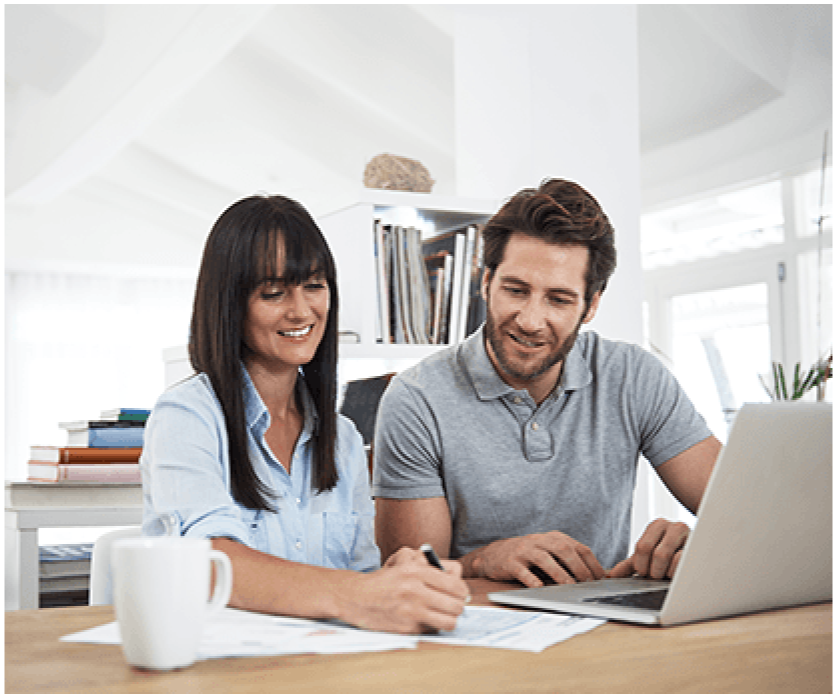
Why do I need asset protection as a business owner? Should know

investax.com.au/knowledge-base/why-do-i-need-asset-protection-as-a-business-owner



For many small business owners running a business comes with many potential risks – an unexpected event can happen at any time. Your business might end up struggling to pay creditors due to circumstances out of your control or your business is a party to a lawsuit. The same applies to your personal life. Perhaps you've been involved in an accident and are now being sued for damages. It is important to consider employing asset protection strategies to shield your personal wealth from any potential risks.

Asset protection can take many forms. Most mechanisms will involve a separation of key business assets from the trading entity, coupled with complimentary insurance cover (for example, professional indemnity and public liability insurance). For asset protection and tax purposes, valuable business assets are commonly held by a related company on trust for a designated trust entity. Which structure is appropriate for you will depend on your business experience, the type of business (high risk vs. low risk), and the size of your business (including the number of owners).

Asset protection strategies to consider.

Establishing a Discretionary Trust for Asset Protection

Discretionary trust is the most common type of trust in Australia. In the case of a discretionary trust, the trustee is given complete discretion as to how the trust income is distributed to the beneficiaries. Discretionary trusts are generally associated with asset protection and tax planning. For example, a family trust (which is the most common type of discretionary trust), is usually set up to manage a family business or hold a family's personal or business assets.

The reason these discretionary trusts are used as asset protection strategies is because the beneficiaries have no right to any of the property within the trust. Having no interest in the trust property means that if any of the beneficiaries become liable to settle debt, a creditor won't be able to obtain an order against the trust property.

Example

Robyn started her own business in 2019. She had run it for just over a year, but unfortunately, the effects of the COVID-19 lockdown meant that she couldn't run her business and it was wound up. Because she was renting retail space to operate her business from, her landlord ended up obtaining a court order against her for $150,000. Robyn had used discretionary trust, to which she was a beneficiary, to purchase an investment property. As a result, her landlord would not have any claim against the investment property because she is not the owner, the discretionary trust is.

Note: A discretionary trust can be used to purchase interests in businesses, shares in companies and investment properties. So, the trust can have its own creditors and those creditors have a right to property held in the trust.

One major downfall of using a trust as an asset protection strategy is that you will have to transfer ownership of your assets to the trustee, who will become the new legal owner. This could result in significant stamp duty costs and capital gains tax issues. It is best to seek professional advice before carrying out this plan.

Restructuring Your Business as an Asset Protection Strategy

There are various factors you'll need to consider before deciding on the right business structure. In terms of asset protection, however, you may want to steer clear of sole traders and partnerships. This is because sole traders and partners are personally liable for financial or tax debts. In other words, assets in your name can be used to pay business debts. So, there is no division between business assets or personal assets; including your share of joint assets such as your house or car.

Example.

If we look at Robyn's example again, even though her investment property is held in a trust, she would not be personally liable for her business debts as she had set her business up as a company.

Transfer Personal Assets To Low-Risk Spouse

If you're going to invest in property or any other assets, and you partake in high-risk commercial or professional activities, you may want to consider having your low-risk spouse own the assets. Generally, if your spouse owns the family home, your creditors will not be able to access that property to settle any debts.

