

Modern Day Pirates *and* Pots of Gold



During a three-month period, several successful business owners caught up in unrelated civil disputes were forced to remortgage their homes and cash in RRSPs before retirement age.

Why? Those assets were not judgment-proof and the cost of the disputes was out of control. The costs actually threatened the existence of their businesses and their own financial security.

As the lawyer working to fend off the raiders of their “pots of gold,” I found it strange that none of the business owners’ professional advisors had recommended that they secure their personal assets from business risks. Each had established relationships with company lawyers, accountants, insurance agents, and investment advisors, yet none of them had an Asset Protection Plan in place.

In 24 years of advising business owners, I have discovered that many factors conspire to leave business owners’ personal assets fully exposed to attack. This column addresses the key phenomenon; the Myth of Limited Liability™¹ and introduces the solution: integrated wealth strategy planning.

The Myth

Success leads many professionals and business owners to incorporate their businesses. They want to achieve tax savings and limited liability protection. Ironically, the tax benefits of incorporating will create a substantial pot of gold that can be raided by future creditors.

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Business owners can find themselves caught in a regulatory hearing, an aggressive audit, or a law suit brought by adversaries who will become their creditors and who:

- have very deep pockets;
- have no incentive to settle reasonably because they are not spending their own money or are driven by policy;
- hire lawyers who are paid a percentage of what they take from your pot.

The Reality

Canadian Courts will allow creditors to attack business assets that the owners have saved for their retirement to pay both business and personal liabilities. Conversely, the Courts will order individual owners to use personal assets to pay business liabilities.

Here are three fundamental reasons why successful business owners—incorporated or not—should care about asset protection planning and, in particular, creditor protection.

1. Anyone can take a run at your pot of gold, whether your pot is your company, an RRSP, a holding company, or the family home.
2. Business today is conducted in an absurdly regulated environment.
3. Canada is following the American trend of escalating litigation. Furthermore, Canadian businesses supplying goods or services to the USA are exposed to:
 - a. hostile foreign policies, for example, softwood lumber tariffs;
 - b. runaway juries, for example, the Loewen bankruptcy. Loewen was sued by a disgruntled vendor for less than \$5 million. Incredibly, the jury awarded

\$478 million in damages. A \$640 million company went bankrupt over one small law suit. NAFTA provided no relief.

Business is so heavily regulated today that competent professionals and business owners can unknowingly develop creditors as a result of laws, regulations, activities, and events beyond their knowledge and control. While researching this article, I spoke with numerous legal experts, compliance officers, and experienced leaders in several industries. Even those experts admit they do not know the full extent of the legal responsibilities of those they advise. The rules are not written in stone and there are a lot more than 10 of them!

Unforeseen Creditors

Here is a partial list of how experienced business owners—incorporated or not—can develop unforeseen creditors.

1. RRSPs and RRIFs are not creditor-protected the way government pensions are protected.
2. Personal guarantees of business debts jeopardize family financial security.
3. Misstatement of company financials to investors or lenders brings personal liability, for example, failing to disclose that a key customer or contract is in jeopardy, a lawsuit is pending, or that your partner had a heart attack.
4. Canada Revenue Agency is increasing its use of retroactive and retrospective taxation, that is, re-assessments—What was acceptable before may not be acceptable now.
5. Land managers and owners face increased risk, due to:
 - environmental protection legislation that personally impacts past and present land owners; and
 - consumer legislation that penetrates the corporate veil, for example, leaky condos.

6. “Whoever *can* pay *will* pay for *all* defendants” when a dispute involves many people, for example, a construction project, a development partnership, etc.
7. Creative legal procedures can expand the means of attack on shareholders’ assets.
8. There is an increase in “social host” and “commercial host” liabilities.
9. Matrimonial and common-law legislation creates financial entitlements for spouses, children, and stepchildren, including entitlements to assets owned before the relationship began, for example, RRSPs, a professional practice, family business, or inheritance.

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10. Some business owners separate but do not divorce to avoid dividing assets. A new relationship can then create income and property obligations to more than one spouse that impact both retirement security and estate distribution plans.
11. Wills and estate distribution laws can turn disappointed beneficiaries into creditors.
12. There is vicarious liability for the acts of others, for example, someone driving your car while impaired or an employee or independent contractor committing a tort.
13. Contrary to popular belief, there is no immunity for directors of charitable organizations, such as soccer leagues or hospital foundations. Directors can be held responsible for unscrupulous or other wrongdoing of the charity’s employees or consultants.
14. Professional and directors’ liability insurance is increasingly expensive

and harder to purchase. Yet, the umbrella of coverage is shrinking.

Why do some lawyers and accountants recommend that their clients incorporate, even though the advisors know the theory of limited liability dissolves in reality?

- There are economic incentives for doing so.
- Startup companies and their owners may own few assets to begin with.
- Incorporating offers a thin layer of creditor protection in limited circumstances.
- Incorporating does allow certain tax savings and deferral opportunities.

Why doesn’t every business owner put an Asset Protection Plan in place?

Owners accept the inherent risks of doing business as a manageable challenge. Many owners have a common-sense yet unrealistic understanding of the risks they carry. Some count on the fact that they have successfully weathered their fair share of storms along the way.

The Phenomenon of Excessive Risk

That the risks of doing business today are excessive is illustrated in a speech to the Canadian Bar Association on 16 November 2001, by then British Columbia Attorney General Geoffrey Plant. He made the following points.

- In recent years, there has been an expansion in the liability rules that apply to civil litigants, as well as an upward trend in civil damage awards.
- The expansion of liability is not limited to negligence law. Recent cases have greatly expanded the liability of employers through the doctrines of vicarious liability and non-delegable duty. (Managing brokers take note.)
- All too often, it seems the analysis in such cases is exclusively results-driven. A plaintiff has been injured; someone with money must pay.

- The Supreme Court of Canada has "effectively abolished" the statute of limitation, other than to subject claims to the ultimate limitation period of 30 years.

Roy McMurtry, former Attorney General and now Chief Justice of Ontario, said on 10 November 2005, "In fact, the current high cost of civil litigation is increasingly preventing almost all but the very affluent from pursuing a legal remedy through a trial."

Clearly, successful business owners will include an asset protection component in their wealth management plans.

The Solution

How can a prudent business owner protect his or her lifestyle and financial security, given the phenomena of excessive risks and the Myth of Limited Liability™?

Begin by recognizing the realities outlined in this article. Then create an integrated wealth management strategy that addresses the need to protect personal assets from unmanageable risks.

There are three steps to building a sound asset protection plan.

1. **Identify** the financial and other assets that are essential to your financial security.
2. **Assess** objectively the risks and the impact of a peril occurring.
3. **Integrate** the legal, tax, investment, and insurance components in a way that reasonably protects those essential assets from avoidable risks.

The tools used and the financial and legal structure of a sound asset protection plan can only be determined after assessment of the business risks, family circumstances, and the type of assets the owner wants to protect in the context of the applicable laws and regulations.

Caveat: There is no legal and effective asset protection plan available once the pirates stake their claim.

Once an Asset Protection Plan is in place, business owners can continue to do business in an honest and competent manner, confident they have sheltered their essential assets from unacceptable and uncontrollable risks. ▲

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¹ The name of the author's registered seminar