

SHOULD I INCORPORATE MY NEW BUSINESS TO PROTECT MY PERSONAL ASSETS?

Individuals starting a business often worry about getting sued. They believe that if they incorporate, the corporation will protect them from having their assets confiscated in a lawsuit.

However, before incorporating, consider that:

- Only a tiny percentage of the millions of annual business transactions end in a lawsuit.
- Most lawsuits are settled between the parties and do not end up with a Court Award.
- If your business is sued, it is not the court or settlement that will make you go broke; it is the attorney fees you must pay to defend yourself that will put you in the poor house!

Consider what the Plaintiff (a person bringing the lawsuit) must do to bring a lawsuit to Court.

- Hire an attorney and usually pay a retainer before the attorney takes on the case.
- Gather written documentation and "evidence" of what transpired to cause their loss. This information must be succinctly communicated so the attorney has the facts before making a complaint.

When individuals recognize the cost and time necessary to bring a lawsuit, they generally find alternative means to get satisfaction. It is common to have an attorney send a "demand letter," but rarely will it advance to a lawsuit, even if the resolution is not reached.

If a case proceeds to Court, it is still unlikely to go to trial. Judges want to "clear their dockets" and pressure both sides to settle. If no settlement is reached, the Court may recommend arbitration, asking both parties to split the cost.

Only 1% of all civil cases filed in Court proceed to trial, and only .07% end up with a jury. [Civil Cases to Trial](#).



THINKING OF INCORPORATING THINK TWICE.

If the motivation to incorporate is to protect assets, consider:

- It costs between \$1500 - \$2,000 in legal and filing fees.
- Once incorporated, should the corporation be sued, the Court **REQUIRES** a licensed attorney represent the business (except in small claims court). Therefore, the owner **CAN NOT** defend themselves in Court.
- If the corporation files a separate tax return, anticipate paying \$ 750-\$1500 to the tax preparer *A single-owner LLC can report their business income & expense with their personal taxes using form 1040 Schedule C*
- Some states impose a minimum annual corporate tax.

So, if you are worried about a lawsuit – take a deep breath – that rarely happens. However, your business will suffer if sued because you must hire and pay an attorney to respond, and legal fees are incurred whether your company is incorporated.

**Consider buying business insurance if you want to protect your assets.
If a claim is brought for a covered item,
the insurance company will provide the legal representation at no cost.**

WHAT TYPE OF INSURANCE SHOULD I BUY?

There are many types of business insurance policies. Working with an insurance broker should help determine which are necessary and which are optional. The key policies are:

LIABILITY POLICIES

1. **Business General Liability policy** (also called Completed Operations policy). General liability insurance policies typically cover you and your company for claims involving bodily injuries and property damage resulting from your products, services, or operations. It may also cover you if you are liable for damages to your landlord's property.
2. **Commercial Automobile policy**—Businesses with company-registered vehicles need Commercial Automobile Coverage. If you use a personal car for business-related purposes, you should check with your insurance carrier to be sure your policy covers incidents that occur if you use your vehicle for work-related business.
3. **Commercial Property policy** – A Commercial Property policy can cover the structure and the contents. The property owner may have coverage for both. However, tenants are generally required to maintain, as per the lease, a policy to cover contents. If you rent a premises, check your lease terms to see what insurance and in what amounts are required.
4. **Property Flood Insurance** - The US government underwrites flood insurance, which is available when the property is in a flood zone. The mortgage lender often requires it.
5. **Professional Liability Insurance/ Errors and Omissions policy** protects a company if it makes a mistake or omission. Errors can arise when delivering professional services or when a professional does not follow commonly accepted practices or policies. An example would be if the Human Resources department forgot to enroll an employee in the company health insurance plan and told or led the employee to believe they had coverage. Later, if the employee made an insurance company, which was denied, the employee might have grounds for a lawsuit.

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6. **Directors and Officers Liability (D&O)** is a standard for larger corporations because those who serve want to be protected and know that if they are sued, the insurance company will defend them, pay a claim, and safeguard their assets.
7. **Business Income Interruption policy:** If a covered event results in the loss of business income, the policy will provide funds to maintain operations. Business Income interruption is often an optional endorsement of a general liability policy.
8. **Data Breach Policy (Cyber Insurance)** helps a business respond to a data breach if personally identifiable information is lost or stolen. Some insurers may call this cyber coverage insurance. Data breach insurance can help pay the costs of notifying impacted individuals, offering identity theft monitoring services, and creating a public relations campaign. This type of insurance is becoming more challenging to obtain, and applicants must prove what kind of cyber security they have as part of the application process. If they do not have any, they are doubtful to get insurance.