Example

Before opening her business, Robyn consulted her financial advisor who suggested that she either transfer the property to a discretionary trust or her spouse's name. It would have been a good strategic move to place assets in her spouse's name if he was low-risk. However, he was also running his own business, and they agreed it would be better protected in the discretionary trust. Again, there may be stamp duty and capital gains tax consequences so it's best to seek advice before implementing this strategy.

Asset Protection Insurance – Take out appropriate insurance policies

One of the most common strategies for asset protection is insurance. This can be a relatively inexpensive option for all types of entities including sole traders.

Some types of insurance that may be applicable to your business include:

- **Public liability**: covers the cost of legal action and compensation claims made against your business by a client or member of the public who encounters personal injury or damages to their property
- **Professional indemnity**: protects you and your business against claims for alleged negligence or breach of duty arising from the performance of professional services
- **Worker's compensation**: covers your employees' wages and related costs if they are ever require treatment for work-related injury or illness.

However, these policies may only be able to provide limited protection of your assets in specific scenarios and may not be able to protect the assets from circumstances outside of business such as marriage breakdown. It is important to understand what the policy does and doesn't cover. A knowledgeable insurance broker should be able to sit down with you to help you find a policy appropriate for you and your business.

As a small business owner, you should consider taking out traditional business property insurance which insures the buildings, equipment, stock, and possessions of your business from physical threats such as fire, flood, theft, or malicious damage. Most people are familiar with this type of policy since they are like those you would take out on your own house, car and home contents. This insurance covers the cost of repairing or replacing your lost or damaged stock or assets.

Another form of business insurance is ‘business interruption’ or ‘business continuity’ cover, which protects you against financial losses should you have to temporarily halt your operations for some reason. Whether your loss is due to physical damage to your property, or other circumstances outside of your control such as a power outage. This type of insurance protects your income and is often used in conjunction with property insurance.

Why do I need asset protection insurance?

Depending on the kind of business you have, your assets may represent a substantial investment. They could include offices, factories, manufacturing equipment, technology, and vehicles. If you operate a manufacturing or retail business, you may also have a high value of the stock to protect. Property insurance helps you to meet the costs of repair or replacement, and get your operations back up and running as soon as possible, should something happen to your premises, merchandise or equipment.

Even service businesses, with no stock and fewer physical assets, may have financial reserves, intellectual property or technology which is essential to their operations. How would it affect your business if you lost access to your computers or communications network? What would it cost you, in reparations and reputation? If you have business or equipment loans you may be required to take out property insurance as a condition of your financing.

Example

Robyn made sure that she had insurance covering her business as well as her future income to protect her in circumstances of need. Her business liability insurance covered her legal expenses as well as the cost of the judgment against her, whilst her income protection insurance kept her from having to file for bankruptcy.

Summary

Organizing your asset protection strategies should be a vital part of your business planning – especially if you run a business or building your portfolio. It’s also an important aspect of making sure your family is protected in any event that may unexpectedly put your assets at risk. Each person’s circumstances are different, and so your assets will need to be protected in a manner that suits those circumstances.

- Wherever possible, you should use a separate legal entity to hold the business assets, away from the legal entity or activity that poses the risk.
- Having assets carefully ‘locked away’ is a powerful deterrent to would-be claimants.

- Company directors need to adopt additional protection measures given their exposure to personal liability for company debts.
- Tax benefits to business owners are often a welcome side-effect of careful asset protection.

As with setting up a trust or a company, it's always important to get professional advice on your options. Even if you recognise the importance of asset protection as a business owner, it can be overwhelming to make and implement a plan. If you would like to speak to an experienced accountant who can provide you with the right advice on asset protection strategies, simply call our office to arrange an appointment.

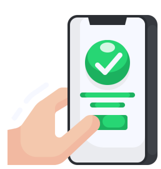
Please contact our office for further assistance.

BOOK YOUR COMPLIMENTARY CONSULTATION NOW – We offer a 15-minute free consultation to discuss your tax, property investment and business needs.

General Advice Warning
The material on this page and on this website has been prepared for general information purposes only and not as specific advice to any particular person. Any advice contained on this page and on this website is General Advice and does not take into account any person's particular investment objectives, financial situation and particular needs.

Before making an investment decision based on this advice you should consider, with or without the assistance of a securities adviser, whether it is appropriate to your particular investment needs, objectives and financial circumstances. In addition, the examples provided on this page and on this website are for illustrative purposes only.

Although every effort has been made to verify the accuracy of the information contained on this page and on this website, Investax Group, its officers, representatives, employees, and agents disclaim all liability [except for any liability which by law cannot be excluded), for any error, inaccuracy in, or omission from the information contained in this website or any loss or damage suffered by any person directly or indirectly through relying on this information.



We offer a 15-minute free consultation to discuss your tax, property investment and business needs. Book your complimentary consultation now.

Book Now

Table of Contents

- Asset protection strategies to consider.
- Restructuring Your Business as an Asset Protection Strategy
- Asset Protection Insurance – Take out appropriate insurance policies
- Why do I need asset protection insurance?