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## How To Protect Your Personal Assets When You Run A Business

People who run their own business are responsible for liabilities they create. This means if your business cannot pay its debts, or if an accident hurts someone, you must pay. If you don't have enough money, then the people with a claim can try to take your home, car, stocks, bank accounts or other property to pay the debt. Because of this significant risk of losing personal assets arising from business claims, business owners try to take steps to reduce their risk of personal liability.

An important way to avoid liabilities is to operate honestly, sell quality products and services, stand behind what you sell, protect the health and safety of customers and workers, and comply with all laws. Keeping these ideas first in mind will reduce claims and liability risks. But risks, claims and some liabilities still occur. Even a business that follows all the rules can face liabilities due to accidents, demanding customers, unreasonable suppliers or other events that could not have been foreseen. Additional steps can significantly reduce these risks. Here are tips.

### *Put Your Business In A Separate Entity*

One of the best ways to protect your personal assets when running a business is to use a legally approved form of entity for your business that protects owners against personal liability. Today, this is commonly a corporation, limited liability company or limited partnership. An owner who follows the rules in using these entities and who does not engage in any personal misconduct normally is not personally responsible for the company's debts, obligations or liabilities (an exception is general partners of limited partnerships, who are personally liable for debts of the partnership).

The basic rules are to set up the entity according to the law's procedures and to follow formalities the law requires to keep the entity in good standing. This means filing a certificate with the state, possibly having bylaws or an operating agreement, and a proper management structure. For corporations it may mean having shareholders and

a board of directors that meets regularly. There are also certain documents that usually must be filed yearly at the state level.

### ***Keep The Entity Separate***

People with claims against a corporation or other limited liability entity sometimes try to break through to reach personal assets and money of the owners. Courts look at several factors when deciding whether to “pierce through” and force an owner to personally pay a company debt.

Some factors a court looks at are whether the entity kept good records of its business, whether its property was kept separate from the owner's property, and whether the entity had a reasonable amount of assets to pay its debts.

To help prevent your business entity from being “pierced,” do not mix property of the business with your personal property. Also, as noted above, treat the separate entity with formality. And perhaps most importantly, make sure there is enough money or assets in the company to pay reasonably expected debts and expenses. Undercapitalizing an entity is one of the main reasons courts will “pierce through” and hold an owner personally liable for a company debt.

### ***Know Your Exposure***

Be aware of the potential for personal liability when you co-own a business. Many people form businesses with one or more other people. This is a simple form of business called a general partnership, but it has important legal ramifications. Each partner is an agent of every other partner, meaning one of your partners can bind you to a contract or other obligation even if you're not active in the business and don't consent to the action. If you want to protect your personal assets, don't operate your business as a general partnership.

### ***Don't Give Personal Guarantees***

Organizations you do business with will sometimes ask for personal guarantees. For example, if you are one of the principals of your corporation, when leasing office space a landlord may ask you to personally guarantee the lease. If you are seeking a business loan, the bank may require a personal guarantee or require you to pledge certain personal property as security for the loan. Be aware that if the corporation does not pay, you will be personally liable (or lose the property pledged), and the corporation or other entity will not shield you from this.

### ***Make Sure Your Contracts Protect You***

Personal liability can be limited or even eliminated by terms in your company's

contracts or in your company's sales invoice and purchase order forms. These documents can say that you are not personally liable for matters arising from the contract (or limit the dollar amount of your liability), say that the other party to the contract waives claims, or even require the other party to the contract to "indemnify" you for goods or services it provides, which means help you defend a claim or even pay the liability for you. A lawyer can prepare language to put in your business documents to reduce the risk of personal liability.

### *Obtain Liability Insurance*

One reason people try to pierce through an entity to get the owner's personal assets is that the business does not have enough money to pay the debt or liability. You can reduce this risk by putting enough money into the company, and also getting liability insurance. Depending how broad your insurance policy is, when you are sued, the insurance company will help pay for or provide your legal defense. If you lose and the claim was covered, they'll pay the judgment.

### *Other Methods*

There are other ways to protect your personal assets when you run a business, including transferring personal assets to your children or other beneficiaries, setting up a retirement plan that creditors can't reach, using certain kinds of trusts and using family limited partnerships to prevent creditors from reaching your personal assets. These strategies for protecting personal assets can be very complicated and have significant tax and legal consequences, so it is especially vital to seek legal assistance when considering them.

Protecting personal assets from lawsuits and other claims is a key concern for most business owners. Our law firm can advise you on the best way to protect your personal assets to reduce the risk of losing them due to claims against your business.

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