

# ASSET PROTECTION

## Asset protection for long-term wealth

Creating wealth through your business and investments is just one-half of your financial planning strategy. The other half is about structuring your financial affairs so that your wealth is protected, writes **Craig West**.

**ASSET PROTECTION IS** about using business practices and structures to create barriers between your assets and the risks faced by your business, or even by yourself personally. It's really part of an insurance strategy, and like any other type of insurance, while you might think it 'couldn't happen to me', you just never know, and if it does, you'll be glad that your business and everything you've worked so hard to build is protected.

Asset protection isn't just something that big business needs to think about. The landscape of litigation and liability has changed dramatically over the past few years and people who never before realised that they faced financial exposure are finding that they do. Anyone who owns a business, provides professional advice, owns property or has a high public profile is potentially at risk, and needs to make asset protection a priority in their financial planning.

So who and what are we protecting ourselves against? The list is long, but commonly includes:

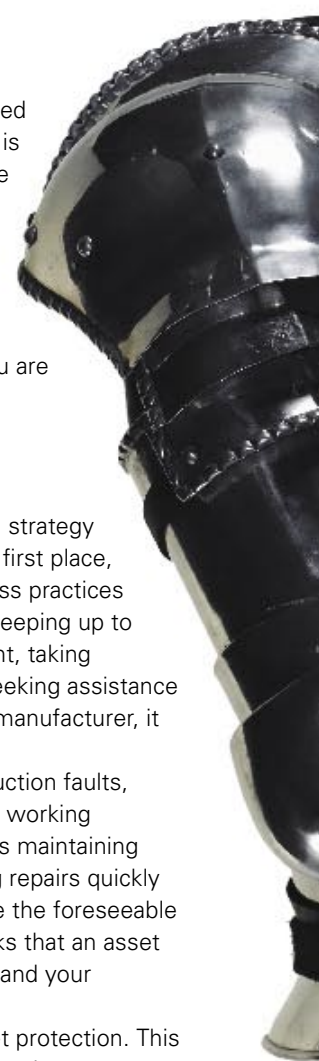
- Employees – e.g. an employee is injured at work and it's not covered by workers' compensation insurance.
- Customers – e.g. if one of your products causes injury to someone; if your products don't work or don't work in the way they are supposed to; or if you are unable to deliver contracted products or services on time or on budget.
- The public – if someone is injured by you or on your property.
- Clients – e.g. if you give someone advice and they suffer loss as a result of taking action based upon it.
- Partners – e.g. if a joint venture partner involves your company in bad business or financial dealings.
- Creditors – everyone to whom you would owe money if your business failed.

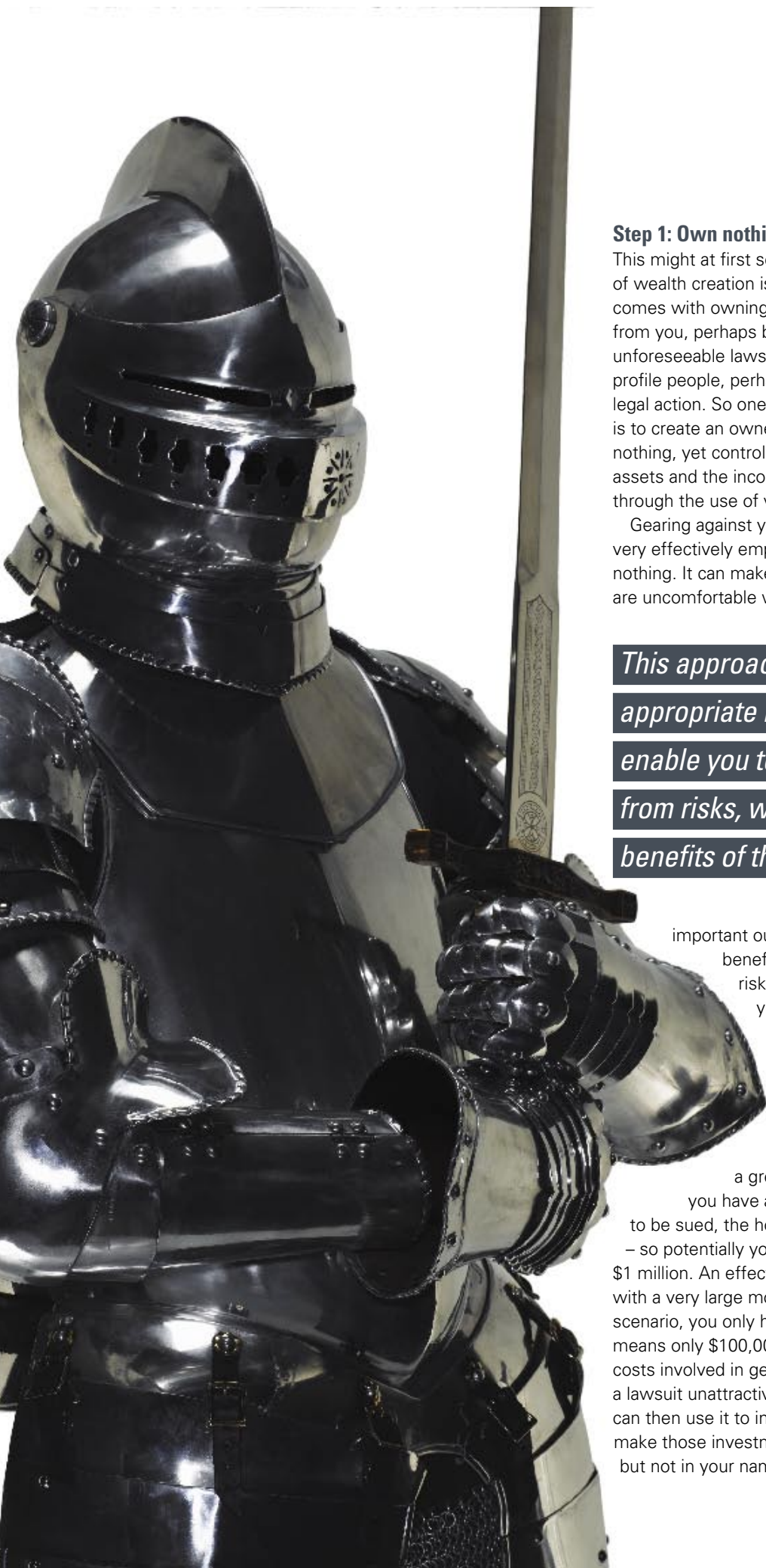
While some of these events can be insured against, others cannot, and unfortunately it is often not until we are facing a claim that we find out whether there are circumstances that exclude the claim from being paid – and that's when our own assets come into play. The objective of an asset protection strategy is to protect your assets from any risks you face so that if you are sued, your assets are not at risk.

