ASSET PROTECTION PLANNING:

STICKY FINGERS IN THE TAR HEEL STATE

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I. Introduction

Asset protection planning is an important part of an estate planning attorney's array of services. Estate planning attorneys are uniquely positioned to assist clients with implementing appropriate and timely asset protection strategies, because the estate planning attorney is privy to a client's entire financial situation, and importantly, the estate planning attorney often is aware of a client's finances in advance of developing creditor issues.

Asset protection planning presents an opportunity to add value to a client representation. Regardless of practice, chances are high that the estate planning lawyer already is performing some form of asset protection planning, such as designing and implementing credit shelter trusts, qualified terminable interest property (QTIP) trusts, and generation-skipping transfer (GST) tax exempt trusts designed to minimize transfer tax burdens and preserve assets from the claims of taxing authorities, unhappy spouses, subsequent spouses, and other potential creditors. These strategies and others can be useful in protecting a client's wealth from other potential claimants.

Successful asset protection planning often hinges on the timing in which planning is implemented. Early planning—such as when potential claims are unknown and unrealized—is more effective than later planning. Engaging in planning too late—such as after claims are realized or a judgment lien is filed—will be ineffective and may lead to client and practitioner liability.

II. Statutory Framework

The field of asset protection planning is governed by federal and state bankruptcy law, laws concerning voidable transfers (formerly called fraudulent conveyances), applicable statutes of limitations, and various defenses. In addition, burdens of proof, jurisdiction, and equitable considerations factor into the efficacy of asset protection planning.

A. Bankruptcy Law Primer

Under federal bankruptcy law, an individual debtor may choose to exempt from the bankruptcy estate property listed in either:

1. 11 U.S.C. § 522(b)(2) and (d), unless state law applicable to the debtor precludes election of the federal exemptions; or

2. 11 U.S.C. § 522(b)(3).

North Carolina has elected out of the federal exemptions in the first alternative, that is, the exemptions of 11 U.S.C. § 522(d). N.C.G.S. § 1C-1601(f) ("[t]he exemptions provided in The Bankruptcy Code, 11 U.S.C. § 522(d), are not applicable to residents of this State. The exemptions provided by this Article and by other statutory or common law of this State shall apply for purposes of The Bankruptcy Code, 11 U.S.C. § 522(b)."). Thus, North Carolina residents may choose between state law exemptions of N.C.G.S. § 1C-1601 or the federal law exemptions of 11 U.S.C. § 522(b)(3). The two lists of exemptions share common elements, although the list of North Carolina state law exemptions generally is more inclusive.

B. The North Carolina Uniform Voidable Transfer Act (UVTA)

The UVTA became effective October 1, 2015, and repealed the prior Fraudulent Conveyances Act.

1. Creditors and Insolvency

The Act addresses three kinds of creditors:

a. Present creditor who has obtained a judgment against the debtor, or who is owed a debt by the debtor prior to the transfer.

b. Known potential future creditor whom the client could reasonably foresee (for example, victim of a tort who has not yet obtained judgment).

c. Unknown future creditor whom the client could not reasonably foresee.

Insolvency under the UVTA occurs when the sum of a debtor's debts is greater than the value of all the debtor's assets at a fair valuation. N.C.G.S. §39-23.2. A debtor who generally is not paying debts as they come due is presumed insolvent. The 2015 revisions to the UVTA provide that the party against whom the presumption is directed (usually the debtor) has the burden of proving that the nonexistence of insolvency is more probable than its existence.

For determining whether a debtor is insolvent, the debtor's property secured by a valid lien is not considered an "asset." Likewise, in determining whether a debtor is insolvent, debts that are secured by a valid lien on property excluded from the debtor's assets are also excluded from debts for the calculation. The 2015 revisions to the UVTA clarify that non-payment of a debt that is subject to a bona fide dispute is not a factor in the determination of insolvency.

Note that the 2015 revisions to the UVTA removed the more specific definition of when a partnership is insolvent that previously appeared in §39-23.2. Now, partnerships are subject to the general definition of insolvency.

2. Bright Line Test

A bright line test applies to present creditors. A transfer is voidable if the debtor made the transfer or incurred the obligation:

a. without receiving a reasonably equivalent value in exchange for the transfer or obligation; and

b. the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer or obligation. N.C.G.S. § 39-23.5(a).

The 2015 revisions to the UVTA clarify that the creditor has the burden of proving the elements of the claim that the transfer is voidable by a preponderance of the evidence. N.C.G.S. § 39-23.5(c).

3. Facts and Circumstances Test

In addition, a facts and circumstances test applies to both present and future creditors. A transfer is voidable as to a creditor if it was made with intent to hinder, delay, or defraud any creditor of the debtor. N.C.G.S. § 39-23.4(a)(1). Intent is demonstrated by a nonexclusive list of factors set out in the statute, including whether:

(1) The transfer or obligation was to an insider;

(2) The debtor retained possession or control of the property transferred after the transfer;

(3) The transfer or obligation was disclosed or concealed;

(4) Before the transfer was made, the debtor had been sued or threatened with suit;

(5) The transfer was of substantially all the debtor's assets;

(6) The debtor absconded;

(7) The debtor removed or concealed assets;

(8) The transfer was or was not a gift (in other words, was consideration reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred);

(9) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) The transfer occurred shortly before or shortly after a substantial debt was incurred;

(11) The debtor transferred essential assets of the business to a lienor who transferred the assets to an insider of the debtor;

(12) The debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor reasonably should have believed that the debtor would incur debts beyond the debtor's ability to pay as they became due; and

(13) The debtor transferred the assets in the course of legitimate estate or tax planning. N.C.G.S. § 39-23.4(b).

A transfer also is voidable as to a creditor, whether the creditor's claim arose before or after the transfer, if the debtor made the transfer without receiving reasonably equivalent value in exchange for the transfer and the debtor was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction or the debtor intended to incur or believed that he would incur debts beyond his ability to pay them as they became due. N.C.G.S. § 39-23.4(a)(2).

A recent North Carolina case reviewed the statutory factors of a facts and circumstances analysis and discussed the estate planning exception to intent to hinder, delay, or defraud any creditor. In Philips Med. Sys. v. Tec Holdings, the Federal District Court for the Western District of North Carolina denied a motion for preliminary injunction seeking to freeze trust assets in an action seeking liability for violation of the Uniform Voidable Transactions Act. The plaintiff argued that the defendants, two members of the Wheeler family, unlawfully transferred substantially all corporate assets, worth approximately $16 million, to three irrevocable trusts after the plaintiff sent a cease and desist letter threatening litigation. The defendants argued that the assets were transferred in the course of legitimate estate and tax planning and that the "wheels were already in motion on the Wheelers' estate planning (including the use of trusts) months before and preceding receipt of [the cease and desist letter]." The court reviewed the "badges of fraud" and held that while the plaintiff had shown a likelihood of success on the merits, other factors weighed against the entry of a freeze order. Thus, the injunction was denied. 2022 WL 10208557 (W.D.N.C. Oct. 17, 2022).

4. Statute of Limitations

The UVTA has a four-year statute of limitations. A creditor may seek to set aside a transaction for up to four years after it was made. N.C.G.S. § 39-23.9. But, if a transfer was made to an insider for an antecedent debt, the statute of limitations is one year. N.C.G.S. § 39-23.9(3).

5. Defenses

A debtor who has engaged in a voidable transfer, or a transferee who received property from an insolvent debtor, may nevertheless offer a defense for the transfer.

a. Foreclosure sale. If the transfer is the result of a regularly conducted, non-collusive foreclosure sale, a debtor conclusively has received reasonably equivalent value. N.C.G.S. § 39-23.3 and cmt.

b. A transferee can raise a defense that it took in good faith. N.C.G.S. § 39-23.8(a). The 2015 revisions require that a transferee will qualify for the good faith defense only if the transferee took in good faith and gave reasonably equivalent value to the debtor. *Id.* at cmt 1.

c. The defense for a subsequent transferee who takes in good faith and for value applies not only to an action on a money judgment, but also to a recovery of, or from, the transferred property or its proceeds, by levy or otherwise. N.C.G.S. § 39-23.8(b)(1)(b).

d. Lawful lease termination. N.C.G.S. § 39-23.8(e)(1).

e. Absolute defense for transfer that results from enforcement of a security interest in compliance with Article 9 of the UCC. N.C.G.S. § 39-23.8(e)(2).

f. The transfer results from the payment of taxes, debts, fines, penalties, or other obligations or amounts to the State or to any political subdivision of the State. N.C.G.S. § 39-23.8(e)(3).

g. Where an insider gave new value to or for the benefit of the debtor after the transfer was made, except to the extent the new value was secured by a lien. N.C.G.S. § 39-23.8(f)(1).

h. If the transfer was made in the ordinary course of business or financial affairs of the debtor and an insider. N.C.G.S. § 39-23.8(f)(2).

i. If made pursuant to a good-faith effort to rehabilitate the debtor, and the transfer secured present value given for that purpose as well as an antecedent debt of the debtor. N.C.G.S. § 39-23.8(f)(3).

