LUKINOVICH LAGNIAPPE

January 2016 Volume V

LUKINOVICH
A PROFESSIONAL LAW CORPORATION

Lukinovich, APLC has law offices in Metairie and Baton Rouge, Louisiana. Our areas of practice include estate planning, wills and trusts, business planning, wealth preservation, probate administration and specialized fiduciary litigation.

Our mission is to devote our best skills, efforts and resources to advise our clients enthusiastically and creatively to accomplish their business, tax, family and estate planning goals and objectives, and we offer superior personalized attention with the utmost regard for privacy and confidentiality.

Learn more about our areas of practice online:
www.lukinovichlaw.com

(504) 818-0401

The Forbidden Words in Estate Planning – "Asset Protection"

Greg LaCour

Mention the words "asset protection" the next time that you meet with your estate attorney and you are liable to give him or her a case of indigestion. This is understandable, for there are many documented cases throughout the country of clients and/or their attorneys facing both criminal and civil liability due to acts of fraudulent conveyance and/or concealment of assets from creditors. However, proper asset protection planning is not a method or an attempt to hide assets from a creditor. Rather, properly implemented, asset protection planning is a long-term strategy to structure the ownership of assets in such a way so as to make it impossible or much more difficult for creditors to seize those assets. This article will focus on a few key topics that should be considered in the context of proper asset protection planning.

Legal Entities

As an overview, one reason individuals form legal entities (1) to either operate their business or (2) to own certain assets, is to protect themselves personally should a liability arise either from the business or the asset.[1] The general rule is that corporations and limited liability companies ("LLC" or "LLCs") are distinct legal entities, separate from the individuals who own them. Consequently, the shareholders or members generally are not liable for the debts of the companies. The protections afforded by legal entities encourage business investments in high-risk areas, as investors can insulate their personal wealth from the risks inherent in such businesses. It is also true that individuals sometimes place certain assets into legal entities in an attempt to ensure that future creditors of the individual cannot access assets owned by such entities.

Creditor's Rights: Limited Liability Companies. A member of a LLC has no direct interest in the LLC's property; rather, the member only owns a membership interest in the LLC. Thus, a member cannot make the LLC's property available to the member's

[1] This article focuses on corporations and limited liability companies. Partnerships are another type of legal entity that individuals can form.

creditors who are not also creditors of the LLC. The good news then, from a debtor's perspective, is that a creditor of an individual member cannot seize and sell assets held within an LLC.

However, Louisiana's LLC laws do authorize a judgment creditor of a member to obtain a charging order (similar to a garnishment) against the member's interest in the LLC. Typically, though, the charging creditor only has the rights of an assignee of the membership interest. Thus, the judgment creditor who obtains a charging order obtains only the right to receive distributions to which the member is entitled. In a closely-held company, it is conceivable that the members of the LLC might voluntarily limit future distributions in the case where a creditor has obtained a charging order.

Under the default provisions of the Louisiana LLC Law, a member whose interest is seized by a judgment creditor continues to be a member in the LLC. The judgment creditor does not become a member of the LLC nor does the judgment creditor exercise any of the rights and powers of the member. The judgment creditor holds a position similar to an assignee of the membership interest, who will not be admitted as a member of the LLC unless the other members unanimously consent in writing, which is very unlikely. The assignee judgment creditor may not vote on LLC matters, may not inspect the LLC's books and records, and may not exercise a member's right to withdraw from the LLC and receive a distribution in liquidation of the attached membership interest. Further, it is doubtful that a judgment creditor would be able to force a member to exercise the member's withdrawal rights in order to obtain satisfaction of the judgment.

Creditor's Rights: Corporations. The Louisiana Business Corporation Laws are more favorable to creditors than Louisiana's LLC Laws. While a charging creditor of a member's interest in an LLC receives only financial rights, a creditor who seizes a shareholder's stock in satisfaction of a debt acquires all of the rights associated with the stock, which may include financial rights, voting rights and the right to sell the stock.

Bypassing the Legal Entity

Of course, the protection afforded by a company to an individual owner is not a one hundred percent (100%) guarantee. In certain situations, creditors can bypass the protections afforded by a legal entity in order to hold the shareholder or member personally liable for the debts of the company.