### Six simple steps to asset protection

At the top of the list in any asset protection strategy is minimising the risks of being sued in the first place, which means making sure that your business practices are sound. For a professional, that means keeping up to date with ongoing professional development, taking extreme care when providing advice and seeking assistance from other experts when necessary. For a manufacturer, it means having quality control systems in place that minimise the chances of production faults, complying with contracts and having a safe working environment. For property owners, it means maintaining the upkeep of the property and undertaking repairs quickly and safely. Such steps will help to minimise the foreseeable risks, but there are other unforeseeable risks that an asset protection strategy can help to protect you and your business against.

I recommend a six-step approach to asset protection. This approach is about creating the appropriate business structures that enable you to quarantine your assets from risks, while still enjoying the benefits of those assets.





### **Step 1: Own nothing**

This might at first seem counterintuitive. After all, the point of wealth creation is to accumulate assets, but the risk that comes with owning assets is that they can be taken away from you, perhaps by creditors, perhaps as a result of an unforeseeable lawsuit, and, particularly in the case of high-profile people, perhaps through opportunistic and predatory legal action. So one of the first objectives of asset protection is to create an ownership structure in which you literally own nothing, yet control everything and can still easily access the assets and the income they generate. This can be achieved through the use of various business structures.

Gearing against your assets is another strategy that can be very effectively employed to achieve the objective of owning nothing. It can make some people nervous, especially if they are uncomfortable with using debt, but it can achieve two

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important outcomes. First, it enables you to enjoy the benefits of your assets without exposing them to risk. Second, by borrowing against your assets you release your equity, which you can then use to invest in more assets (but not in your own name).

Let me give you an example of how this can work. Say you purchase a \$1 million home, unencumbered. You don't owe anything on the house, which is a great feeling and a fantastic achievement, but you have a \$1 million asset fully exposed. If you were to be sued, the house could be sold to release your equity – so potentially you lose your home and your \$1 million. An effective alternative would be to buy your home with a very large mortgage against it, say \$900,000. In this scenario, you only have \$100,000 equity in the home, which means only \$100,000 exposed to any potential risk – and the costs involved in getting at your \$100,000 are likely to make a lawsuit unattractive. By releasing your \$900,000 equity, you can then use it to invest in other assets through structures that make those investments for your benefit, but not in your name.



### Step 2: Quarantine your assets

Everyone is familiar with the practice of quarantine – it's about isolating risks. Quarantining your assets is about isolating them from risks by creating ownership structures that make people and organisations who are not exposed to risk the legal owners of the assets.

Mixing assets and risks is a dangerous practice. I have a client who runs a very successful import business – he is the sole distributor of a particular type of industrial equipment in Australia. Over the years, he has been successfully sued twice as a result of injuries sustained by people using the equipment he imports. When I met him he had \$1 million cash in the bank. This is a great example of how to expose your assets (\$1 million) to risk (high possibility of future legal actions). Should he be sued again (which, based on past experience could reasonably be expected) he had \$1 million in cash ready and available for any award made against him – it wouldn't even have been difficult to release his assets, a simple bank transfer could have seen his \$1 million paid out instantly.

Quarantining assets is about separating them from risk, so that where there is risk, there are no assets. The key is to identify people without risk who can become the legal owners of the assets. My wife, for example, is a person without risk – she doesn't work in my business, she doesn't advise clients and isn't a shareholder or director of any of my companies. The likelihood of her being sued is virtually nonexistent, so it makes sense that she should be the owner of the assets. While it is usually a spouse that is identified as a person without risk, that's not always the case – the important thing is that it is someone who is completely isolated from ownership of your business and its operations.