6. Burden of Proof

A creditor has the burden of proving the elements of a voidable transaction. N.C.G.S. § 39-23.8(g)(2). A debtor has the burden of proving the elements of a defense to a voidable transaction. N.C.G.S. § 39-23.8(g). The elements of a claim or defense must be proven by a preponderance of the evidence. N.C.G.S. § 39-23.8(h).

7. Jurisdiction

A claim under the UVTA is governed by the local law of the jurisdiction where the debtor was located when the transfer was made or when the obligation was incurred. N.C.G.S. § 39-23.9A(b). A debtor who is an individual is located at the individual's principal residence. N.C.G.S. § 39-23.9A(a)(1). A debtor that is an organization is located at its place of business if it has only one place of business or at its chief executive office if it has more than one place of business. N.C.G.S. § 39-23.9A(a)(2) & (3).

8. Series Organizations

The UVTA addresses series organizations and treats each entity that is part of a series organization as a "person" for purposes of UVTA, regardless of how it is treated for other purposes.

9. Equitable Considerations in North Carolina

A finding of a fraudulent transfer may result in judgment against a complicit transferee. In Boykin v. United States, the District Court for the Western District of North Carolina granted partial summary judgment in favor of the Internal Revenue Service in a quiet title suit brought by a taxpayer's spouse contesting nominee liens that the IRS filed against the spouse's home. The taxpayer, an emergency room physician, did not pay income taxes from 1999 through 2006. As a result, the IRS imposed statutory penalties and interest along with civil fraud penalties. In 2009, the taxpayer entered into four installment agreements with the IRS to resolve his tax debts. The taxpayer married in 2015 and subsequently transferred to his new spouse a 50% ownership interest in an LLC through which the taxpayer collected income from various emergency rooms. The spouse did not provide any monetary consideration for the transfer. From 2015 through 2019, the spouse received $340,625 attributable to her 50% ownership interest in the LLC. In additional, since June 2015 the spouse had lived in a house that she built on a parcel of land in Boone, North Carolina. The IRS filed an action to reduce to judgment the taxpayer's tax liabilities in 2019 and asserted nominee tax liens against the spouse's Boone residence.

After applying Section 39-23.5 of the North Carolina Uniform Voidable Transactions Act, the court held that the transfer of LLC interest to the spouse was fraudulent because it was made for no consideration, after tax debts were pending, and at a time when the taxpayer was insolvent. The spouse claimed that she did provide consideration—in the form of love, affection, and companionship—but the court found that such intangibles were not valid consideration. While the IRS originally sought the foreclosure on the spouse's Boone residence, the court awarded the IRS with a monetary judgment in the amount of $340,625 as allowed by N.C. Gen. Stat. Section 39-23.8. Boykin v. U.S., 2023 WL 3467769 (W.D.N.C. May 15, 2023).

10. Other Equitable Considerations

In United States v. Evseroff, the United States District Court for the Eastern District of New York held on remand that assets transferred to an irrevocable trust were available to satisfy a tax lien because the transfer was a fraudulent conveyance under the Uniform Fraudulent Transfers Act and because the trust was essentially the alter-ego of the debtor. The Evseroff court noted that actual intent to hinder or delay is adequate, even without an actual intent to defraud. The Evseroff court also found that trust assets were available to creditors because the trust was the settlor's alter-ego. The court stated, "Although the New York Court of Appeals has never held that the alter-ego theory may be applied to reach assets held in trust, there is no policy reason why veil-piercing would apply only to corporations but not to trusts. The policy behind corporate veil piercing is to prevent a debtor from using the corporate legal form to unjustly avoid liability. That policy applies equally to trusts." U.S. v. Evseroff, No. 00-cu-06029 KAM, 2012 WL 1514860, at *13 (E.D.N.Y. Apr. 30, 2012), aff'd, 528 F. Appx. 75 (2d Cir. 2013).

11. Crime-Fraud Exception to Attorney-Client Privilege

In United States v. Lax, the Internal Revenue Service filed an action against members of the Lax family to collect unpaid federal income and estate tax liabilities owed by the Estate of Chaim Lax and to obtain money judgments related to alleged schemes undertaken to shield businesses and property held by the Lax family from creditors of the Estate, including the Internal Revenue Service. The decedent was a diamond merchant and real estate developer who was diagnosed with terminal cancer in 2006. Before his death, he orchestrated several schemes in an effort to avoid payment of income tax, estate tax, and other liabilities. These schemes involved a series of fraudulent transfers and other artificial transactions designed to hide Lax family assets from the IRS and other creditors in an attempt to make it appear as though the Estate were insolvent.

The IRS sought to categorize these schemes as fraudulent conveyances under the New York Debtor and Creditor Law. In an effort to combat the charges, the Lax family asserted attorney-client privilege relating to numerous emails and other documents exchanged between attorneys, some of whom provided advice about these transactions before they took place. The United States District Court for the Eastern District of New York determined that the transactions were in fact fraudulent and that the crime-fraud exception to attorney-client privilege prevented the Lax family from hiding the evidence of their fraudulent transactions. U.S. v. Lax, 2022 WL 17987043 (E.D.N.Y. Dec. 29, 2022).

III. Asset Protection Planning Techniques

A. Life Insurance

A client's policy of life insurance is exempt from creditors' claims if the policy is

1. on the client's life; and

2. is for the sole use and benefit of the client's spouse or children or both.

Any cash value in the policy is free from creditor's claims during the client's lifetime. N.C. CONST. art. X, § 5; N.C.G.S. § 1C-1601(a)(6).

At the client's death, the policy proceeds are payable to or for the benefit of the client's spouse or children (or both) free from the claims of creditors of the client or the client's estate. N.C. CONST. art. X, § 5; N.C.G.S. § 1C-1601(a)(6). Specifically, the North Carolina constitution provides:

> A person may insure his or her own life for the sole use and benefit of his or her spouse or children or both, and upon his or her death the proceeds from the insurance shall be paid to or for the benefit of the spouse or children or both, or to a guardian, free from all claims of the representatives or creditors of the insured or his or her estate. Any insurance policy which insures the life of a person for the sole use and benefit of that person's spouse or children or both shall not be subject to the claims of creditors of the insured during his or her lifetime, whether or not the policy reserves to the insured during his or her lifetime any or all rights provided for by the policy and whether or not the policy proceeds are payable to the estate of the insured in the event the beneficiary or beneficiaries predecease the insured. N.C. CONST. art. X, § 5.

N.C. Gen. Stat. § 58-58-115 extends broad protection from estate creditors for other beneficiaries of life insurance proceeds, provided that no transfer with intent to defraud creditors is at issue. It states:

> If a policy of insurance is effected by any person on his own life or on another life in favor of a person other than himself, or, except in cases of transfer with intent to defraud creditors, if a policy of life insurance is assigned or in any way made payable to any such person, the lawful beneficiary or assignee thereof, other than the insured or the person so effecting such insurance or the executor or administrator of such insured or of the person effecting such insurance, shall be entitled to its proceeds and avails against creditors and representatives of the insured and of the person effecting same, whether or not the right to change the beneficiary is reserved or permitted, and whether or not the policy is made payable to the person whose life is insured if the beneficiary or assignee shall predecease such person: Provided, that subject to the statute of limitations, the amount of any premiums for said insurance paid with the intent to defraud

> creditors, with interest thereon, shall inure to their benefit from the proceeds of the policy; but the company issuing the policy shall be discharged of all liability thereon by payment of its proceeds in accordance with its terms unless, before such payment, the company shall have written notice by or in behalf of the creditor, of a claim to recover for transfer made or premiums paid with intent to defraud creditors, with specifications of the amount claimed.

(Emphasis added.) *See also* N.C. Gen. Stat. § 28A-15-10 (which fails to include life insurance proceeds in the list of assets that may be acquired by the personal representative in order to pay claims).

Likewise, N.C. Gen. Stat. § 58-58-95 also states in pertinent part that "[w]hen a policy of insurance is effected by any person on his own life, or on another life in favor of some person other than himself having an insurable interest therein, the lawful beneficiary thereof, other than himself or his legal representatives, is entitled to its proceeds against the creditors and representatives of the person effecting the insurance."

