Tax, Retirement & Estate Planning Services

Investment Insight

Creditor protection – Top 10 tips for business owners

Whether you're an established entrepreneur or just starting out, it's important to regularly review your creditor protection strategy. Most business owners, officers and directors don't realize that their personal assets are at risk of creditor claims in the event that something goes wrong with their business.

Here are some tips to help manage your risk:

1. Consider incorporating your business if it is either large or at risk of litigation. Professional practices should carefully consider this option.

2. Not all debt is created equal. Always pay your statutory debt on time; directors and officers can be personally liable for these debts.

3. Ensure sufficient personal liability coverage (e.g. director's home and auto coverage). In the event of a serious accident, your personal assets (e.g. home, car, boat) could be seized to pay any shortfall in insurance.

4. Ensure that your spouse[1] is outside the reach of creditors in the event that anything goes wrong in the business. Directors and officers can carry liability for debts. If your spouse is an employee, or not involved in the business, you will have much more flexibility in your creditor protection plan.

5. Make use of spousal Registered Retirement Savings Plans (RRSPs) to transfer wealth to a spouse – and away from creditor risk.

6. Consider moving your personal assets – like your house and your savings – to your spouse's name. You can transfer home ownership to your spouse tax free. If your spouse is involved in the business, consider setting up a family trust.

Your legal professionals, with the assistance of your advisor, can help you develop a creditor protection plan.

[1] The definition of spouse may include a common-law spouse depending upon applicable legislation.

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7 . Hold life insurance contracts personally (not corporately). Name a "family class" beneficiary on life insurance contracts and list yourself as both the owner and the annuitant/insured. Doing so may prevent creditors from seizing the assets, as well as ensuring the assets transfer immediately to your beneficiary at the time of your death. Remember that if the death benefit is payable to your estate, your assets can get tied up in probate and may be subject to fees and seizure by creditors of your estate.

8. Place your savings into investment products sold by insurance companies. A segregated fund contract or a Guaranteed Interest Contract (GIC) product purchased through an insurance company offers potential creditor protection when you name a "family class" or irrevocable beneficiary.

9. Get professional tax and legal advice on a creditor protection plan. This is not a do-it-yourself plan.

10. Make a plan now. Once your business is in trouble, it is almost impossible to establish a creditor protection plan. It must be done while the business is healthy or new.

What is a "family class" beneficiary?

A family class designation is a spouse, child, grandchild or parent of the annuitant in all provinces except Quebec. In Quebec, a family class designation includes the spouse, ascendants and descendants of the policy owner.

[2] Directors are personally liable for wages to a maximum of 6 months for each employee owed.

Be cautious about naming an irrevocable beneficiary

Your rights as an owner become limited. You can't:

- Change the beneficiary
- Change the ownership
- Cash in the policy
- Assign the policy as collateral for a loan

...without the consent of the person you've named as irrevocable beneficiary.

Naming a child as irrevocable beneficiary on an insurance contract, including an investment contract, means that the contract is effectively frozen until the child is grown – because children cannot legally give consent until they have reached the age of majority. Manulife generally recommends against naming irrevocable beneficiaries based on the limitations this designation can impose on the owner.

A note on liability

Business owners, officers and directors can be personally liable for:

- Any debts they have given a personal guarantee
- Any statutory debts, such as wages[2] and vacation pay
- Any source deductions and commodity taxes
- Health and safety violations including environmental damage

For more information, please contact your advisor or visit manulife.ca/investments

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