Formalities. Once you have formed the legal entity, it is very important to follow the formalities for that entity. Never sign your name individually for the entity. Always list the entity first, then the word "by," followed by your name and your title (officer position or manager if an LLC). Corporations are required to have annual meetings. Make sure that you have minutes which document these meetings. Though LLCs are not required to have annual meetings, it is recommended that LLCs hold annual meetings, documented by minutes of the meetings, to add a sense of formality in case there is ever an attempt by a creditor to pierce the corporate veil. It is very important to keep your bank accounts for your company separate from your personal bank accounts. It is equally important to keep accounts for one company separate from accounts for another company. Commingling accounts, either between personal and business accounts or among multiple business accounts, is never a good idea.

Piercing the Corporate Veil. The protection afforded to shareholders and members of companies is not guaranteed. Creditors can pierce the corporate veil and hold owners personally liable under certain circumstances.[2] Note that it is the strong policy of Louisiana to favor the recognition of the corporation's separate existence, so that veil-piercing is an extraordinary remedy, to be granted only sparingly.

However, cases involving the piercing of a corporate veil do occur. Generally, courts permit a creditor to pierce the veil of the company in those situations where the company is found to be simply the "alter ego" of the shareholder/member. It usually involves situations where fraud or deceit has been practiced by the shareholder/member acting through the company. Another basis for piercing the corporate veil is when the shareholders disregard the requisite corporate formalities to the extent that the corporation ceases to be distinguishable from its shareholders. Courts consider five factors when determining whether to apply the alter ego doctrine.[3] In addition to these five factors, courts also must consider the "totality of circumstances" presented in each case, thus opening up the inquiry into anything the court chooses to consider.

Louisiana courts are reluctant to hold a shareholder, officer or director of a corporation personally liable for corporate obligations in the absence of fraud, malfeasance or criminal wrongdoing. However, when there is fraud or deceit found in a case, courts are significantly more likely to rule in favor of piercing of the corporate veil.

Single-Business Entity. Another action that a creditor can bring against legal entities is called the “single business entity” theory. This theory of recovery is different from traditional veil piercing. With a single business entity theory, a creditor attempts to have one company be held legally liable for the debts of another company. This exception occurs when a corporation is found to be the alter ego, agent, tool or instrumentality of another company.

Rather than employing a “simple” five step process, as is done in a veil piercing case, the single business entity case involves the consideration of eighteen different factors.[4] In addition to the list of eighteen factors, the court also must consider the "totality of the circumstances" in each case. No single factor is dispositive of the issue of whether a single business enterprise exists.

Other Actions Available to Creditors

Revocatory Action. A revocatory action in Louisiana is similar to a fraudulent transfer or fraudulent conveyance action that can be brought in common law jurisdictions. The

---

[2] The concept of piercing the corporate veil and holding the owners personally liable applies both to corporations and to limited liability companies.

[3] The five factors are: 1) commingling of corporate and shareholder funds; 2) failure to follow statutory formalities for incorporating and transacting corporate affairs; 3) undercapitalization; 4) failure to provide separate bank accounts and bookkeeping records; and 5) failure to hold regular shareholder and director meetings.

[4] The eighteen factors utilized by courts to determine whether a group of entities constituted a single business entity: 1) corporations with identity or substantial identity of ownership, that is, ownership of sufficient stock to give actual working control; 2) common directors or officers; 3) unified administrative control of corporations whose business functions are similar or supplementary; 4) directors and officers of one corporation act independently in the interest of that corporation; 5) corporation financing another corporation; 6) inadequate capitalization ("thin incorporation"); 7) corporation causing the incorporation of another affiliated corporation; 8) corporation paying the salaries and other expenses or losses of another corporation; 9) receiving no business other than that given to it by its affiliated corporations; 10) corporation using the property of another corporation as its own; 11) noncompliance with corporate formalities; 12) common employees; 13) services rendered by the employees of one corporation on behalf of another corporation; 14) common offices; 15) centralized accounting; 16) undocumented transfers of funds between corporations; 17) unclear allocation of profits and losses between corporations; and 18) excessive fragmentation of a single enterprise into separate corporations.