The Supreme Court of North Carolina explained in Home Sec. Life Ins. Co. v. McDonald that "[t]he protection afforded by this section is not limited to any particular class of beneficiaries. It relates to a policy on the life of the insured payable to any third-party beneficiary[,]" and that the "words 'proceeds' or 'proceeds and avails,' when used in life insurance exemption statutes, comprehend the protection of cash surrender values and other values built up during the life of the policies, as well as the death benefits." In re Laues, 90 B.R. 158, 1988 Bankr. LEXIS 1468 (Bankr. E.D.N.C. 1988). Thus, life insurance proceeds are protected from estate creditors. 201 N.C. App. 252, 689 S.E.2d 428 (2009), *aff'd in part and rev'd in part*, 364 N.C. 528, 702 S.E.2d 294 (2010).

Practice tip: Beneficiary designations are important! Policy proceeds payable to an estate will eliminate creditor protection and subject the policy proceeds to claims of the estate creditors.

B. Section 529 Account

Funds in a Section 529 college savings plan are exempt from creditors' claims if the funds are

1. for the child of a client; and
2. do not exceed a cumulative limit of $25,000.

N.C.G.S. § 1C-1601(a)(10).

Funds placed in a Section 529 college savings plan account within the preceding twelve months of a debtor's bankruptcy filing date are excluded from exemption protection, unless and to the extent that the contributions were made in the ordinary course of the client's financial affairs and were consistent with the client's pattern of prior contributions.

Protection is available only to the extent that the funds are for the debtor's child and will actually be used for the child's college or university expenses. Note that although Section 529 plan funds may be withdrawn up to $10,000 per child per year to pay for elementary and secondary school tuition at a public or private school, funds for these purposes are not encompassed in the statute providing relief from creditors' claims. Section 529 plan funds transferred to a Roth IRA in the name of the child, up to $35,000 during the child's lifetime, under the Securing a Strong Retirement Act of 2022 (SECURE Act 2.0) similarly are not encompassed in the statute.

C. Retirement Assets

1. Federal Bankruptcy Protection

For federal bankruptcy purposes, contributions to and earnings on IRAs, Roth IRAs and other qualified retirement accounts are exempt up to $1,512,350. 11 U.S.C. § 522(n). A bankruptcy judge may increase the limit if the interests of justice so require. The limit does not apply to amounts attributable to rollover contributions. 11 U.S.C. § 522(b)(4)(C). The federal exemption applies whether the debtor elects federal bankruptcy exemptions or state law exemptions. 11 U.S.C. § 522(b)(3)(C) & (d)(12).

In Clark v. Rameker, 573 U.S. 122 (2014), Justice Sotomayor authored a unanimous opinion that resolved a split among circuits as to the protection of inherited IRAs under the Bankruptcy Code. The Court affirmed a Seventh Circuit Court decision that held that inherited IRAs lose their character as "retirement funds" in the hands of the inheriting party, and therefore are not protected under 11 U.S.C. § 522(b)(3)(1). Though not specifically addressed in the opinion, it is possible that this decision may have an impact on spousal IRAs as well, if the spousal rollover occurs at the time when the beneficiary spouse has existing creditors.

In In re Moore, 640 B.R. 397 (Bankr. S.D. Ohio 2022), the United States Bankruptcy Court for the Southern District of Ohio determined that distributions made from a self-directed IRA by the owner, Mr. Moore, to his personal account for the benefit of his company, Louisiana Oil, did not disqualify the IRA for exemption from Chapter 7 of the Bankruptcy Code under Ohio state law. Before filing for bankruptcy, Mr. Moore, who was then 64 years old, transferred a total of $94,000 from the IRA to his personal bank account. He reported these distributions as regular distributions for federal income tax purposes. Following the distributions, Mr. Moore made several transfers from his personal bank account, one to Louisiana Oil directly and another in the form of a loan to a second company in which Louisiana Oil held an ownership stake. Upon filing for bankruptcy, Mr. Moore claimed the self-directed IRA as exempt property under Ohio Revised Code § 2329.66(A)(10)(b). The bankruptcy trustee objected to Mr. Moore's claimed exemption, asserting that the IRA had made a distribution to a disqualified person in violation of ERISA and IRS rules, which would cause the IRA to lose its tax-exempt status.

The court held that although distributions were made to a disqualified person as defined by IRC Section 4975, they were made by Mr. Moore in his personal capacity as an eligible beneficiary of the IRA benefits, and not directly or indirectly by the IRA or Mr. Moore in his capacity as fiduciary. The court determined that Mr. Moore's dual status as plan fiduciary and beneficiary did not disqualify him from receiving the IRA distribution. The court noted that an

owner of a self-directed IRAs necessarily acts both as fiduciary and beneficiary and that Mr. Moore was entitled to take regular distributions without tax penalties based on his age at the time of the distributions. The court found that Mr. Moore claimed the distributions as income on his personal tax returns as required and was not required to use the distributed funds for any particular purpose. The court stated that "IRS rules limit how plan assets can be used and when they can be withdrawn but do not regulate the purpose for which the funds are used after they are withdrawn by the beneficiary and cease to be plan assets." In re Moore, 640 B.R. at 406.

Effective January 1, 2020, the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), as expanded by the Securing a Strong Retirement Act of 2022 (SECURE Act 2.0), provides that an inherited IRA generally is distributed out to a qualified beneficiary over a period not to exceed ten years. Once a distribution is made from an IRA, the distribution no longer enjoys protection from creditors.

2. North Carolina State Law Protections

IRAs and Roth IRAs also are exempt from creditors' claims under North Carolina law. N.C.G.S. § 1C-1601(a)(9). Also exempt are individual retirement plans (as defined in the Internal Revenue Code) and any plan treated in the same manner as an individual retirement plan under the Code, including individual retirement accounts and Roth retirement accounts as described in IRC §§ 408(a) and 408A, individual retirement annuities as described in IRC § 408(b), and accounts established as a part of a trust described in IRC § 408(c). N.C.G.S. § 1C-1601(a)(9).

In order to qualify as an individual retirement annuity under Section 408(b) of the Internal Revenue Code (and, in turn, to receive protection from the claims of creditors) all of the following must be true of an annuity:

- The annuity contract must be issued by an insurance company.
- The individual retirement annuity by definition generally cannot include life insurance.
- An individual retirement annuity must not be transferable by the owner.
- A fixed rate contract issued after November 7, 1978, cannot qualify as an individual retirement annuity.
- The annual premium for an individual retirement annuity cannot exceed the applicable contribution limit for IRAs. IRC § 408(b) and Treas. Reg. §1.408-3(a).

The North Carolina exemption for IRAs has been judicially extended to IRC § 403(b) annuities. In re Grubbs, 325 B.R. 151 (Bankr. M.D.N.C. 2005).

In response to the United States Supreme Court's Clark decision, the North Carolina General Assembly clarified its position on inherited IRAs:

> Any money or other assets or any interest in any such plan remains exempt after an individual's death if held by one of more subsequent beneficiaries by reason of a direct transfer or eligible rollover that is excluded from gross income under the Internal Revenue Code, including, but not limited to, a direct transfer or eligible rollover to an

inherited individual retirement account as defined in section 408(d)(3) of the Internal Revenue Code.

N.C.G.S. 1C-1601(a)(9), as modified by 2013 S.B. 279.

The Supreme Court of North Carolina held that the corpus of a debtor's IRA was exempt from creditors' claims but upheld a court order requiring that any future withdrawals from a debtor's IRA must comply with the terms of an escrow agreement for creditors' benefit. Kinlaw v. Harris, 364 N.C. 528 (2010); *see also id.* (Edmunds, J., dissenting).

Practice tip: Consider trust planning for IRA beneficiary designations in light of the SECURE Act, which generally requires an inherited IRA to be distributed to a qualified beneficiary over a period not to exceed 10 years.

D. Tenancy by the Entirety

Tenancy by the entirety began as a common law doctrine related to ownership of real property by a married couple based on the following five unities:

- Unity of time—title vests in both spouses at the same time.
- Unity of title—both spouses' interest in the property derives from the same source. In North Carolina, since only real property may be owned as tenants by the entirety, the instrument is typically a deed.
- Unity of interest—each spouse has an equal interest in the property.
- Unity of possession—each spouse has an equal right to possess the property.
- Unity of person—the spouses are married to each other. This notion derives from the common law when husband and wife were regarded as one person under the law.

The doctrine of tenancy by the entirety has since been codified. *See* N.C.G.S. § 41-58. Under the statute, spouses have an equal right to the control, use, possession, rents, income, and profits of real property held by them in tenancy by the entirety. Neither spouse may bargain, sell, lease, mortgage, transfer, convey or in any manner encumber any property held as tenants by the entireties without the written joinder of the other spouse. N.C.G.S. § 41-58. Income from property held as tenants by the entirety becomes personal property held by the spouses as tenants in common in equal shares, and each spouse is considered for income tax purposes to have received one-half the income or loss from the property. N.C.G.S. § 41-59.

