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Opinion: Safeguarding your personal assets

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Chris Balalovski discusses how directors and business owners can ensure they are protected if the unexpected happens and creditors come calling.

It's the stuff of nightmares for directors or owners of small to medium-sized enterprises (SMEs): how do you appropriately protect your assets against creditors or litigants if something goes wrong?

There are, of course, many things that can go wrong. With mortgage delinquencies and business insolvencies on the rise, it's clear that the climate for these kinds of risks is rising. A sudden change in demand can leave your business with large debts and revenue problems at a time when customers are taking longer to pay their bills, if they can pay them at all. Or, a project or business relationship may not proceed as expected, leaving one or both parties financially exposed and open to litigation that is costly to defend.

While many company directors and business owners rely on professional advice to assist them with their businesses, they often fail to invest in safeguarding their personal assets. Even business succession plans are often too focused on the business and fail to look at the owner, his or her family, lifestyle and other aspirations.

Protecting your assets is about using sophisticated and legally permissible techniques to ensure they are secured should something unexpected happen. It is not about hiding assets or acting unethically to avoid financial responsibility.

In Australia, asset protection is particularly important as we are considered to be one of the most litigious nations in the world. With individuals and businesses at risk of potential claims and with an increasing number of Australians engaged in professional and small-business fields, asset protection is more relevant than ever. So, it makes sense to have a sound asset-protection plan in place.

Protecting the family home

The family home is often one of the most significant assets a person can own but as it is generally held in an individual's name, it can be at risk.

There are several ways a business owner can ring-fence the family home from his or her business activities, but there are also some common misperceptions about the right way to protect this important asset.

Sometimes people think that establishing a business in a company or trust structure gives the owner the protection of the corporate veil and that creditors only have access to the company's or trust's assets, and this is generally true. But as a director or trustee, if the structure has a deficit of assets to pay its debt, the creditor can sometimes access the personal assets of the director or trustee to make up the difference.

There are three main ways to protect the family home in these circumstances. The first is to give majority ownership of the home to a person who is not at risk from any bankruptcy or litigation procedures, typically a spouse.

This does not usually result in any capital gains tax (CGT) liabilities and there may also be stamp duty exemptions and concessions. But the business owner should still retain some interest in the family home to ensure the asset can't be dealt with without his or her authority. This strategy still means the asset is held by the family, but the business owner is largely dissociated from it.

Business owners have to be aware of the traps of taking this approach. If the house is put in the name of the unexposed spouse, it is essential to ensure the spouse hasn't guaranteed any loans of the business. If so, it could mean he or she and the home are exposed in the event of litigation.

There are also estate-planning issues to consider. For example, if the family home is in the name of the unexposed spouse and he or she dies, leaving everything to the exposed spouse, the house would again be under threat if there is litigation. An alternative is to leave everything to the kids and give the exposed spouse the right to occupy the property for life via a will.

Business owners who have signed over the family home to the unexposed partner shouldn't worry about getting their fair share of the value of the asset if their relationship breaks down. The Family Court doesn't care whose name the house is in, so the business owner should still be entitled to any proceeds from the sale of the home in a property settlement.

An alternate strategy to signing over the property to the unexposed partner is to undertake borrowings and to allow a related charge to be made over the main residence. This structure means very little equity in the home would be available to an external party.

But as the value of the asset rises and the business owner builds additional equity in it, there will be greater exposure to potential creditors, so there is a need to periodically refresh the charge to ensure little (if any) equity is available to someone who sues the business owner.

Trusts and other entities

Another solution could be to use a trust to hold the home, but there could be tax implications. A main residence owned by an individual is generally eligible for CGT and land tax exemptions. However, if the property is owned by an entity such as a company or a trust, these exemptions don't necessarily apply.

A further option is to use a service entity, which delivers asset protection and tax advantages. Typically, a business owner would create a service entity that owns assets to be used by the business such as premises and plant and equipment and provides labour to it as well.

Separating these assets into a service entity means someone who might have received faulty goods or services from the business owner, and who subsequently launches a legal action, can't pursue the assets held by the service entity as its never had any dealings with it.

But the Tax Commissioner Michael D'Ascenzo is very concerned about the rates paid to service entities, so it's very important they are appropriate and not artificial.

Superannuation

Unless the business owner makes an unusual contribution to defeat creditors when he or she knows litigation is on the cards, superannuation has statutory protection from creditors. It is also a tax-effective environment in which to grow your assets.

Progressively moving your private company and investment portfolio into a self-managed super fund (SMSF) can provide more control and flexibility over retirement assets than a corporate or other super fund. But, because moving shareholdings into a SMSF can result in a significant CGT liability, we have advised some of our clients to create a Private Ancillary Fund (PAF) to offset this and to facilitate their philanthropic endeavours.

The asset-protection plan

The sooner the director or SME business owner begins safeguarding his or her assets, the better protected he or she and the family will be. Starting sooner can minimise costs. Another reason is the law. To ensure assets are transferred between individuals or structures for genuine reasons, there are many laws surrounding certain financial transactions. If there are questions regarding the financial situation of the transferring party at the time an asset protection strategy is executed, it is possible that assets will remain exposed.

A well-developed asset-protection plan should also consider tax minimisation, estate-planning strategies and intergenerational wealth issues. And, because every person's situation is different, there is no one-size-fits-all solution so seeking professional advice is important.

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