

# Old Colony Law

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## *Four Firewalls: Asset Protection for Business Owners*

In an increasingly litigious world, business owners are concerned about protecting their personal assets from claims by customers, vendors, employees, competitors and other creditors. Business owners can mitigate those concerns by using four important tactics to establish a firewall to prevent potential creditors from penetrating their personal assets.

### **CORRECT USE OF BUSINESS ENTITIES**

Operating your businesses as a corporation or limited liability company (LLC), as opposed to a general partnership or sole proprietorship, protects your assets from business-related claims such as contractual disputes, “slip and fall” injuries on business premises, or cyber theft of customers’ financial information by a third-party.

After forming the corporation or LLC, you must take certain steps, generally known as “corporate formalities,” to maintain the corporate or LLC protections, including:

- Hold annual shareholder, director or member meetings
- Follow and keep records of corporate bylaws and operating agreements and changes to those documents
- Elect directors, officers or managers and prescribed in the bylaws or operating agreement
- Avoid commingling of personal and business assets and debts
- Keep accurate accounting records
- Make annual filings with the Massachusetts Secretary of State
- Maintain an up-to-date corporate or LLC record book of current business documents, meeting minutes, shareholder and director resolutions, leases and major transactions

Massachusetts courts have allowed creditors to “pierce the corporate veil” and reach a business owner’s personal assets for debts incurred in connection with the business. In determining whether to allow this to happen, courts look to a number of factors, including whether corporate formalities have been observed. Therefore, failure to follow these corporate formalities may be an invitation for creditors to attach their interests to your personal assets.

## **CREATIVE ESTATE PLANNING**

Strategic allocation of a married couple's assets between the two spouses may also help protect those personal assets from business-related claims. An important and creative estate planning technique is to divide a married couple's assets, to the extent practicable, between them in order to take full use of both spouse's estate tax exemptions. This allocation of assets provides an opportunity to put at-risk assets in the name of the non-business owner spouse and assets unreachable by creditors in the name of the business owner spouse. Then, once at-risk assets are in the name of the non-business owner spouse, creative estate planning allows for such assets to be held in an asset protection trust for the benefit of the business owner spouse should the non-business owner spouse die before the business owner spouse.

## **RETIREMENT ACCOUNTS**

Any small business owner should, as part of comprehensive personal asset-protection planning, to the extent practicable, fully fund retirement accounts, such as Individual Retirement Accounts (IRAs), Simple Employee Pensions (SEPs), 401(k) plans and Defined Benefit Plans. Assets placed in retirement accounts are generally protected from the claims of creditors. Most employer-sponsored pension plans are protected from creditors through the federal Employee Retirement Income Security Act of 1974 (ERISA).

## **INSURANCE COVERAGE**

Insurance policies can serve as a first line of defense against legal claims. Some types of insurance are required under Massachusetts law, but other policies may be advisable. The type of insurance policies and extent of coverage that is advisable will depend the value of the assets that are to be insured; the size and nature of your business; and whether your business has employees, among other factors. In addition, umbrella insurance policies can supplement another insurance policy when claims exceed that underlying policy's coverage limit. As part of comprehensive asset protection, business owners should conduct periodic risk assessments and ensure that their insurance coverage is calibrated to their needs and risk tolerance.

**Please contact us at 413 387 0080 or [office@oldcolonylaw.com](mailto:office@oldcolonylaw.com) for help with your asset protection plan.**

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