When spouses take real property, they take the property as tenants by the entirety and not as joint tenants or tenants in common, regardless of whether they are identified in the conveyance as married to each other. N.C.G.S. § 41-56(a)(6). The spouses "by virtue of their marital relationship, acquire the entire estate, and each is deemed to be seized of the whole, and not of a moiety or any undivided portion thereof." Davis v. Bass, 188 N.C. 200, 203 (1924). *See also* N.C.G.S.§ 41-56. On the death of one spouse, real property owned as tenants by the entirety is vested solely in the surviving spouse. N.C.G.S. § 41-64(a); Davis, 188 N.C. at 203.

In 2020, codification of the doctrine of tenancy by the entirety was expanded to include real property held by spouses as tenants by the entirety that is transferred to a joint trust or in equal shares to two separate trusts, provided that the spouses remain married, that the property continues to be held in the trust or trusts, and that both spouses are beneficiaries of the joint trust or of each separate trust. N.C.G.S. § 41-65(a) & (b).

The common law doctrine of tenancy by the entirety was not superseded by legislative enactment of state law exemptions of N.C.G.S. § 1C-1601. In re Banks, 22 Bankr. 891 (W.D.N.C. 1982). The common law doctrine and principles of equity supplement North Carolina statutory law except to the extent they conflict or are inconsistent with the General Statutes. N.C.G.S. § 41-66. Thus, a client enjoys the protection afforded by tenancy by the entirety in addition to exemptions afforded by state law. In re Knapp, 285 B.R. 176 (Bankr. M.D.N.C. 2002).

North Carolina law specifically exempts property held by spouses as tenants by the entirety from the individual debts of either spouse and precludes a judgment lien against one spouse from attaching to such property. N.C.G.S. § 41-60(a)(1). In other words, North Carolina generally is known as a "full bar" rather than "modified bar" state. See John N. Hutson, Jr. "Asset Protection Using Tenancy by the Entirety Ownership and Pitfalls of Arbitration Provisions," NCBA 44th Annual Estate Planning & Fiduciary Law Program (2022). Property held by a debtor and spouse as tenants by the entirety also is exempt from claims of the debtor's separate creditors under federal bankruptcy exemptions. 11 U.S.C. § 522(b)(3)(B). However, the property is liable for the joint obligations of the spouses, and there is no protection against the attachment of liens under such circumstances. N.C.G.S. § 41-60(a)(2). These protections expire upon the divorce or death of a spouse or when such property is converted into individually owned property or a tenancy in common. N.C.G.S. §§ 41-60(b), 41-63.

Proceeds from a voluntary sale of property held as tenants by the entirety are held as tenants in common and are not protected from the claims of creditors. N.C.G.S. § 41-63(1). Similarly, insurance proceeds for property held as tenants by the entirety become divisible personal property held by spouses as tenants in common and thus are not protected from the claims of creditors. N.C.G.S. § 41-62. In contrast, proceeds from an involuntary transfer of title of entireties property, such as condemnation proceeds, continue to be held by the spouses as tenants by the entirety. N.C.G.S. § 41-63(3). As North Carolina does extend tenancy by the entirety to bank accounts, it is unclear how spouses would preserve the character of proceeds as tenancy by the entirety.

Spouses may convey property held as tenants by the entirety by joint deed of both spouses to anyone of their choice free and clear of a judgment lien against either spouse. N.C.G.S. § 41-60(a)(1). A conveyance from one spouse to another of his or her interest in the property terminates tenancy by the entirety and vests the property or interest formerly held as tenants by the entirety in the grantee spouse. N.C.G.S. § 41-63(4). Under North Carolina common law, a debtor-spouse may convey entirety property to his or her spouse without consideration free and clear of a judgment lien. L&M Gas Co. v. Leggett, 161 S.E.2d 23, 24-25 (N.C. 1968).

However, this protection did not extend to debts owed to the IRS in Morgan v. Bruton. 130 A.F.T.R.2d (RIA) 2022-5504 (M.D.N.C. 2022). In Morgan, the District Court for the Middle District of North Carolina affirmed the Bankruptcy Court's conclusion that a Winston-Salem home owned by a husband and wife as tenants by the entirety was not exempt from the husband's bankruptcy estate under 11 U.S.C. Section 522(b)(3)(B) with respect to the $18,000 in unpaid taxes the husband alone owed to the IRS. The court stated that while a property held in a tenancy by the entirety usually is protected under federal and North Carolina law, "such property is not exempt under the U.S. Tax Code." *Id.* at *4 (citing U.S. v. Craft, 535 U.S. 274 (2002), which held that a lien attaches to entireties property even if only one spouse is liable for the tax debt). Thus, the property was barred from exemption and was subject to the bankruptcy estate. *See also* U.S. v. Barcyzk, 434 F. App'x 488 (6th Cir. 2011), *cert. denied*, 132 S. Ct. 1118 (Jan. 17, 2012), in which a Michigan wife's entireties interest in the marital home was sold, and her husband's fifty percent of the sale proceeds was ordered payable to the IRS for delinquent taxes owed by her husband.

Caution: Note that not all states that recognize tenancy by the entirety share North Carolina's "full bar" creditor protection benefits for entireties property. For example, Oregon law offers "modified bar" protection and permits the creditor of one spouse to execute on the spouse's interest in entireties property. Ganoe v. Ohmart, 121 Or. 116 (1927).

E. Trusts

1. Uniform Trust Code

The North Carolina General Assembly adopted the Uniform Trust Code effective January 1, 2006. The Uniform Trust Code provides spendthrift protection for certain trusts. The effect of a spendthrift provision generally is to insulate a beneficiary's interest until a distribution is made and received by the beneficiary. UNIFORM TRUST CODE § 506 cmt.

Under the Uniform Trust Code, a creditor may not attach a beneficiary's trust interest that is protected or restricted by

(1) a spendthrift provision;

(2) a protective trust interest; or

(3) a discretionary trust interest.

N.C.G.S. § 36C-5-501. Each of these provisions is discussed below.

2. Spendthrift Trust

A spendthrift provision restrains voluntary and involuntary transfer of a beneficiary's trust interest and is valid under North Carolina law. N.C.G.S. § 36C-5-502. However, a spendthrift provision is not effective against the child support claims of a beneficiary's child. N.C.G.S. § 36C-5-503(b). The term "child" includes any person for whom an order or judgment for child support has been entered in North Carolina or another state. N.C.G.S. § 36C-5-503(a).

Drafting tip: Following is a sample spendthrift provision.

> Except to the extent prohibited by law and except as otherwise provided under this trust instrument, no beneficiary shall have any power to dispose of, encumber or charge by way of anticipation any interest he or she may have in any trust established for his or her benefit hereunder; and all payments made thereunder to any beneficiary shall be free and clear of his or her debts, contracts, alienations and anticipations and from all liabilities or judgments for levies and attachments and proceedings of whatsoever kind, at law or in equity. This spendthrift provision shall not restrict the exercise of a disclaimer or renunciation by any beneficiary hereunder.

3. Protective Trust

North Carolina's enactment of the Uniform Trust Code brings forward with minor modifications prior law with respect to a protective trust in which the beneficiary's interest is not voluntarily or involuntarily transferable. N.C.G.S. § 36C-5-508 cmt.*; see* N.C.G.S. § 36A-115(3)(2000) (repealed). The terms of a protective trust provide that a beneficiary's interest terminates or becomes discretionary if:

a. the beneficiary transfers or attempts to transfer the interest;

b. any creditor attempts to reach the beneficiary's interest by attachment, levy or otherwise; or

c. the beneficiary becomes insolvent or bankrupt.

N.C.G.S. § 36C-5-508. A restriction on the transfer of a debtor's beneficial interest in a trust that is enforceable under state law also is enforceable under federal bankruptcy law. 11 U.S.C. § 541(c)(2).

Drafting tip: Following is a sample protective trust provision.

> In the event it is determined by either a court or an authority of competent jurisdiction that the existence of this Special Needs Trust renders my son ineligible to receive Means-tested public benefits to which he would otherwise be entitled, or if the Trustee determines, in the Trustee's discretion, that notwithstanding the fact that this is a discretionary trust, the trust may become subject to garnishment, attachment, execution or bankruptcy proceeding by a creditor of my son or by the state or federal government, then the Trustee shall terminate this Special Needs Trust and dispose of the then remaining trust property pursuant to the Paragraph of this Section entitled "Termination Upon Death."

4. Discretionary Trust

A discretionary trust interest means an interest in a trust that is subject to the trustee's discretion, whether or not the discretion is expressed in the form of a standard of distribution. N.C.G.S. §36C-5-504(a)(2). A discretionary trust interest includes:

a. a trust in which the amount to be received by the beneficiary, including whether or not the beneficiary, or a class of beneficiaries, is to receive anything at all, is within the discretion of the trustee; and

b. a trust in which the trustee has no duty to pay or distribute any particular amount to the beneficiary, but has only a duty to pay or distribute those sums that the trustee, in the trustee's discretion, determines are appropriate for the beneficiary's support, education or maintenance.