Also, there are a substantial number of risks that are not covered. For example, common exclusions include defects in the infrastructure that lead to losses, cyber warfare, and the failure of the insured to maintain adequate insurance. Check with your broker to see what kind of coverage is available and carefully review the exclusions

9. **Business Umbrella policy:** Most General Liability and Commercial Automobile policies only insure losses up to \$1-\$2 million. If a loss exceeds that amount, the umbrella policy will cover losses over the primary insurance level.

EMPLOYEE BENEFIT INSURANCE POLICIES

10. **Worker's Compensation insurance** – Many states, including New York State, require that business owners have worker's compensation insurance to provide compensation and medical care if their W-2 employees have a job-related injury. In the states with this requirement, not having workers' compensation insurance is a severe issue, and it is subject to massive fines by the state where the company operates.

Worker's Compensation is priced based on employees' job classification and earnings.

Companies pay a rate per \$100 of payroll, and rates vary widely based on job classification. For example, the premium to cover a clerical worker (NYS code 8810) is 12 cents per \$100 of payroll, whereas the premium to cover a bakery route salesperson (NYS code 2003) is \$5.31 per \$100.

When starting a business, it is critical to classify employees correctly; changing classifications once the company is established can be challenging. The policy is usually written with a good faith estimate of the anticipated payroll per job classification. At the end of the year, the insurance company will audit the payroll and adjust the premium. If the payroll is higher than projected, the business will be invoiced for an additional premium; if the payroll is less than projected, the company will receive a credit.

Workers' compensation policies are often discounted on renewal, or a surcharge is applied based on the firm's losses compared to those of others in the same industry. Getting a copy of the "loss runs" is crucial, as is encouraging workers to return to work even if they need accommodations. Worker's Compensation insurance can be a significant business expense.

11. **Employee Health Insurance**—The Affordable Care Act requires employers to offer health insurance if they employ more than 50 full-time employees. States may have additional requirements. Most employers realize that providing health insurance is a significant employee benefit, so those who can afford it offer a plan. Employees often pay a portion of the cost. Insurance brokers specializing in employee benefits should be retained to obtain coverage. They generally differ from those specializing in liability insurance.
12. **Employee Disability Policy**—Many states require that companies with W-2 employees have a disability policy to cover employee wage loss if the employee becomes sick or injured in a non-work-related incident. Disability policies are often available through a state insurance fund. In some states, the employer may pay the employee part of the cost.
13. **Unemployment Insurance**—Many states require companies with W-2 employees to have an unemployment insurance policy so that the state will pay a portion of the employee's wages if the employee is discharged from employment. The employer pays the premium based on payroll and the company's "experience rating." In setting the "experience rating," the state tracks how many claims former employees make—the more claims, the higher the premium.
14. **Life Insurance policy**—It is common for a lender to require "key-person" life insurance so that if the business owner dies, there are funds to pay off the loan. Life insurance policies are also used to protect partners; if one partner dies, the policy proceeds are used to buy out the deceased partner's share of the business so the remaining partner(s) can continue the business.
15. **Personal Umbrella Policy**—Individuals with substantial assets often buy a personal umbrella policy. An umbrella policy only offers protection if there is an underlying policy, and the policy limit has been reached. (These policies are usually homeowners' or automobile policies.) While a personal umbrella policy is not business, it often gives entrepreneurs peace of mind.

Independent contractors are often not covered by the policies mentioned above, particularly Workers' Compensation and Disability. Verify coverage with your broker.

However, Louisiana, Florida, and California mandate that employers provide workers' compensation for independent contractors engaged in manual construction.

WHAT OTHER IMPORTANT FACTORS SHOULD I CONSIDER?

DEDUCTIBLES—Most insurance policies have a deductible of a specific dollar amount. If there is a loss, the insurance company will not cover the amount up to the deductible. For example, if the deductible was \$5,000 and there was a \$50,000 loss, the insurance company would only pay \$45,000.

