When going into business for ourselves, what we want to do is to protect our family's assets so that the family will not be harmed by actions taken against the business. The most vulnerable kinds of business structure are the sole proprietorship and the partnership. Both these kinds of businesses are considered to be the same legal entity as the person who owns the business putting the family assets at risk. Creditors can sue the owners for their personal assets, homes, investments and RRSPs.

If the business was incorporated, a creditor could sue the business for its assets and investments, but in most cases could not sue the owner personally. An incorporated business is considered a separate legal entity from the persons who own the business in Canadian Law. The main reason to incorporate would be to separate personal assets from business assets as well as the tax advantages. If the owner signs any personal guarantees, then the separation between business and personal becomes non-existent until the terms that created the personal guarantees have been fulfilled. Personal guarantees should be avoided if at all possible. Legislation has been passed recently with respect to statutory liabilities such as GST payable, corporate taxes payable and payroll taxes payable, in that the Canada Revenue Agency now has authority to go after the directors of the corporation to satisfy the statutory debts of the corporation, so there is no way out for the directors of the corporation.

A holding company could be created between the shareholders and the operating company. Any excess funds could be transferred to the holding company by way of dividends, keeping the active business income in the operating company who can then take advantage of the lower tax rates and the small business deduction. The operating company would be kept lean and less of a target for creditor litigation. The holding

company would keep all the excess funds but technically would have no creditors other than the shareholders and therefore no risk of loss.

Another option would be to create a shareholder's loan back to the company. The shareholder would then become a secured creditor of the corporation that would have first rights to corporate assets if the company goes under. This loan would need to be documented by way of a promissory note and kept in the company's minute book.

Referring back to a sole proprietorship or partnership situation, a business owner could transfer personal assets into the names of children or the spouse to safeguard them from possible creditor litigation against the business and the business owner. The spouse or children cannot be directors or guarantors for the business or personal debt of the business owner in order to remain creditor proof.

Personal assets could also be sheltered in a 'living trust'. The issue with creditor protection with this kind of trust is whether the trust is non-revocable or revocable. Creditors may still be able to access non-revocable trusts, however, they will first be required to petition the court for a change order before they can attack the assets held in a trust.

Funds could also be sheltered by having the business owner make contributions into a spousal RRSP. Again for the RRSP to be creditor proof, the spouse must not be a director of the corporation and must not be a guarantor for the business owner's debts. Other ideas for large income generating business owners might be the use of life insurance investment policies, Individual Pension Plans, Retirement Compensation Arrangements or a Health and Welfare Trust.

Of course before you decide to implement any of the above strategies please make sure that you have several discussions with your financial planners, accountants and lawyers to determine what the best future protection plan would work for you and your family and future generations.

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