



Your Guide to Business Asset Protection



FIFTH THIRD BANK

Imagine finding yourself on the wrong end of a costly judgment in a lawsuit. Or re-building your business after a destructive natural disaster. Potentially worse, learning your business has been the victim of malware or cyber fraud.

All of these issues have one thing in common — their impact can be mitigated by a comprehensive asset protection plan.



In today's integrated business environment, leaders must take a holistic approach to asset protection — one that guards against both traditional evergreen risks and new, ever-evolving threats.

To do so requires undertaking a thoughtful accounting of the risks your company faces and creating a plan that ensures all processes and procedures designed to facilitate asset protection are integrated into the daily operations of the company.

Ideally, the time to put such a plan in place is long before it might be needed: After all, preparation is almost always less costly — both monetarily and strategically — than damage control.

There are several essential areas you will want to focus on as you tailor your asset protection plan to the specific needs and vulnerabilities of your business. The overall strategy is to ensure you have in place the right legal structure, proper insurance coverage, cyber security protections and family contingency plan.

Choose the Right Legal Structure for Your Business

The nature of your business — as well as the number of owners or partners — will likely determine the type of legal entity you ultimately choose to establish. Business structures typically vary based on tax obligations and liability.



1

A **C-Corporation**, which is versatile in terms of deductions available, can be appropriate for companies with a large number of shareholders or that sell products and stock inventory. Corporations are considered to be independent legal entities—meaning owners’ assets are not part of the company’s assets. Corporations can be expensive to maintain, however, since they have more complex accounting, legal and tax requirements.

2

An **LLC**, on the other hand, might be a better structure for companies actively investing in appreciating assets.

An LLC provides corporate protections by limiting your liability to the investment you have in the business. LLCs are relatively less complex in terms of tax and reporting requirements, making them an attractive option for those seeking asset protection with minimal paperwork. LLCs are also subject to double taxation, so an **S-Corporation** can be used in conjunction with an LLC to adjust how the business is taxed. (An S-Corporation has similar limited liability, but the tax structure differs.)

3

*Why not establish a **sole proprietorship**?*

A sole proprietorship is attractive for its simple tax structure and full control of the business. However, sole proprietorship means that as the owner you are fully responsible for the liabilities of the business, leaving your personal assets fully exposed to creditors and civil lawsuits.

Whichever type of entity is chosen, it's important to draw a distinct line between business and personal activity. Basic steps in this direction include maintaining separate personal and business bank accounts, using your business name on all correspondence, titling any property owned by the business in the entity's name, and maintaining a corporate records log and annual meeting notes.

If anything is not clear or you would simply like to get an accurate, detailed lay of the land, consult with an advisor who has expertise in your industry.

Establish a Qualified Retirement Plan

Qualified retirement plans — such as a **401(k)** or a defined benefit pension — not only allow business owner(s) and employees to build a retirement nest egg but also protect contributions from creditors in the event of a lawsuit per the Department of Labor’s Employee Retirement Income Security Act (ERISA).

It’s particularly important for business owners, as your retirement fund will likely be one of the most valuable assets you own (aside from your business). Should you become subject to a civil or creditor lawsuit, you will want to ensure your retirement assets are protected.

If some of your retirement assets are in an IRA, pay special attention to the state your fund is located in. The creditor protection afforded to IRA accounts varies by state and circumstances, so it is important to understand the state rules before rolling over qualified plan money to an IRA account.



Obtain Proper Insurance Coverages

While the insurance market boasts countless types of coverage plans — including some that are specialized and specific to certain types of products or services — there are basic coverages most businesses should have in place.



General liability insurance protects your business against any number of third-party claims such as bodily injury, and damage done by your employees to the property of another business or individual. These types of claims can occur:

- If you visit your client's place of business or provide services on-site for them
- If your company represents your client in business transactions
- If you use a third-party location to conduct your business or provide your business' services

Additionally, some contracts and business transactions will require your company to have general liability at the time the contract is signed.



Professional liability insurance is often known as errors and omissions coverage. Typically, professionals in areas like law and medicine carry this type of coverage, but it may also suit the needs of companies offering technology, engineering, or other services that customers depend on for their own income.



Worker's compensation coverage provides benefits to workers who become ill or injured due to work-related circumstances. This coverage is generally mandated for companies with at least one employee, though the requirements vary by state.



Commercial auto coverage covers liability should a vehicle used for work be in an accident. If your business involves the use of trucks or larger vehicles more specific coverage may be required.



