THE LAWRENCES® LETTER

News and information for clients and friends of Lawrence, Lawrence, Stevenson LLP

SUMMER 2009

Protecting the Money You've Made

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John and Jane run a website development business through their corporation, Risk Inc. John and Jane's business grows and Risk finds itself with significant retained profits. This gives John and Jane the confidence to have Risk branch out into software development. Risk attracts a large client, Windfall Inc., which asks them to create several proprietary programs. Seeing even greater success on the horizon, John and Jane cause Risk to invest heavily in the work for Windfall, hiring qualified staff and incurring extensive costs so that they can meet Windfall's needs. Unexpectedly, Windfall experiences catastrophic financial difficulty and is put into bankruptcy. Suddenly, Risk is owed a huge receivable by a now bankrupt Windfall and has many unpaid creditors of its own.

Until and unless they are distributed, Risk's retained profits comprise one of its assets. When one of its major customers goes bankrupt at a time when it owes Risk a great deal of money, Risk's retained profits can quickly disappear.

Various legal asset-protection strategies could have been used to protect Risk's retained profits. Such strategies require careful planning and implementation and must be done before the type of situation described above comes to pass. The steps involved in one such strategy are as follows:

1. John and Jane incorporate a second corporation, Holdco Inc.
2. John and Jane transfer their shares in Risk to Holdco. Using the "rollover" provisions of the *Income Tax Act*, this can be done without triggering tax consequences.
3. Risk pays a dividend to Holdco in the amount of the retained profits. Under the *Income Tax Act*, this inter-corporate dividend flows tax-free to Holdco.
4. Holdco lends these profits back to Risk and, as security for this loan, Risk grants a general security agreement to Holdco.

Had such a strategy been properly implemented, Holdco would have been a secured lender to Risk at the time of Windfall's bankruptcy and Risk's retained profits would be beyond the reach of Risk's trade creditors.

Effective creditor-proofing of this type is not to be confused with fraudulent schemes that attempt to avoid debt obligations. Rather, it is a legitimate and prudent strategy that is a responsible and necessary part of managing business activities. Lawrences' Business Law Group has helped many successful business owners structure their businesses to protect their best interests.

Bill chairs Lawrences' Business Law Group. He has over 20 years' experience advising clients on corporate and business structuring, reorganizations and business succession and transition planning. Bill can be reached at (905) 452-6871 or wsirdevan@lawrences.com.

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