Creditor protection planning is often overlooked

By PETER MERRICK

Of the 1.1 million active incorporated businesses in Canada, 75 per cent employ fewer than five people—and it is these companies that drive our economy. The owners have built businesses and learned how to succeed.

Many turn to 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.

I have always been fascinated by how many times I have met smart and successful business owners who have neglected to put in place strategies that creditor proof what they have spent a life time to build.

Too late in the process, I see owners of incorporated businesses who have personally guaranteed loans for their companies, or non-incorporated business owners who have left themselves exposed to personal creditor attacks.

If they had only invested the time and money in structuring their financial affairs in such away that their money would have stayed in their pockets. When it comes to creditor protection an ounce of prevention is worth more than a pound of cure.

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.

Incorporate

In Canadian law proprietorships and partnerships are 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 businesses and take aim at their personal assets such as 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 owners 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 assets in the holding company, keeping the active company 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 voids this separation from business and personal assets and the creditors of the business can successfully attack personal assets.

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Create an* inter-vivo *trust

A living trust is created while a person is alive. This type of trust enables a person to control the distribution of an 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 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.

Put personal property in a spouse or in grown children's names

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 children are not directors or guarantor 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, having first rights to corporate assets if the company has debt and other financial troubling issues.

Establish a 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.

Consider insurance products

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 pension plans and retirement compensation arrangements

Incorporated business owners who have a T4 income of more than $100,000 per year should consider creating a "super charged RRSP" in a pension or retirement compensation plan. Contributions to these vehicles that 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 cannot be seized by creditors of an incorporated business. These vehicles offer additional tax-deferred income to be set aside for retirement which could protect hundreds of thousands and even millions of dollars from corporate creditors.

Create a health and welfare trust

HWT is a bank account whose deposits are spent exclusively on healthcare expenses, meaning that business owners may convert the expenses into deductions and a nontaxable benefit.

These monies are segregated from personal and corporate assets and are immune from creditors.

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Niche insurance product commands attention

TYERS

By PAUL TYERS

One of my colleagues reminds me regularly that disability insurance is for employees while critical illness is for employers.

He often cites the Ontario Hydro blackout when, despite the lack of power and other inconveniences, every business owner he was scheduled to meet with was there for the meeting, but they were generally on their own without employees.

The reason is straight-forward; it takes a whole lot of adversity to dissuade a business owner from showing up for work, so they aren't likely to use disability insurance. Therefore, what is the value of paying for something you aren't likely to use? On the other hand, even the hard-driving entrepreneur's priorities change when faced with a life threatening illness.

As baby boomers advance in age, the likelihood of being stricken by a critical illness increases sharply. Many people are surprised to learn that the average age of claimants of critical illness insurance is 47, according to 2000 data from Munich Reinsurance Co.

The good news is that many more people are surviving from cancer and recovering from heart disease and strokes. And that's often the financial problem: Where will the money come from during the recovery period? Enter critical illness insurance, which is designed to address the non-medical lifestyle costs of surviving and recovering from a serious illness.

CI insurance provides insurance coverage in the form of a lump-sum cash payment to anyone diagnosed with a disease covered by the policy and who survives for at least 30 days after diagnosis. ore than 20 different diseases, illnesses and medical procedures (cancer, heart disease and strokes, Parkinson's and Alzheimer's disease, plus organ transplants) are currently covered depending on the individual policy.

As boomers age, the likelihood of critical illness jumps.

CI insurance has found a niche between disability insurance and life insurance. What is making CI insurance increasingly popular is the lump-sum payment that flows to the policyholder quickly following the diagnosis of a disease or condition covered in the plan. There are no strings attached as to how that money is spent. You can use it in any way you choose, including:

- Household or special medical costs (making your home wheelchair-accessible, for example)
- Once-in-a-lifetime vacation
- Keeping a business going during your crucial recovery period
- Protecting your portfolio and assets from being spent on recovery

CI insurance doesn't restrict any other benefits the policyholder may be entitled to under existing disability and life insurance policies.

Insurance companies deal with each individual on a case-by-case basis, and eligibility rules vary with each company.

A medical examination is typically required. Policies are generally for between $25,000 and $125,000 but can go as high as $1 million. Coverage can be for life or can be purchased in 10-year increments

One of the unique features of CI insurance is the optional return of premium rider that has the insurance company return 100 per cent of the premiums paid if no claims have been made by the policy expiration date. No interest is paid, but this is one instance where you could actually end up paying for the insurance only if you need it.

When you're healthy, you're probably not thinking about coping with a life-altering illness. But that may be the best time to consider the impact an illness could have on you, your family and your finances.

While medical treatments and survival rates have improved, government health plans cannot help critical illness patients recover their financial footing if they are not prepared for the financial consequences of surviving a critical illness. When you advise your clients on risk management issues, don't forget to point out CI insurance. Believe me; they'll thank you if a critical illness ever occurs.

Lastly, I just want to point out that those in their own practices should look seriously at CI.

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