



# 10 Creditor-Proofing Business Strategies

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**T**oday in Canada there are 1.1 million active incorporated businesses. Of these, 75% employ fewer than five people. It is these companies that drive our economy. The owners of these businesses have become very successful at building businesses and have learned how to make their own money and success. Many of these business men and women turn to their accounting, financial and legal professionals to help them legally structure their companies and financial affairs to achieve three glorious outcomes: wealth preservation, legal tax avoidance and creditor protection.

Of these three outcomes I have always been fascinated with how many times I have met very smart and successful business owners who have neglected to put in place strategies that creditor proof what they have spent a lifetime to build. Too late in the process, I see stumble into my office owners of incorporated businesses who have personally guaranteed loans for their companies or non-incorporated business owners who have left themselves exposed to creditor attacks personally. They should have invested the time and money structuring their financial affairs in such a way that their money would have stayed in their pockets and not in the pockets of someone else.

I have always promised myself that given the opportunity and time I would write a check list of successful strategies that business owners and their accounting, legal and financial professionals have put into action to ward off creditors. By no means is this a complete list of creditor-proofing solutions. I invite you to forward some of your ideas that I fail to mention in this article.

## **Incorporate your business**

The problem in Canada is that proprietorship and partnership businesses in Canadian law are seen and deemed to be the same legal entity as the person and people who own and operate them. This means that creditors can sue the owners of these types of business structures and take aim at their personal assets such as their homes, investments, and RRSPs.

When a business is incorporated under Canadian law it is considered a separate legal entity from the individual or individuals who own the incorporated business. This means that if an incorporated business is sued successfully the personal assets of the business owner(s) are protected from creditors in most situations.

## **Create a holding company**

Holding companies may be placed between shareholders and their operating companies for reasons of taxation and legal protection. The income in the operating company remains subject to a lower tax rate using small business deductions. Dividends may be paid from the operating company to the holding company at a preferred tax rate to build up assets in the holding company, keeping the active company mean and lean and free from creditor intrusions.

## **Avoid signing personal guarantees**

The main reason one chooses to incorporate his or her business is to segregate his or her personal assets from his or her corporate assets and liabilities. If one signs a personal guarantee for corporate debt, he or she void this separation from business and personal assets. Then creditors of the business can successfully attack personal assets.

## **Create an inter-vivos trust (living trust)**

A living trust is created while a person is alive. This type of trust enables a person to control the distribution of their estate while they are alive. An individual is able to transfer ownership of his or her property into a trust. A revocable living trust is a vehicle that is very helpful in avoiding probate and completing an estate freeze.

In some cases non-revocable trust assets that are transferred to the trust may remain available to creditors. However, a living trust will make it much more difficult for creditors to have access to the assets of the trust. Creditors will first have to petition the court for a changing order to be able to attack the assets held in the trust.

### **Transfer ownership of personal property to a spouse or grown children**

When one transfers the ownership of assets to a spouse or their grown children, these assets no longer belong to the grantor. After a transfer of asset ownership, it would be very difficult or impossible for creditors to go after the transferred assets. Creditors will not be able to attack the assets transferred to a spouse or grown child provided that the spouse or grown child are not directors or guarantors for either the business or personal debt of the contributing spouse.

### **Make shareholder loans to become a secured creditor**

An owner of an incorporated business can make shareholder loans back to his or her company becoming a secured creditor to have first rights to corporate assets if the company has debt and other financially troubling issues.

### **Spousal RRSP**

A business owner should consider making part or all of his or her RRSP contributions to a spousal RRSP. The business owner will take the tax deduction and the asset becomes the spouse's property. Creditors will not be able to attack the assets of the spousal RRSP provided that the spouse is not a director or guarantor for either the business or the personal debt of the contributing spouse.

### **Purchase investment and retirement products through insurance companies**

Investment products held in insurance companies such as universal life policies, segregated investment funds and annuities may be protected from an individual's creditors if the named beneficiary of these insurance products is a spouse, parent, or grandchild of the annuitant, or if the named beneficiaries on these insurance products are irrevocable.

### **Create individual pension plans and retirement compensation arrangements for business owners**

Incorporated business owners who have a T4 income of over \$100,000 per year should consider creating a "super charged RRSP" in the form of an Individual Pension Plan (IPP) or a Retirement Compensation Arrangement (RCA). Contributions to these two vehicles exceed the maximum allowable RRSP limits, are fully deductible by a company and are a non-taxable benefit for the beneficiaries of these plans. Assets held within the IPP or RCA cannot be seized by creditors of an incorporated business. IPPs and RCAs offer significant amounts of additional tax-deferred income to be set aside for a business owner's retirement, which could protect hundreds of thousands and even millions of dollars from corporate creditors.

### **Create a Health and Welfare Trust (HWT)**

Incorporated business owners should consider creating a Health and Welfare Trust for themselves. A HWT is a bank account whose deposits are spent exclusively on health care expenses. By having an HWT, business owners may convert health care expenses into 100 percent business deductions and a non-taxable benefit for him or herself. All monies deposited into a HWT are only to be used for health care expenses. Therefore, these monies are segregated from both personal and corporate assets and are immune from creditors.

All Canadians subjected to personal liability as a result of their professional activities should consider creditor protection as absolutely critical. A wise person is someone who does not live in fear of the worst-case scenario but is aware of it and has prepared to the best of his or her ability to prevent or lessen it from happening.

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