Legal Corner

Attorney Judy Gedge

Why Not Protect Your Assets by Transferring Them to Your Spouse?

Q: I am just about to go into business for myself. I've always dreamt of opening my own bookstore and now that I've taken early retirement, I'm making all the arrangements to pursue my dream. I met with my accountant the other day about my new business and I asked him whether I should form a corporation or other entity for my new business. He told me not to bother with all that and that I should just transfer the house and all my other assets to my wife. But I wonder what you think about this advice. If it's that simple, why doesn't everyone follow this route?

A: Congratulations on your new career as a small business owner! Perhaps you'll want to stock *AOB News* in your bookstore! You are smart to ask your accountant for bookkeeping and tax advice to start up your business. In addition, you should meet with an experienced business attorney to help you with the legal aspects of starting your business. You're obviously aware that running a business can expose you to potential liability. Maybe it's a customer who slips and falls while in your store. Or perhaps one of your part-time employees gets into a car accident while picking up supplies for the store. These are just two examples of potential liability you might face in your new business.

If you do not form a limited liability entity, there is no legal distinction between you and your business. This means that if a judgment is obtained against your business, your personal assets can be seized to satisfy the judgment. On the other hand, if you operate your business as a corporation or other limited liability entity, then it is the assets of the business that are at risk, not your personal assets. Your accountant has suggested that you protect your assets by transferring them to your wife. At first blush that may seem a simple solution to your problem but let's take a closer look at what might happen.

Remember that employee of yours who got into a car accident. Let's assume the accident was his fault and he only carried minimal car insurance. Not only is the employee sued as the driver of the car, you are sued as well, as his employer. (You didn't know that, as an employer, you have strict liability for your employees' acts while they are on the job?) There's no defense to the action and the injured plaintiffs obtaina judgment against you for $600,000.

You transferred the house and all your other assets to your wife before you started the business so there's nothing to worry about, right? But you do have at least one asset: your bookstore. All of the assets of the bookstore can be seized to satisfy the judgment including the cash in the cash register. So much for your dream of running your own business.

Now maybe you decide to shut up shop, thinking that will solve your problems. But a judgment lasts a long time (over fifteen years in most states). Any income or assets that you acquire in the future can be seized to satisfy the judgment. Personal bankruptcy may be the only avenue open to you and that's not a step to be taken lightly.

As you can see, any assets that you have or acquire in the future can be seized to satisfy the personal judgment against you. In addition, your creditor may be able to recover against the house and other assets that you transferred to your wife before you started the business. Under a law that dates back to sixteenth-century England, your creditor may be able to recover the assets that you transferred to your wife if she didn't pay you for those assets.

Where does that leave you? If you want to protect yourself from the risks of your business, you'll want to form a corporation or other limited liability entity. And one other thing, don't rely on your lawyer for tax advice and never rely on your accountant for legal advice.

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This article contains general information and is not intended as a substitute for obtaining the advice of legal counsel.

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