revocatory action allows a creditor to annul certain transfers made within one year from the time the creditor knew or should have known of the transfer, with a three year preemptive period except in cases of proven fraud. In a revocatory action, the creditor must prove that the debtor owed the creditor an obligation as of the date of the transfer and that the debtor caused or increased his or her insolvency by the transfer. Note that in the case of a tort (a personal injury), the tortfeasor's liability to the victim of the tort accrues at the time that the injury is sustained, not at the time that the lawsuit is filed nor at the time that a judgment is obtained. Louisiana law defines insolvency from a balance sheet approach, when the total of the obligor's liabilities exceeds the total of his fairly appraised assets. [5]

Oblique Action. Unlike in a revocatory action, a creditor in an oblique action seeks to enforce a right or an action on behalf of the debtor against a third party. Similar to a revocatory action, the creditor must prove that the debtor owed the creditor an obligation at the time of the debtor's failure to act and that the debtor's failure to act caused or increased his or her insolvency.

Simulation Action. A creditor also can move to set aside a transaction by the debtor if the creditor can prove that the transaction is a simulation. A contract is a simulation when, by the agreement of the parties to the transaction, it does not express their true intent but instead is a mere sham. Louisiana law recognizes two types of simulations: absolute and relative. A simulation is absolute when the parties intend their contract to have no effects between them. A simulation is relative when the parties intend their contract to produce effects between them that are different from those recited in their contract.[6]

Whether a simulation is absolute or relative, a court will give effect to the true intent of the parties. Thus, in the case of an absolute simulation, the courts typically have held that no transfer ever took place because the simulated sale is a nullity. In the case of a relative simulation, the transfer is respected as a gift rather than as a sale, and the provisions of the Louisiana Civil Code on donations apply to the transfer. A court will not annul a simulation where the property has passed into the hands of an innocent third party who has purchased the property for value and in reliance on the public records. A simulation action in fraud of a creditor's rights can be avoided at any time.

Trusts

Revocable Trusts. In a revocable trust, a creditor typically is able to seize assets within the trust to satisfy obligations of the debtor/settlor who created the revocable trust.[7]

Irrevocable Trusts. On the other hand, the transfers of assets to an irrevocable trust for the benefit of children or third-parties ordinarily will place the assets outside the reach of the settlor's creditors, and, if such transfers are (and as long as they remain) in trust with spendthrift provisions, using an irrevocable trust will place the assets outside the reach of the beneficiaries' creditors.[8] A "spendthrift trust" generally provides significant protection from seizure of the interest

---

[5] La. C.C. art. 2037.

[6] For example, a sale that appears to be valid on its face but is intended by the parties to be a gift rather than a sale, is a relative simulation.

[7] A revocable trust simply means that a settlor has reserved the right to revoke the trust in whole or in part: the trust can be undone.

[8] A spendthrift trust means a trust under which alienation by a beneficiary of an interest in income or principal is restricted to the full extent permitted by the Louisiana Trust Code. La. R.S. 9:2001-2007.

of a trust beneficiary. Typically, a settlor (the creator of the trust) cannot protect his or her own beneficial interest in a trust. However, a beneficiary's interest in income or principal of a spendthrift trust ordinarily is not subject to seizure until it is distributed or required to be distributed by the trustee (e.g., upon termination of the trust as to all or part of the principal). Also, there are certain special categories of obligations that may not be protected by a spendthrift trust, including: alimony or child support, necessary services or supplies furnished to a beneficiary or to someone he or she is obligated to support, and damages arising from a felony criminal offense committed by a beneficiary.

Note that in cases where protection from claims of the beneficiary's creditors is an important objective in establishing a spendthrift trust, ordinarily the beneficiary should not be the designated trustee and should have no power to compel trust distributions.

Conclusion

You should contact your estate attorney to review your asset protection plan. Asset protection planning is a long-term strategy. The time to implement an asset protection plan is now, before you or your company becomes liable to a creditor.

LUKINOVICH
A PROFESSIONAL LAW CORPORATION

4415 Shores Drive
Suite 200
Metairie, LA 70006
(504) 818-0401

17991 Old Perkins Road East
Suite F
Baton Rouge, LA 70809
(225) 756-5454

www.lukinovichlaw.com