

## *Silver Advantage* **Accounting Alert**

### **LLC or Corporation: Take Steps to Protect Your Personal Assets**

**By Daniel Mulvey and Jennifer Barliant**

October 2013 – One of the primary ways that entrepreneurs and small business owners can protect their personal assets from the possibility of litigation or bankruptcy is through the formation of a corporation or a limited liability company (LLC). By definition, the formation of these entities limit owner and officer liability, and in normal circumstances, they shield the owner's assets from legal settlements or bankruptcy proceedings.

However, the processes of protecting personal assets from company litigation or bankruptcy are both challenging and constant. The efforts that owners contribute to protecting their personal assets can prove futile if, in the eyes of the court, the company's actions are deemed to be wrongful or fraudulent; if there is no real separation between the company and its owners; or if in the case of bankruptcy, the creditors suffer an unjust cost.

One of the most common problems for small businesses is the lack of proper separation between the company and its owners. There are many questions that should be addressed in determining whether an appropriate separation exists, including:

- Does the company commingle its assets with its owners?
- Is there failure by the company to follow corporate or LLC formalities?
- Is the company adequately capitalized?
- Is it controlled by one individual or by a small group of people?

In order to safeguard against the loss of personal assets by incorporating a small business or establishing it as an LLC, certain guidelines should be taken in order to mitigate any unfavorable consequences, in the event that these questions fail to be considered.

First, many small business owners use the company's checkbook to pay their personal bills. In order to maintain a separation between the company and its owners, this practice should be eliminated. Payments out of the company's checking account should be restricted to those that serve the express business purpose of the company.

Second, it is important to establish bylaws for a corporation or an operating agreement for an LLC, to file all required annual reports with state agencies, and to document decisions and important matters (through written minutes) that arise from stockholders' or members' meetings. These are key tasks that will help ensure that the company is following corporate or LLC formalities. Additionally, the company name should clearly state either "Inc." for corporate entities or "LLC" for limited liability companies, and all business communications should indicate that the owners are acting as representatives of the company, not as individuals, by documenting their company title and applying their written signature.

Third, if the company does not have sufficient funds to function on its own, this could give the impression that the company is simply an extension of the owners. To avoid this misperception, owners should examine the costs associated with launching and running the company, and ensure that the company is sufficiently capitalized with a reasonable investment for all of its related activities.

Finally, many small businesses are managed by owner/operators. We would recommend that they establish a board of directors or some other similar advisory board to assist them in determining the company's vision and mission as well as help ensure that the entity operates separate and apart from the owners. Owners should seek ongoing advice from their boards and trusted business advisors, including their accounting and tax advisors, particularly when making decisions that will have a major impact on the company.

Personal liability protection is one of the primary reasons to make a decision to incorporate or to form an LLC. While it's prudent to avoid the need to test this decision, unforeseen circumstances can occur. Asking the right questions and following these guidelines can provide some level of defense to help protect the personal assets of company owners in any legal proceedings.

Michael Silver & Company CPAs can assist in determining the most appropriate entity structure for an entrepreneurial or small business, and help outline the policies and procedures a company should consider and address, with an emphasis on protecting personal assets. Please contact us with any questions or concerns you may have regarding your business entity structure or other matters related to safeguarding personal assets.

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