When purchasing a policy, always ask how changing the deductible will affect the premium. Increasing the deductible often reduces the premium substantially.

EXCLUSIONS—Most policies have a long list of items not covered, called “exclusions.” It is worthwhile to acquaint yourself with those provisions.

LIMITS OF LIABILITY CAN BE REDUCED – Most policies will deduct the cost of defense from the limit specified. Suppose the policy limit is \$1 million, and the defense costs are \$200,000. The amount available to pay a claim under the policy would be \$800,000.

Some policies do not deduct defense costs from the policy limit, which might be a factor to consider when purchasing the policy.

Note, too, that if the policy covers some but not all of the risks, the insurance company will only cover defense costs for covered risks. As you can imagine, this can lead to a lively debate between the policyholder and the insurance company about which legal costs the insurer will pay.

ONCE I DECIDE TO GET INSURANCE, WHAT IS THE NEXT STEP?

Before finding an insurance broker, write a business synopsis to make your company look attractive to an insurer. This might include:

COMPANY BACKGROUND

- Company legal name corporate, mailing address, phone, email, website, and any additional locations used for warehousing or storage (plus the estimated inventory value kept at those locations).
- Provide your Federal Employer Identification Number (or, if you are a solopreneur, your Social Security Number).
- Who is the key contact at your company to negotiate insurance or answer questions, including name, position, email, and phone number.

BUSINESS OPERATIONS

- How long have you been in business (defined as selling your product to the public),
- Description of your business operations: what you sell, typical clientele, manufacturing locations, and the method used to fulfill and deliver the product.
- Include what percentage of your clients are residential vs. commercial.

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- What states do you conduct business in? And do you have employees based in those states? (If you are operating in NYC, mention that as well)
- Projected annual sales: Is the trend up or down?
- Sample client contracts, purchase orders, or agreements (even if it is an online disclaimer)
Does the business use independent contractors? - what do they do, approx. How many, and how much compensation per year total

EMPLOYEES & SUBCONTRACTORS

- Number of full-time employees, part-time employees, and the percentage of men and women.
- Do you employ subcontractors? If yes, how many subcontractors do you anticipate using in a year? What is the nature of the work they perform? Do you request they provide proof of insurance before engaging them? Do you have them complete a W-9 form?

OWNERSHIP

- List business shareholders and percentage of ownership
- If you are the sole proprietor, include your resume and mention whether you have ever been sued or had an insurance loss in the past five years. You may also want to include your credit rating if it is excellent.

PROFESSIONALS

- Name of attorney and accountant familiar with the business - if applicable.

TYPE OF INSURANCE NEEDED

- At minimum, this includes General Liability and an Umbrella Policy. If you have employees, you will generally need a Worker's Compensation, State Disability Policy, and Unemployment Policy. If you have specific limits and deductibles, mention them or wait for the broker's suggestions.

HOW DO I FIND AN INSURANCE BROKER?

Once the write-up is complete, it's time to "shop for an insurance broker." As with any vendor, recommendations are a valuable resource, particularly if they come from someone in the same line of work, as their broker will be familiar with the industry.

Other sources are the State Insurance Fund or the Internet. If you search the Internet, contact a firm specializing in business insurance and licensed in the state where the business is headquartered—e.g., Google "New York business insurance."

QUESTIONS TO ASK AN INSURANCE BROKER

You will want to vet the broker. Below are some questions to ask.

QUALIFICATIONS & BACKGROUND

1. In which states are you licensed to sell insurance?
2. How many years have you held your license?
3. How many years has your firm been in existence? and how long have you been with this brokerage firm?
4. What kind of insurance do you offer to your typical customer? Does that cover employee benefits?
5. What proportion of your customers purchase personal insurance vs business insurance? What size of company is your typical business customer?
6. How will you handle my account? Who in your firm is responsible for explaining coverage, getting quotes, handling claims, etc.?
How many insurance companies does your firm work with to provide coverage, and what proportion of your business have you written with each?
7. Considering our insurance needs, which companies will you approach for a quote?
8. Do you anticipate being able to get multiple quotes for our insurance needs?
9. Can you provide references for businesses like ours that you have worked with for a few years?
10. What percentage of your clients renew with you after the first year?
11. What is your typical response time if we email or call you?

