

The Estate Planning Advisor

A Corporation to Protect Your Assets? Think Again!

By Richard J. Shapiro, J.D.

Recently I've been hearing a radio ad for a company that forms corporations to "help you protect your assets." The pitchman says that while "we don't give legal or accounting advice," he quickly adds that you don't need a lawyer to establish your own corporation.

It is true that anyone can form a New York corporation, which simply involves filing rudimentary paperwork with the Secretary of State; however, merely forming the entity doesn't mean you don't need legal or accounting advice. Once the corporation is "formed," the real question is what benefit does the client receive from having this new entity in place?

Today, few business law attorneys regularly form corporations. For most businesses, the *limited liability company*, or LLC, provides greater flexibility, and better asset protection than a corporation. Under the laws of most states, corporate stock is considered personal property that is attachable by the shareholder's creditors. For example, imagine that you have formed a trucking business that is incorporated as XYZ Corporation. Assume you own 100% of the stock. XYZ Corporation in turn owns all of the business's assets including vehicles, machinery and inventory. One day you have a party at your home (which is owned in your name), and some inebriated partygoer trips going down stairs on your deck and breaks his neck. It just so happens that the injured person's cousin is a high-powered personal injury attorney. After bringing the jury to tears over his client's plight, the attorney is able to secure a judgment against you personally for \$10 million. Even if you have a \$2 million "umbrella" insurance policy, you will still have an \$8 million judgment entered against you.

As you take stock of your situation you say to yourself, "well, at least my business is protected." Think again. In most states, your judgment-creditor will be able to seize your corporate stock. Once in control of all of the corporation's stock, the new creditor-shareholder will surely fire you as the president of the corporation, remove you as a director, and substitute himself in your place. The creditor can then liquidate the business's assets, or do anything else with the business that he so chooses.

The above scenario can be prevented if the business is established as an LLC. The laws of New York, and many other states, provide that a judgment-creditor *cannot* seize the judgment-debtor's membership interests in the LLC, and thus cannot gain control of the business's assets. The judgment-creditor's only remedy is a "charging order" against any distributions made from the LLC to the judgment-debtor as the member. The judgment-debtor would retain ownership of the LLC's membership interests, would remain in control of the entity's assets and be able to keep those assets at bay from the creditor. With the judgment-creditor being unable to reach the judgment-debtor's most

valuable assets, he may be encouraged to settle his claim for much less than the judgment amount.

One important caveat: in the past few years three federal bankruptcy court decisions in other states have allowed creditors to liquidate assets of a single-member LLC. Those decisions stated that no such liquidation would have permitted if the LLC's in those cases included more than one member. Accordingly, we are now recommending that all LLC's be formed with at least two members, even if one member holds a significantly greater percentage of the membership interests.

Although it may be "fast and easy" to form a business entity, and tempting to "cut corners" in this challenging economy, appropriate professional guidance is needed to maximize the asset protection benefits that establishing a formal business structure can provide to the business owner.

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