

Creating a shield from business creditors



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In meeting with business owners from Timmins, Sudbury and North Bay, Ont., where demand for copper, nickel and zinc have led to a boom, some themes began to emerge.

One business owner said, "Even though I have success now, I live in constant fear that I am one event away (a lawsuit, a downturn in the economy, a personal disability or premature death) from losing everything, and I don't know where to start to protect my family."

Many northern Ontario businesses owners supporting the mining industry live in constant fear of the potential corporate criminal liability they face under Bill C-45. This bill was prompted by the federal government's review of the Westray mine disaster in Nova Scotia, which saw 26 miners die from a methane explosion in 1992.

Bill C-45, enacted in March 2004, holds corporate decision makers responsible for the health and safety of their employees. It establishes a higher standard of care for employees and the public and extends the responsibility to individuals who direct work. If those in charge are found guilty of violations under the bill, they face

the very real possibility of criminal prosecution and high fines that may lead to corporate and personal bankruptcy.

Over the last four years since the passing of Bill C-45 these business owners have received much advice on how to put in place the procedures to protect against criminal prosecution, but little focus has been placed on creditor protection strategies.

Here are some tips for basic creditor protection for a business and its owners. Please note that it is highly recommended that you consult with the proper financial, accounting, and legal professionals before applying any of these strategies, to find out if they work for your situation.

Incorporated businesses

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 creditors can sue the owners 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. What this means is if an incorporated business is sued successfully the personal assets of the business owner 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, free from creditor intrusions.

No personal guarantees

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

Create a living trust

This is created while a person is 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.

All in the family

When the ownership of personal assets is in a spouse's or grown child's name, these assets are separated from the business owner's assets and liabilities. Creditors will not be able to attack assets of a spouse or grown child provided that the spouse or grown child are not directors or guar-

antor for either the business or personal debt of the contributing spouse.

Shareholder loans

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

Spousal RRSP

In some provincial jurisdictions RRSPs are creditor protected. However, it is a wise strategy for a business owner to consider making part or all of his or her RRSP contributions into 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.

Purchasing through insurance

Investment products held in insurance companies such as RRSPs, 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 plans

Incorporated business owners who have a T4 income of over \$100,000 per year should consider creating a 'supercharged 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.

These 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 trust

Incorporated business owners should consider creating a health and welfare trust (HWT) for themselves. A HWT is a bank account in which deposits are spent exclusively on health care expenses. By having a HWT, business owners may convert health care expenses into 100 per cent business deductions and a non-taxable benefit.

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.

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