RECOMMENDATIONS – NEXT STEP

12. What information do you need to determine what kind of insurance we require?
Do we have any issues getting that coverage?
13. Please advise on the costs and benefits of various policy limits, deductibles, and exclusions. I also recommend obtaining quotes from insurance companies that reflect these different limits, deductibles, and exclusions.
14. What do we need to provide for you? Secure quotes, and how long will the process take?
15. Is an audit at the end of the policy period included in your services?

CAUTION: Brokers often state they have relationships with "all insurance companies" but do not accept that non-specific statement. Ask them to provide the names of the top five companies they work with. Then, authorize them to approach ONLY those companies to secure a quotation.

By limiting the companies the broker can approach, the business owner can engage a second broker to approach different companies and expand the possibilities of securing a quote.

HOW LONG WILL IT TAKE TO GET A QUOTE?

Typically, a broker takes two weeks to deliver a multi-policy quote; a single-policy quote might be faster.

However, do not be surprised if the broker reports that the insurance company chose not to quote. It is common practice for companies to be selective in the industries they serve, and they may not be comfortable writing the policy unless the firm has a track record and can prove it has not had many losses in the past few years. Encourage the broker to keep shopping on your behalf until they find a company that will provide the coverage at a competitive price.

WHAT FACTORS ARE IMPORTANT IN REVIEWING AN INSURANCE PROPOSAL?

- **Premium** - the cost of the coverage for one year
- **Deductible** – the initial loss amount they will NOT cover; the loss must exceed that amount before any claim is paid. Increasing the deductible will reduce the premium, so it is worthwhile to ask how a deductible increase would affect the premium.
- **Policy Limit** – the maximum amount they will pay. Sometimes, it is broken down as an amount for a claim vs. an amount for the policy's life.
- **Exclusions** – loss situations/events they will not cover (read the proposed policy)
- **Policy Term – thus Start and End date**– particularly important if replacing existing coverage.
- **Credit Rating of the Insurance Company** - consider the credit-risk rating of the insurance company by using AM BEST, a firm that rates over 16,000 insurance companies worldwide.
<https://web.ambest.com/home>

WHEN IS THE PREMIUM DUE?

Companies have different billing policies. If you are a new client, they will likely ask for a 25% down payment, and in some cases, they may even want the entire year paid upfront.

However, once you become a policyholder, renewals are more manageable, and the client generally has 30 days to pay.

A company can request a payment plan for significant premium policies. Usually, a down payment is required, and the balance is paid over the next nine months. Sometimes, a small fee is charged for a payment plan.

The insurance company will send a cancellation notice if the client does not pay the premium according to the terms. The non-payment notice includes the terms of when coverage will cease if the premium remains unpaid.

HOW MUCH WILL IT COST?

Most companies charge a minimum premium of a few hundred dollars to cover their set-up costs. After that, the premium for a liability policy can vary significantly and is based on the Standard Industrial Classification (SIC code) for business operations or the insurance company's classification system for General Liability rating. A typical small business in New York can expect to pay **between \$300 and \$5,000 annually** for its general liability policy.

WILL THE POLICY AUTOMATICALLY RENEW?

In most cases, a notice will be sent out 30 days in advance indicating that the policy will be renewed and any change in terms or rates. Companies raising the premium by more than 10% in some states must send a notice.

HOW CAN THE BUSINESS GET BETTER INSURANCE RATES?

The best way to get better rates is to prove to the Insurance company that the business is a reasonable risk by giving them loss runs that show no claims or payouts. This can only occur after coverage has been provided, so the Insured must obtain a copy of their "loss run" report at the end of each policy period, which shows all claims and payouts.

A new insurance company being asked to quote will always request the past five years' loss runs. If no losses have occurred, the company is more likely to quote competitively.

HOW DOES THE BROKER GET PAID?

The insurance company pays Insurance brokers a commission (generally 2-8% of the premium).

Rates are often governed by the state in which the policy is sold.

<https://www.investopedia.com/ask/answers/050715/how-does-insurance-broker-make-money.asp>

Insurance companies sometimes sell directly to the consumer through their salaried staff and do not compensate the broker.

WHAT IF MY COMPANY IS DENIED INSURANCE?

States have mechanisms to force companies to provide coverage for policies required by law, such as worker's compensation insurance. The Insured is assigned to an insurance company's "risk pool." Unfortunately, the premiums charged to risk pool clients are not attractive.