N.C.G.S. § 36C-5-504(a)(2).

A beneficiary's creditor may not compel a distribution from a trust in which the beneficiary has a discretionary trust interest even if the trustee abused the trustee's discretion in making or withholding trust distributions. N.C.G.S. § 36C-5-504(c). Note, however, that statutory protection afforded a discretionary trust interest is not effective against the child support claims of a beneficiary's child, and a court may order a distribution to satisfy a child support order. N.C.G.S. § 36C-5-504(d)(1). The court-ordered distribution is limited to an amount the court deems equitable under the circumstances and may not be more than the amount the trustee would have been required to distribute had the trustee complied with the standard or not abused the discretion. N.C.G.S. § 36C-5-504(d)(2).

Drafting tip: Following are two alternative sample discretionary trust provisions.

(1) During the lifetime of the child, the Trustee may distribute all or any portion of the trust property to any one or more of the group consisting of the child and the child's issue in such amounts and at such times as the Trustee, in the Trustee's discretion, may determine.

(2) During the lifetime of the child, the Trustee may distribute all or any portion of the trust property to any one or more of the group consisting of the child and the child's issue in such amounts and at such times as the Trustee, in the Trustee's discretion, may determine to be necessary for their health, support, maintenance and education after taking into consideration other financial resources available to them.

5. Special Trust Issue: Beneficiary as Trustee

A creditor may not reach the interest of a beneficiary who is also a trustee or co-trustee, or otherwise compel a distribution, if the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard. N.C.G.S. § 36C-5-504(f). This provision of the Uniform Trust Code is intended to overrule the Restatement (Third) of Trusts § 60, comment g, which provides that the beneficial interest of a beneficiary who also serves as trustee may be reached by the beneficiary-trustee's creditors. UNIFORM TRUST CODE § 504(e) cmt.; *see also* N.C.G.S. § 36C-5-504(f) cmt.

The result under the Uniform Trust Code is that the beneficiary-trustee's interest is protected to the extent it also is exempt from federal estate tax. UNIFORM TRUST CODE § 504(e) cmt. The protection afforded by North Carolina law is not greater than if the beneficiary had not been named as trustee.

However, to maximize creditor protection of trust assets, many commentators recommend appointing an independent trustee. *See* Steve R. Akers, SH005 ALI-ABA 1063, *Trustee Selection; Retaining Strings Without Getting "Strung Up" or "The Fancy Stuff is Fun—But This Is What I Wrestle With Every Day*," (Aug. 1-3, 2002) (CLE Course Material for Estate Planning for the Family Business Owner).

6. Special Trust Issue: Revocable, Self-Settled and Grantor Trusts

During life, a revocable trust affords the settlor no protection from creditors' claims. N.C.G.S. § 36C-5-505(a)(1) ("During the lifetime of a settlor, the property of a revocable trust is subject to the claims of the settlor's creditors.") At death, no additional protection is afforded the assets of a revocable trust. The property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent that the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances, unless barred by applicable law. Livesay v. Carolina First Bank, 665 S.E.2d 158 (N.C. App. 2008) review dismissed as moot, 686 S.E.2d 517 (2009) (quoting N.C.G.S. § 36C-5-505).

With respect to an irrevocable trust, a settlor's creditor or assignee may reach the maximum amount that can be distributed to or for the settlor's benefit. N.C.G.S. § 36C-5-505(a)(2). The position adopted by the drafters of the Uniform Trust Code is based on the Restatement (Third) of Trusts § 58(2) cmt. e (Tentative Draft No. 2, approved 1999) and Restatement (Second) of Trusts § 156(2) (1959) and rejects the approach taken in states like Alaska and Delaware, which extend creditor protection to self-settled trusts. UNIFORM TRUST CODE § 505(a)(2) cmt. *See* Pilkington v. West, 99 S.E.2d 798, 802 (N.C. 1957) (stating, "[O]ne cannot remove his property from liability for his debts or restrict his right of alienation by a conveyance to a trustee for the sole use and benefit of the owner grantor.")

A trustee's discretionary distribution to pay income tax payable by the grantor on trust income is not subject to the claims of other creditors. N.C.G.S. §36C-5-505(a)(2a).

In 2012, a Virginia bankruptcy court considered the case of a debtor who earlier transferred assets in trust for her husband. She served as trustee, and after her husband passed away, became successor beneficiary of the trust. Applying Virginia's enactment of the Uniform Trust Code, the Virginia bankruptcy court ordered that the assets of the trust be turned over to the bankruptcy trustee because the debtor was the trust settlor, was the sole beneficiary of the trust, and retained "complete control over the use and disposition of the assets." In re Salahi, 2012 WL 1438213 (Bankr. E.D. Va. Apr. 25, 2012).

7. Special Trust Issue: Withdrawal Rights

Despite the general rule that North Carolina law offers no protection from creditors to assets held in a self-settled trust, North Carolina has favorable law with respect to a beneficiary's withdrawal right over trust property. With respect to a power of withdrawal over trust property exercisable by a power holder other than the settlor of the trust, such as a Crummey withdrawal right, the property subject to the exercise of the power is subject to the claims the creditors of the holder only when and to the extent the holder exercises the power. N.C.G.S. § 36C-5-505(b)(1).

Note, however, that a beneficiary's creditor or assignee may reach a mandatory distribution of trust property if the trustee has not made the distribution to the beneficiary in a reasonable time after the designated distribution date. N.C.G.S. § 36C-5-506(b). A "mandatory distribution" includes a distribution of trust property that the trustee is required to make to a beneficiary under the terms of the trust. N.C.G.S. § 36C-5-506(a). A mandatory distribution does not include a distribution subject to the exercise of the trustee's discretion, including distributions made pursuant to a support or other standard to guide the trustee in making distribution decisions, or distributions under a support or other standard that the trustee may have discretion to make. A mandatory distribution includes a distribution upon termination of the trust, if the trustee has failed to make a payment within a reasonable time after the designated distribution date. UNIFORM TRUST CODE § 506 cmt. For example, a mandatory distribution is found in a qualified terminable interest property trust, a charitable remainder trust, and a grantor retained annuity trust where the trustee is required to make a distribution of income or an annuity or unitrust amount. N.C.G.S. § 36C-5-506 cmt.

The lapse, release, or waiver of the power is not deemed to be an exercise of the power and does to cause the holder to be treated as the settlor of the trust. N.C.G.S. § 36C-5-505(b)(2).

Practice tip: For an age-terminating trust, allow the primary beneficiary the right to withdraw all the trust property upon reaching the specified age rather than requiring the trustee to terminate the trust and to distribute the remaining trust property at the time the beneficiary reaches the specified age.

7. Special Trust Issue: Privacy

Because trusts agreements generally are not subject to public scrutiny, trusts historically have been used to protect privacy. To combat nefarious use of trusts, anti-money laundering, and terrorism financing, a trust which meets certain minimum ownership requirements in a reporting company soon will be required to provide information about the trust to the reporting company. The reporting company will be required to report the information to the Financial Crimes Enforcement Network (FinCEN) through the Beneficial Owner Secure System (BOSS) to comply with the Corporate Transparency Act effective January 2, 2024. 31 C.F.R. § 1010.380.

F. Limited Liability Companies

A limited liability company can offer effective protection from claims arising from company activities, called inside liability protection, as well as protection from a member's separate creditors, called outside liability protection.

1. Inside Liability Protection

A member, manager, director, or executive of a limited liability company is not liable for the obligations of a limited liability company solely by reason of being a member, manager, director, or executive. A member, manager, director, or other executive of a limited liability company does not become liable by participating in the management or control of the business. N.C.G.S. § 57D-3-30. Further, it is improper to name an individual member of a limited liability company as a party defendant without supporting evidence. Page v. Roscoe, 497 S.E.2d 422, 428 (N.C. Ct. App. 1998).

2. Outside Liability Protection

a. Statutory Protection

The protection from a member's personal creditor afforded under the North Carolina Limited Liability Company Act is based on the Revised Uniform Limited Partnership Act. *See generally* Elizabeth M. Schurig & Amy P. Jetel, *The Alarming Potential for Foreclosure and Dissolution by an LLC Member's Personal Creditors,* 20 PROB. & PROP. 3, 42 (2006).

The exclusive remedy of a member's personal creditor is a charging order. N.C.G.S. § 57D-5-03 ("On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the membership interest of the member with payment of the unsatisfied amount of the judgment with interest.") The judgment creditor has only the rights of an assignee of the membership interest. N.C.G.S. § 57D-5-03.