Business interruption insurance protects the income and stability of a business if it is interrupted by a fire, tornado, flooding or other covered peril — both during events and in the recovery process.



Commercial umbrella insurance extends the coverage of your general liability insurance. The umbrella policy covers claims that extend beyond the limits of the general liability policy providing an extra layer of protection for the company against larger claims.



Commercial flood insurance specifically covers losses to your business from floodwater damage.

Depending upon the nature of your business, what products and services are offered, the industry you are in and other factors, your company may need additional types of coverages as well.

Begin by asking yourself a few questions: Does your company have general liability insurance coverage in place? Are the limits adequate for the size and scope of your business? Have you shopped around for this coverage lately?

Factors such as the cost of coverage versus the risk of loss will help you decide if a particular type of coverage is worth pursuing. In some cases, self-insurance against some or all of the potential liability might be a reasonable path.

Implement Protection Measures Against a Cyber-Attack

Whether resulting in the exposure of proprietary information about your company, customer data loss and litigation, or loss of business, recovering from a cyber breach can be expensive, time-consuming, and difficult.

Thankfully, there are steps that companies, large or small, can — and should — take to protect their data.



These include:

- Ensuring your system includes a high-grade firewall
- Using a commercial quality, cloud-based anti-virus program that updates frequently and automatically and includes sophisticated reporting on network threats can eradicate a multitude of viruses
- Backing up your data online in addition to locally. Many viruses and malware can render local backups useless.
- Keeping all software up to date. Many software updates are to fix holes in their security that hackers and viruses can exploit.
- Training employees in cybersecurity best practices to enhance system security

A number of insurance carriers offer cyber liability and data breach coverage. What is and isn't covered may vary, however. These policies can help companies deal with the costs involved in notifying customers in the aftermath of a data breach as well as any subsequent liability.

Family Contingency Plans

Risks of Divorce

Depending upon the state in which you reside and other factors, your spouse may be entitled to as much as half of the value of your interest in the business in the event of a divorce. If you acquired your interest in the business prior to or separately from the marriage it *may* be protected.

Some examples of this would be:

- An investment in the business that was owned prior to marriage
- An inheritance received by one spouse specifically
- A gift to one of the spouses from a third-party other than their spouse
- As part of a judgment in a lawsuit or personal injury settlement

As unromantic as this may sound, it is often best to have a prenuptial agreement in place that establishes the business and other assets as separate property prior to walking down the aisle. It's important that the prenup is entered into willingly by both parties.

A knowledgeable and sensitive attorney can help craft an agreement that leaves the business owner protected while assuring their spouse that he or she will receive fair and adequate compensation in exchange for relinquishing any claims on the business if the marriage dissolves. Such concurrence and documentation make a legal challenge to the agreement less likely.

Transferring Ownership to Family Members

Transferring all or part of the ownership of the business to a family member can be beneficial — but also carries potential risks.

The business is likely a significant part of your net worth and retirement planning. While the desire may be to pass the business on to family members, doing so before the time is right can have consequences.

A full management succession plan is a must — you want to be absolutely certain that the next generation is fully prepared and qualified to run the business in your absence. It's equally important to reward and incentivize top-performing talent to stay with the company to assist your designated successor(s) in running the business.

Beyond issues of succession and management, there can be issues related to estate planning and tax strategy that come into play when transferring some or all of your ownership interest to a family member.

As you may suspect, this can be a complex area and it is wise to seek the advice of a financial planning advisor and other experts before making any final decisions.



Plan with the Rules of Your State in Mind

Most business asset protection strategies require an adherence to the unique rules of your state. Some states have pro-business protection rules in place. Others are known to be “creditor friendly.”

To this point, consider the location of your company’s incorporation. You can choose which state you incorporate in, to some extent. Be aware, however, this might or might not be recognized should a legal proceeding arise and its perceived that this was just a legal ploy.

Additionally, various states treat different types of business entities in different ways. For example, it can be more advantageous to have an LLC in one state over another.

Benefit From Staying Ahead of the Game

Protecting the assets of your business from liability is a baseline requirement to ensure the flourishing and continuity of the business. A judgment arising from a lawsuit, becoming the victim of a theft of client data or key proprietary business information, or other types of claims can prove an existential threat to a business. To prepare for those potentialities in advance, however, not only protects the assets you’ve worked so hard to acquire but also gives you a competitive advantage over those companies that fail to do so.

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