### Step 3: Identify appropriate structures

Structures are the means through which you can achieve the objectives of asset protection. There are many different types of structure, which each offer different levels of asset protection, and we'll take a brief look at some of the most commonly used structures below.

There are two important considerations when dealing with business structures: the first is that it is important to establish a strategic direction for your structure as early as possible because it can be costly and complicated to change structures once established; and the second is to be aware of the need to recognise the trade-offs that may be required between structuring for asset protection and tax minimisation. If you structure solely for asset protection, without considering tax, you'll probably end up paying more tax than you need to. Likewise, if you structure solely for tax benefits, you probably won't end up with the asset protection that you need. There are many choices and trade-offs that you will have to make in order to achieve the appropriate balance and these should be considered with expert advice from specialists.

The most common types of business structure include:

#### **Individuals (sole traders).**

This is a simple, inexpensive business structure in which there is no distinction made between the individual and the business – the individual is the business. The assets of the individual are the assets of the business, so there is no protection, and the business earnings are taxed at the individual's marginal tax rate.

#### **Partnerships.**

Another quite simple and inexpensive business structure. The partnership may be between two individuals, two entities (such as a company or trust) or between an individual and a business entity. Again, there is no distinction made between the individual's assets and the assets of the partnership, so there is no asset protection. In fact, a partnership exposes each individual to potential liability for actions taken by the other. Earnings of the partnership are taxed at each partner's marginal tax rate.

#### **Companies.**

The most significant difference between a company structure and the previous two is that a company has its own legal identity. The company is not the people who own it – it has

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its own assets, its own liability and its own rate of tax. It offers asset protection benefits because the owner's assets are separate from the company's assets (although individual directors can be personally liable for negligent or fraudulent activities conducted by the company). Companies pay a lower rate of tax (30 per cent) than many individuals.

## **Trusts.**

Trusts are one of the most flexible, yet most misunderstood and under-utilised structures available. There are a number of different types of trust structure, including unit trusts, discretionary trusts and hybrid trusts. The primary difference between trusts and companies is that trusts don't pay tax on their income, but all of their income must be distributed to beneficiaries (which may be individuals or companies) and the beneficiaries must then pay tax according to their marginal tax rate on those earnings. Trusts offer excellent asset protection because they are a structure within which ownership of an asset can be held for the benefit of the beneficiaries, without the beneficiaries actually owning the asset. This is a complex subject, which you should discuss with a specialist.

## **Self-managed superannuation funds (SMSFs).**

These are actually another type of trust. Because of their nature they are very heavily regulated, but they also offer excellent asset protection and tax advantages. Because their purpose is to preserve assets for your retirement, SMSFs are extremely difficult to get assets out of, but they are subject to only 15 per cent tax on income. SMSFs can be used to excellent advantage, but they are complex and should be discussed with a specialist.

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## **Step 4: Creating the ideal structure**

The ideal structure is not intended to be an off-the-shelf solution for your finances – there is no one solution that will suit every circumstance. Part of the asset protection process is about creating a customised solution that meets the unique requirements of each person's business, investments and goals. All that this model is intended to demonstrate is how the best elements of different structures can be combined and leveraged to create a solution that provides excellent asset protection and meets the criteria of having you own nothing, while controlling everything and still accessing the financial benefits of your assets.

## **Step 5: Insurance**

Having adequate amounts of the right types of insurance is an essential element of asset protection. There are insurance products that offer coverage for an enormous range of business circumstances. Here are just a few of the more commonly needed types of business-related insurance:

- Disability caused by accident or sickness
- Breakdown of electronic equipment and machinery
- Employee theft
- Burglary and armed hold-up
- Damage to premises and contents
- Tax investigation
- Landlord's insurance
- Public and product liability
- Professional indemnity.

Part of the asset protection process is identifying the risks that are unique to your business and the types of insurance available to protect you against those risks.

## **Step 6: Legal protections**

The final step in the process is to ensure that you have legal protections that work in conjunction with the rest of your asset protection strategy. Without the right protections, or documents that support the objectives of your strategy, all of your structural tactics can be undermined. If you don't currently have a will, you do need one and you should have a lawyer draft one for you. Another type of trust, a testamentary trust, can be established to take ownership of your assets in the event of your death, which enables you to move all of

your assets into trust for the benefit of your nominated beneficiaries. Again, speak to a specialist about this.

## **Overall**

There are many different business functions involved in effective asset protection, including business processes, ownership and structures,

insurances and legal protections. It is vital that you are working towards a fully integrated plan, coordinated by a project manager who has a bird's-eye perspective of what you are trying to achieve.

In many cases, a strategic direction can be established and then handed to your existing accountants and lawyers to implement and manage on your behalf.

If you don't currently have an asset protection strategy in place, ask yourself how easy it would be to access your assets if you were subject to an unforeseen legal action. Don't risk everything you've worked to create by not taking the proper steps to protect your wealth over the long term.