In First Bank v. S&R Grandview, LLC, 232 N.C. App. 544 (2013), defendant Rhine, who was a member and manager of an LLC, was subject to a $3.5 million judgment based on his default on various loans and guaranty agreements. In an effort to collect on the judgment, the bank petitioned for and obtained a charging order against Mr. Rhine's interest in the LLC. Mr. Rhine appealed the charging order and argued that the order effectuated an assignment of his interest to the bank and enjoined him from exercising his rights as a member of the LLC. The Court of Appeals agreed with Mr. Rhine and reversed and remanded to the trial court to issue a new charging order that affords the judgment creditor only the rights of an assignee. The assignee interest was not a dissolution of the LLC and did not include the right to exercise any of the rights of a member. The assignee's rights were limited to receiving, to the extent assigned, only the distributions and allocation to which the assignor would be entitled but for the assignment. The case was decided under prior N.C.G.S. 57C-5-02 and -03 (2011).

Note that some jurisdictions may permit a judgment creditor to foreclose on a charging order. The Tenth Circuit Court of Appeals held that the Utah Limited Liability Company Act (ULLCA) enabled a creditor to invade a multi-member LLC and to force distributions to the debtor-member's creditor under a charging order. Earthgrains Baking v. Sycamore, 2022 U.S.

App. LEXIS 3988 (10th Cir. Feb. 14, 2022). The trial court determined that Leland Sycamore owed EarthGrains over $5,000,000 in damages and fees for various intellectual property violations. After two years of Mr. Sycamore's refusal to pay damages, the court entered a charging order against Mr. Sycamore's 48% interest in Sycamore Family LLC. The majority of Mr. Sycamore's assets were held in the LLC, initially beyond the reach of his creditors. After another four years, damages remained unpaid. EarthGrains filed a motion for contempt sanctions, which the trial court granted.

The trial court found that Mr. Sycamore, his family, and the LLC cooperated to avoid making any distributions to Mr. Sycamore directly from the LLC, thus eluding the mandatory payments to EarthGrains. For example, despite the LLC's operating agreement requiring minimum distributions, the LLC had not made any distributions to Mr. Sycamore in the six years since the judgment, but it had made substantial cash distributions and other deemed distributions to Mr. Sycamore's wife and their children. In addition, the LLC refused to adhere to corporate formalities, provide relevant financial information, or keep records.

The trial court appointed a receiver, as allowed by ULLCA Section 48-3a-503, to determine the full extent of the distributions made since the charging order. The receiver could have petitioned the court to foreclose on Mr. Sycamore's interest in the LLC under Section 503(3) of the ULLCA, but the receiver determined that it would be ineffective and recommended that the LLC immediately liquidate enough of its assets to pay the remaining balance of Mr. Sycamore's judgment. The district court agreed and mandated the distribution and partial liquidation to effectuate the charging order.

The LLC sought relief in the Tenth Circuit Court of Appeals, arguing in part that the court-ordered invasion exceeded the trial court's authority under Utah law by forcing distributions in lieu of granting a petition for foreclosure. In its analysis of the Utah statute, the Tenth Circuit noted that under the Utah statute, a charging order gives a court the authority to "appoint a receiver . . . to make all inquiries the judgment debtor might have made; *and* make all other orders necessary to give effect to the charging order" (emphasis added). In addition, the LLC argued that ULLCA Section 503(3), allowing for the foreclosure of the lien created by the charging order, is the exclusive remedy as provided by Section 503(8), which states that, "[t]his section provides the exclusive remedy by which a person seeking to enforce a judgment against a member or transferee may, in the capacity of judgment creditor, satisfy the judgment" from the debtor's interest.

The Tenth Circuit disagreed with the LLC and found that the trial court had property applied the latter part of the statute to justify its forced distributions and partial liquidations. It reasoned that the "charging order was frustrated by the LLC's failure to comply" and that the district court had to find a way to give it effect. Earthgrains, 2022 U.S. App. LEXIS 3988, *22. The Court of Appeals agreed that foreclosing on Mr. Sycamore's interest, as permitted by the Utah statute, would be ineffective, and that the only other option was to force the LLC to liquidate assets and distribute cash. The Tenth Circuit further reasoned that to view a foreclosure as the statute's only remedy would be to "eviscerate courts' explicit power to 'appoint a receiver of the distributions subject to the charging order.'" *Id.* at 23. The Tenth Circuit affirmed the district court's decision mandating the invasion of an LLC "[c]onsidering the extended contempt proceedings and rampant bad faith that sustained the nonpayment of the judgment." *Id.* Under

these circumstances, the Court of Appeals found that "the statute's 'necessary' standard was satisfied." *Id.*

While the decision's binding authority is limited to the Tenth Circuit, the reasoning behind it may be persuasive in jurisdictions with statutes similar to the Utah statute. The pivotal provision of the Utah statute seems to be the language found in Section 503(2)(b), which provides that a court may "make all other orders necessary to give effect to the charging order," including appointing a receiver and foreclosing on a debtor's LLC interest. Without such statutory language, it is unclear whether a different court would reach the same conclusion.

b. Special Issue: Single-Member LLCs

Courts gradually have chipped away at the notion that a charging order is the exclusive remedy of a member's personal creditor in the context of a single-member LLC. In response, some states have enacted increasingly protective legislation.

In re Albright, a chapter 7 trustee moved for authority to liquidate property owned by the individual debtor's single-member LLC. 291 B.R. 538 (Bankr. D. Colo. 2003). The trustee maintained that because the debtor was the sole member and manager of the LLC at the time she filed for bankruptcy, the trustee controlled the LLC and could cause the LLC to sell the real property and distribute the sales proceeds to the bankruptcy estate. *Id.* at 539. The debtor asserted that, at best, the trustee was entitled to a charging order and could not assume management of the LLC or cause the LLC to sell the real property. *Id.* After examining the relevant statutes in the Colorado Limited Liability Company Act, the federal bankruptcy court held that the debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the trustee succeeded to all her rights, including the right to control the management of the LLC. *Id.* at 540. The Albright court observed that the purpose of the charging order was to protect other members of an LLC from being forced to involuntarily share governance responsibilities with someone they did not choose and further observed that this purpose was not served in the context of a single-member LLC. *Id.* at 541. *See also* In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005), *vacated by* Movitz v. Fiesta Invs., LLC (In re Ehmann), 337 B.R. 228 (Bankr. D. Ariz. 2006).

The Supreme Court of Florida exercised discretionary jurisdiction to consider the protection offered by a single-member LLC after the United States Court of Appeals for the Eleventh Circuit, 528 F.3d 1310, certified a question concerning the rights of a judgment creditor regarding the respective ownership interests of judgment debtors in certain single-member LLCs. Olmstead v. F.T.C., 44 So.3d 76 (Fla. 2010), *reh'g denied* (Aug. 31, 2010). The court reviewed the Florida Limited Liability Company Act which provides:

> On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest.

Id. at 80 (citing Fla. Stat. § 608.433(4)). Florida law further provided that an assignee has "no right to participate in the management of the business and affairs" of the LLC "except as provided in the articles of organization or operating agreement" and upon obtaining "approval of all of the members of the limited liability company other than the member assigning a limited liability company interest" or upon "[c]ompliance with any procedure provided for in the articles of organization or operating agreement." *Id.* at 79 (quoting Fla. Stat. § 608.432).

The court noted that under general corporate law principles, the remedy of a shareholder's personal creditor is levy of attachments and execution and queried whether the charging order provision of the LLC Act displaced the remedy available under general corporate law. *Id.* The court reasoned that the statutory language regarding rights of an assignee had no application to the transfer of rights in a single-member LLC because the set of "all members other than the member assigning the interest" is empty. *Id.* at 81. The court further noted that both the Florida Revised Uniform Partnership Act and the Florida Revised Uniform Limited Partnership Act both provided for an exclusive remedy provision, which the LLC Act omitted. *Id.* at 82. With the LLC Act remedy inapplicable, the Olmstead court looked to remedies available under corporate law and held that a charging order is not the exclusive remedy of the personal creditor of the sole member of an LLC and that the judgment debtor may be ordered to surrender all right, title and interest in the debtor's single-member LLC to satisfy an outstanding judgment. *Id.* at 77.

Similarly, in In re First Protection, the United States Bankruptcy Appellate Panel of the Ninth Circuit analyzed the Albright decision and summarized that "a charging order protects the autonomy of the original members, and their ability to manage their own enterprise." In re First Protection, Inc., 440 B.R. 821, 830 (B.A.P. 9th Cir. 2010). The court held that a bankruptcy trustee is not a judgment creditor limited to the remedy of a charging order. *Id*. at 832. Rather, the bankruptcy trustee succeeded by operation of law to all transfers of interest in the bankruptcy estate, including the right to control the LLC. *Id*. at 830. The court reasoned that bankruptcy law overrides both contract and state law restrictions on transfers to sweep all interests into the bankruptcy estate. *Id*. The court agreed with the outcome in Albright, but reached the same conclusion by way of another path. *Id.* Although the In re First Protection court cited Olmstead in support of its position, In re First Protection concerned a multi-member LLC while Olmstead involved a single-member LLC.

