

Avoiding Personal Liability for Business Claims

One of the important considerations in starting a new business or operating an existing business is protecting the owner's personal assets and limiting the owner's personal exposure for the liabilities, debts and obligations of the business. A few simple steps can provide a significant level of personal protection and keep your business distinct and separate from you as the owner: 1) incorporate the business as an entity rather than operating as a sole proprietorship; 2) obtain business liability insurance covering the activities of the business and any claims that may arise; and 3) if you own a home, prepare and record a Declaration of Homestead in the Registry of Deeds of the county or district where your home is located. Each of these matters is discussed in further detail below.

When operating as a sole proprietorship, there is no distinction between the business owner and the business itself, and the owner is personally liable for the debts, liabilities and obligations of the business and any claims against the business. This also means that the owner's personal assets, such as the owner's house, vehicles, bank accounts, investments, and the like, are also at risk to claims against the business or by the creditors of the business. Rather, to shield owners from personal liability, it is strongly encouraged that you create a separate and distinct legal entity in which to conduct business, typically as a corporation or limited liability company (LLC). By doing so, the debts and liabilities of the business would remain with the business, and creditors and claimants against the business could only look to the business entity and not the owner personally.

To form an entity, this would involve filing articles of organization with the Massachusetts Secretary of State and paying the required filing fee. Typically, the business would be formed as either a corporation or a limited liability company. The business owner should consult with its lawyers and accountants or tax advisors as to whether a corporation (including a relatively new form of 'public benefit corporation') or a limited liability company is the appropriate entity in which to conduct business, as several different factors may impact that decision.

Once the entity is created, so long as you conduct business through the entity and respect its separate and distinct existence as a stand-alone legal entity, the debts and liabilities of the business and any claims against the business would be limited to the business entity only, and not the owner personally. To respect this separate nature between the business and the owner individually, this means, among other things, obtaining a separate tax EIN number for the business entity, opening separate bank accounts in the name of the business entity, not commingling business and personal funds and expenses, and signing legal documents in the name of the entity in your capacity as its officer or manager, and not individually. Please remember, however, that if a business owner signs a personal guaranty for any of the debts or obligations of the business (for instance, in the context of a lease or a loan to the business, or as may be required by a business vendor for credit terms), then the owner will be held personally liable for those debts and liabilities of the business to the extent of the personal guaranty.

Consideration of business insurance is also a key component to any risk management plan of a new or existing business, and each business owner is strongly encouraged to speak with an insurance agent regarding how best to protect the business and the owner from claims. Some typical forms of insurance, depending on the nature of the business and the risks involved, include: commercial general liability and comprehensive public liability insurance, building and contents coverage, property and casualty, product liability, errors and omissions, hazardous substances and environmental, business interruption, and workers' compensation as required by law once you hire employees. It may also be wise to consider adding key man life insurance or disability insurance to cover the unexpected loss of a key employee or owner to replace those services or revenue. Where there are multiple owners, consideration of cross-purchase buy-sell life insurance or disability insurance is also a possibility to fund the buyout of a deceased or disabled owner's interest following their untimely death or disability. While not all of these coverages, and the expenses involved, will be necessary from

the outset, the business owner should nevertheless have these discussions with their agent from the beginning to determine the appropriate kinds and levels of insurance when starting the business, and periodically review the insurance needs as the business grows and expands.

Finally, it is advisable for any business owner who also owns a home to file a Declaration of Homestead with respect to the property in the Registry of Deeds of the county or district where the home is located. An estate of homestead is protection for the equity value of a person's principal residence from the claims of creditors (excluding mortgage holders). With an automatic homestead protection, the business owner receives one hundred twenty-five thousand dollars (\$125,000) in protection value. However, by filing a Declaration of Homestead form in the Registry of Deeds of the county or district where the property is located, the homeowner/business owner can protect the value of their property up to five hundred thousand dollars (\$500,000) from the claims of creditors. If you are not sure whether or not you previously filed a Declaration of Homestead, many of the registries are now online and you can search your property by name or address for prior filings, or a lawyer or the clerks of the registries should be able to assist you with the search and necessary filing.

By undertaking these important steps, namely incorporating the business, obtaining proper business insurance, and filing a Declaration of Homestead on their residence, the business owner can significantly safeguard their personal assets and liability from the claims and liabilities of the business.

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