Supreme Court Decides Single Member LLCs Are Not Asset Protected

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In June 2010, the Florida Supreme Court stripped single owner LLCs of their asset protection . This is something that I have been warning clients about since a bankruptcy court in Colorado started a trend toward disregarding single member LLCs for asset protection purposes back in 2003. In order to understand what this means, one must understand more about what LLCs are and how asset protection works.

What is Asset Protection?
Asset protection planning involves taking advanced legal measures to delay, deter and sometimes completely avoid the attachment or levy of one's assets by a Judgment Creditor. In other words, making it harder and sometimes ultimately impossible, for your assets to be liened or levied (i.e. taken away) by someone who sues you personally for whatever reason, wins and tries to collect on their judgment (a "Judgment Creditor"). Every asset worth protecting from lien or levy is individually analyzed to evaluate how exposed it is in its current form and then we determine what new structure might provide better protection according to your personal goals and limitations. Most importantly, the transfer or conversion of the asset into the new structure is carefully planned to make it more difficult for a Judgment Creditor to later obtain a court order undoing the transaction. Sometimes the asset requiring the most protection is an ownership interest in a company, whether it's 1000 shares of Google or 25% of the family business.

LLC vs. Corporation
Corporations have stock and stockholders, while LLCs have membership interests and members. If you owned both, for example, a Judgment Creditor can go back to court and obtain a special lien called a "Charging Order" for both your membership interest in the LLC and your stock in the corporation. This order would command the LLC or corporation to pay to the Judgment Creditor any dividends or distributions that would have otherwise been paid to you until their judgment is satisfied. With respect to your stock in the corporation, the Judgment Creditor can go further and obtain another court order commanding the corporation to transfer your stock to them. At that point, they will step in your shoes and have all the rights that you had, including the right to inspect the books and records, voting rights, certain rights to force the corporation to buy them out at appraised value, and even control of the corporation, if that is what you had. The LLC statute, however, specifically limits the Judgment Creditor to only getting a Charging Order on your membership interest. As such, the Judgment Creditor will get paid only if and when the LLC makes distributions, while you retain all your other ownership rights. Instead of making distributions, the LLC can accumulate and/or reinvest its capital and continue paying its ordinary and necessary expenses, including salaries. Accordingly, this restriction tends to make Judgment Creditors more likely to settle or not even bother requesting a Charging

Order in the first place. Those who still hold their assets or businesses in the corporate form should thus consider converting into an LLC to enjoy better asset protection. With careful planning and execution, conversion can be an easy and tax-free process, and nothing has to be transferred since the LLC is treated for all purposes as being the same entity as the corporation. The "new" LLC even keeps the same tax identification number and may continue being taxed as an S-Corporation for IRS purposes if it chooses.

So Now What Do I Do With My Single Member LLC?

This new case basically tells us that the statute limiting Judgment Creditors to Charging Orders with respect to LLC membership interests does NOT apply in the case that the LLC has only one member. [1] Therefore, a Judgment Creditor can actually levy the entire membership interest, become the "legal" owner for all purposes and proceed to sell, liquidate, or even continue operating the LLC if they so choose. In some cases, such as where an LLC is one of multiple LLCs that are all wholly owned subsidiaries of one holding company, the benefits of maintaining that structure may outweigh the costs of changing it. However, most single member LLC owners should take this new case very seriously and consider admitting one or more additional members so this case might not apply to them. The transfer must be carefully designed and implemented, especially when undertaken under circumstances where the owner faces a potential judgment. In any case, a custom tailored operating agreement should be prepared that actually reflects the "deal" between the members regarding all major points by modifying as appropriate the default rules otherwise provided by the statute.

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[1] Although I tend to agree with the two Justices who wrote the 30 page dissenting opinion, the reasoning of the 15 page majority opinion is sound and in any case is now the law.

Eduardo R. Arista is a member of Arista Law in Coral Gables. Mr. Arista maintains a sophisticated business, tax advocacy and wealth preservation practice, encompassing a broad range of transactions and disputes. His previous experiences include working for Ernst & Young as an attorney and CPA and for a successful start-up company as general counsel and CFO. Mr. Arista is also an adjunct professor at the Florida International University College of Business Administration and regularly lectures at continuing education seminars for lawyers, accountants and business people. He is a member of the District of Columbia and Florida Bars (past chair of the Committee on Relations with CPAs). Mr. Arista is also admitted to the U.S. Tax Court and the U.S. District Court for the Southern District of Florida. He earned his Accounting degree from F.I.U. and J.D. degree from the University Of Miami School Of Law, where he was managing editor of the Miami Tax Law Chronicle. While in law school, he also worked for a U.S. Tax Court Judge in Washington, D.C. and for a U.S. Magistrate Judge in Fort Lauderdale, Florida.