In 2011, a Florida bankruptcy court relied on the Olmstead decision. In re Davis Heritage GP Holdings, LLC, 443 B.R. 448, 458 (Bankr. N.D. Fla. 2011). The court explained that before Olmstead, if a Florida judgment creditor levied on a debtor's ownership in a single-member LLC, the most the judgment creditor could get was a statutory charging order, which entitled the judgment creditor only to the judgment debtor's "rights to profits and distributions from the business entity in which the debtor has an ownership interest." *Id.* at 458 (citing Olmstead, 44 So.3d at 79). Pursuant to the holding in Olmstead, after June 24, 2010, the court noted that the judgment creditor became entitled to cause the owner of a single-member LLC to surrender its "right, title and interest" in and to all the LLC assets. *Id.*

In response to the Olmstead decision, the Florida legislature amended the charging order statute effective May 31, 2011, to provide that "a charging order is the sole and exclusive remedy by which a judgment creditor of a member or member's transferee may satisfy a judgment from

the judgment debtor's interest in a limited liability company or rights to distributions from the limited liability company." However, the new statute clarifies that with respect to a single-member LLC, "a charging order is not the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company or the assignee of the sole member." The court may order the sale of the single member's interest in the limited liability company pursuant to a foreclosure sale. Further, the amended statute did not limit the availability of equitable remedies that are not inconsistent with the statute, such as alter ego, equitable lien, constructive trust, and other equitable principles. Fla. Stat. § 608.433 (5), (6) & (9)(d).

In 2014, the Florida legislature repealed its initial response to the Olmstead decision and further clarified the exclusive remedy of a charging order:

> (3) Except as provided in subsections (4) and (5), a charging order is the sole and exclusive remedy by which a judgment creditor of a member or member's transferee may satisfy a judgment from the judgment debtor's interest in a limited liability company or rights to distributions from the limited liability company.
>
> (4) In the case of a limited liability company that has only one member, if a judgment creditor of a member or member's transferee establishes to the satisfaction of a court of competent jurisdiction that distributions under a charging order will not satisfy the judgment within a reasonable time, a charging order is not the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company or the transferee of the sole member, and upon such showing, the court may order the sale of that interest in the limited liability company pursuant to a foreclosure sale. A judgment creditor may make a showing to the court that distributions under a charging order will not satisfy the judgment within a reasonable time at any time after the entry of the judgment and may do so at the same time that the judgment creditor applies for the entry of a charging order.
>
> (5) If a limited liability company has only one member and the court orders a foreclosure sale of a judgment debtor's interest in the limited liability company or of a charging order lien against the sole member of the limited liability company pursuant to subsection (4):
>
>> (a) The purchaser at the court-ordered foreclosure sale obtains the member's entire limited liability company interest, not merely the rights of a transferee;
>>
>> (b) The purchaser at the sale becomes the member of the limited liability company; and
>>
>> (c) The person whose limited liability company interest is sold pursuant to the foreclosure sale or is the subject of the foreclosed charging order ceases to be a member of the limited liability company.

Fla. Stat. Ann. § 605.0503(3), (4) & (5) (West).

Similarly, the Nevada LLC statute provides that a charging order is the exclusive remedy of a judgment creditor. Nev. Rev. Stat. 86.401. Effective October 1, 2011, the Nevada legislature expanded statutory exclusive charging order protection to single-member LLCs. ("This section [p]rovides the exclusive remedy by which a judgment creditor of a member or an assignee of a member may satisfy a judgment out of the member's interest of the judgment debtor, whether the limited-liability company has one member or more than one member. No other remedy, including, without limitation, foreclosure on the member's interest or a court order for directions, accounts and inquiries that the debtor or member might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited-liability company, and no other remedy may be ordered by a court." Nev. Rev. Stat. 86.401.)

In 2012, the Nevada Supreme Court considered whether the judgment creditor has only the rights of an assignee and receives only a share of the economic interests of the LLC, including profits, losses and distributions of assets. The Nevada Supreme Court reversed the district court's charging order and held that the creditor did not succeed to the member's managerial rights and could not reach company assets. Weddell v. H2O, Inc., 271 P.3d 743 (Mar. 1, 2012, *reh'g denied* Apr. 27, 2012).

Note, however, the result in Wyoming in GreenHunter Energy, Inc. v. W. Ecosystems Tech., Inc., 337 P.3d 454 (Wyo. 2014). The Wyoming Supreme Court pierced the limited liability veil of a Wyoming LLC where its sole member used the LLC to avoid creditors. The court's opinion illustrates the modern evolution of law that down plays whether formalities were observed, and instead focuses on the realities of the circumstances and whether the entity was used to avoid liability.

In GreenHunter, Plaintiff provided services to Defendant LLC (LLC), but the Defendant failed to pay. Plaintiff sued for breach of contract and was awarded a judgment of $43,000 plus approximately $2,000 in attorney's fees; however, when the Plaintiff tried to collect, it found the LLC had no assets to satisfy the judgment. Plaintiff then brought an action against the LLC's sole member, a Texas corporation (Corporation) to pierce the LLC's veil and make Corporation directly liable on the judgment. At trial Corporation was proven to be the sole member and manager of the LLC. The LLC never carried a capital account balance that was sufficient to cover its debts. Instead, the corporation simply advanced as much money to the LLC when and as necessary to cover accounts payable.

The LLC did not have any employees of its own. Instead, Corporation negotiated everything for the LLC, including the contract that was the subject of the Plaintiff's underlying debt. Not surprisingly, the LLC and Corporation shared the same business address and the Corporation's employees kept the LLC's books and financial records. As expected, the LLC was a disregarded entity for tax purposes, and all items of income and loss were reported on Corporation's income tax return.

The trial court found in favor of Plaintiff and entered a judgment against Corporation. Corporation appealed to the Supreme Court of Wyoming, which issued a detailed opinion outlining the history of the state's protection for limited liability. The court provided that "Piercings seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled. But,

much like lightning, veil piercing really doesn't strike out of the blue, but requires certain conditions before it happens."

The court noted that prior to 2010, Wyoming had developed case law such that a court evaluating a veil piercing claim would focus on four factors:

1. Fraud;
2. Inadequate capitalization;
3. Failure to observe company formalities; and
4. Intermingling of the business and finances of the company with the party against whom the veil is sought to be pierced.

In 2010, Wyoming updated its LLC law to provide that the failure of a limited liability company to observe any particular formalities relating to the existence of its powers or management of its activities is not a ground for imposing liability on the members or managers for the debts, obligations, or other liabilities of the company. Wyo. Stat. Ann. §17-29-304. The 2010 act made it clear that failure of the LLC to follow formalities was not a ground for veil piercing because LLCs often have few if any traditional corporate formalities. Instead, the Wyoming Supreme Court provided that the veil of a Wyoming LLC can be pierced "under exceptional circumstances" if a two prong test is met:

1. The separateness of the LLC and its owners ceased to exist because of misuse of the LLC; and
2. Under the facts, to respect the separate existence of the LLC would lead to injustice.

The Wyoming Supreme Court continued that inadequate capitalization of the LLC would favor veil piercing. This factor looks to the business that the LLC is conducting and determines whether the LLC was capitalized so as to be financially responsible for its ordinary debts. Also, intermingling the assets and the operations of the LLC and the assets of its owners would favor veil piercing. This test looks to whether the LLC and its owners conducted business on an arms' length basis or whether the assets were regularly comingled.

c. North Carolina Application

For some time it was uncertain to what extent a North Carolina court would apply the Albright and Olmstead courts' analysis to North Carolina single-member LLCs. The North Carolina Limited Liability Company Act provision regarding the charging order was identical to the Florida statute analyzed in Olmstead. *Cf.* N.C.G.S. § 57C-5-03; Olmstead, 44 So.3d at 80 (citing FLA. STAT. § 608.433(4)). However, the North Carolina provision regarding assignment of membership interest differed from the Florida provision, notably omitting the pivotal requirement that an assignee has "no rights to participate in the management and affairs" of the LLC except upon obtaining "approval of all of the members of the limited liability company other than the member assigning a limited liability company interest." *Cf.* N.C.G.S. § 57C-5-02;

Olmstead, 44 So.3d at 80 (quoting Fla. Stat. § 608.432). Also unlike the corresponding Florida statutes, neither the North Carolina Uniform Partnership Act nor the Revised Uniform Limited Partnership Act provides that a charging order is the exclusive remedy available to a partner's personal creditor. *See* N.C.G.S. §§ 59-58 & 59-703.

Nevertheless, the Albright court's underlying policy analysis—that "a charging order protects the autonomy of the original members, and their ability to manage their own enterprise"—and conclusion that such policy reasons do not exist in the context of a single-member LLC, begged North Carolina estate planning practitioners to be aware of this emerging trend and to examine the efficacy of single-member LLCs for asset protection planning purposes. North Carolina practitioners received additional guidance in 2014, four years after the Olmstead decision, when the General Assembly enacted the following exclusive remedy language:

> The entry of a charging order is the exclusive remedy by which a judgment creditor of an interest owner may satisfy the judgment from or with the judgment debtor's ownership interest.

N.C. Gen. Stat. Ann. § 57D-5-03(d).

The North Carolina language is stronger than the language of the Florida statute under which Olmstead was decided. However, the North Carolina language is not as strong as the Nevada statute, which explicitly discusses single-member LLCs. No court decision was identified in which the new North Carolina statute was applied to litigated issues involving a single-member LLC.

Practice tip: An LLC that is intended to afford outside creditor protection should be owned by two or more members. At least one member should not face the same potential claimant as the other member. For example, if both spouses signed a personal guarantee on a promissory note, an LLC with both spouses as members also should include members who are not subject to the guarantee. *See* Herring v. Keasler, 563 S.E.2d 614 (N.C. App. 2002) (affirming the trial court's charging order and holding that the judgment creditor of a husband and wife could not seize and sell the husband's 20% membership interest in various real estate development LLCs).

In further example, a client who considers forming an LLC but does not wish to invite a third party or more remote relative as a member, may wish to consider forming and funding a grantor trust for the benefit of the client's spouse and children to serve as member of more than a nominal interest in the LLC. If the trust is structured as a grantor trust, the LLC may continue to be disregarded for federal income tax purposes. If the trust is for the benefit of persons other than the grantor, the multi-member status of the LLC would distinguish the LLC from the Albright and Olmstead facts.

Another strategy to accomplish asset protection and estate planning objectives is to form and fund an LLC and to transfer an interest in the LLC to a grantor trust in exchange for a secured note. In the asset protection context, this should not be considered a single member LLC and therefore should enjoy charging order protection. Also, the sale in exchange for a note should not be challenged as a fraudulent conveyance because the debtor received a reasonably

equivalent value in exchange for the transfer and the transfer was done in the course of legitimate estate planning.

d. Buy-Sell Agreements

The importance of current governance documents, including appropriate and appropriately funded buy-sell terms at disability, death, and in case of an involuntary transfer, cannot be overstated. For maximum benefit, such provisions must comply with federal tax law as well as state law. For example, the Eighth Circuit recently affirmed a grant of summary judgment to the IRS agreeing that (i) a buy-sell agreement between two brothers should be disregarded because it did not provide a fixed and determinable price and (ii) the corporation's fair market value must include the life insurance proceeds used for redemption of the deceased brother's shares. Connelly v. U.S., No. 21-3683 (8th Cir. June 2, 2023).

In Connelly, the Eighth Circuit agreed with the District Court for the Eastern District of Missouri holding that a buy-sell agreement between two brother shareholders should be disregarded. To provide a smooth transition of ownership upon either brother's death, the brothers and the corporation entered into a buy-sell agreement. Upon one brother's death, the surviving brother had the right to buy the deceased brother's shares, and if not exercised, the corporation was required to redeem the shares. Although the buy-sell agreement provided two methods for determining the price at which the corporation would redeem the shares (by "mutual agreement" annually or by obtaining two or more appraisals of fair market value), it fixed no price nor set a formula for determining one. The brothers and the corporation ignored both pricing methods in valuing the shares for estate tax purposes.

The Eighth Circuit held that the buy-sell agreement did not provide a fixed and determinable price for the deceased brother's shares for estate tax purposes because it did not meet the Section 2703(b) safe harbor. Section 2703(b) requires three elements for a buy-sell agreement to control the value of a decedent's property for estate tax purposes: (i) it must be a bona fide business arrangement, (ii) it must not be a device to transfer property to a decedent's family members for less than full and adequate consideration, and (iii) its terms must be comparable to similar arrangements entered into by persons in an arm's length transaction.

In addition, the court held that the determination of the corporation's fair market value must take into account the life insurance proceeds used for redemption of the deceased brother's shares based on well-established valuation principles. The court used "the willing buyer-willing seller test of fair market value" and found that when valuing closely-held corporations a willing buyer at the time of the deceased's brother's death would have paid a fair market value taking into account the life insurance proceeds. The fair market value of the deceased brother's shares therefore must account for the reality of "an asset that increased shareholders' equity." As such, the court agreed with the IRS in disregarding the buy-sell agreement and taking into account the life insurance proceeds used to redeem the deceased brother's shares.

e. Corporate Transparency Act

Effective January 2, 2024, the Corporate Transparency Act—despite its corporate title—will impose new reporting requirements on LLCs. An LLC meeting certain criteria, including many LLCs formed and employed for estate planning purposes, will be required to provide information about its beneficial owners and company applicant to the Financial Crimes Enforcement Network (FinCEN). Information required to be disclosed includes the company's name, address, and tax identification number. In addition, the name, address, date of birth and photo identification of each beneficial owner and company applicant is required to be disclosed. Compliance will be handled electronically through the Beneficial Owner Secure System (BOSS). Existing LLCs will have until January 1, 2025 to file a report, but entities created on or after January 1, 2024 must comply within a 30-day reporting period. The Corporate Transparency Act is designed to apply to smaller, private entities, including LLCs. 31 C.F.R. § 1010.380

G. Offshore or Domestic Entities

A goal of offshore planning is to avoid attachment of a lien. Attachment is governed by North Carolina General Statutes Chapter 1, Article 35. Note that North Carolina's attachment statute has a broad reach, and removal of assets or threat of removal supplies legal grounds for attachment. As trust and estate counsel may be less familiar with these statutes, the relevant provisions are reproduced below (with emphasis as noted).

§ 1-440.1. Nature of attachment.

(a) Attachment is a proceeding ancillary to a pending principal action, is in the nature of a preliminary execution against property, and is intended to bring property of a defendant within the legal custody of the court in order that it may subsequently be applied to the satisfaction of any judgment for money which may be rendered against the defendant in the principal action.

(b) No personal judgment, even for costs, may be rendered against a defendant unless personal jurisdiction has been acquired as provided in G.S. 1-75.3.

(c) Although there is no personal service on the defendant, or on an agent for him, and although he does not make a general appearance, judgment may be rendered in an action in which property of the defendant has been attached which judgment shall provide for the application of the attached property, by the method set out in G.S. 1-440.46, to the satisfaction of the plaintiff's claim as established in the principal action. If plaintiff's claim is not thereby satisfied in full, subsequent actions for the unsatisfied balance are not barred. (1947, c. 693, s. 1; 1967, c. 954, s. 3.)

§ 1-440.3. Grounds for attachment.

In those actions in which attachment may be had under the provisions of G.S. 1-440.2, an order of attachment may be issued when the defendant is

(1) A nonresident, or

(2) A foreign corporation, or

(3) A domestic corporation, whose president, vice-president, secretary or treasurer cannot be found in the State after due diligence, or

(4) A resident of the State who, with intent to defraud his creditors or to avoid service of summons,

a. Has departed, or is about to depart, from the State, or

b. Keeps himself concealed therein, or

(5) A person or domestic corporation which, with intent to defraud his or its creditors,

a. Has removed, or is about to remove, property from this State, or

b. Has assigned, disposed of, or secreted, or is about to assign, dispose of, or secrete, property. (1947, c. 693, s. 1.)

§ 1-440.4. Property subject to attachment.

All of a defendant's property within this State which is subject to levy under execution, or which in supplemental proceedings in aid of execution is subject to the satisfaction of a judgment for money, is subject to attachment under the conditions prescribed by this Article. (1947, c. 693, s. 1.)

§ 1-440.6. Time of issuance with reference to summons or service by publication.

(a) The order of attachment may be issued at the time the summons is issued or at any time thereafter.

(b) No order of attachment may be issued in any action after judgment in the principal action is had in the superior court. (1947, c. 693, s. 1; 1967, c. 954, s. 3.)

§ 1-440.7. Time within which service of summons or service by publication must be had.

(a) When an order of attachment is issued before the summons is served.

(1) If personal service within the State is to be had, such personal service must be had within 30 days after the issuance of the order of attachment;

(2) If such personal service within the State is not to be had,

a. Service of the summons outside the State, in the manner provided by Rule 4(j)(9)a or b of the Rules of Civil Procedure, must be had within 30 days after the issuance of the order of attachment, or

b. Service by publication must be commenced not later than the thirty-first day after the issuance of the order of attachment. If publication is commenced, such publication must be completed as provided by Rule 4(j)(9)c of the Rules of Civil Procedure unless the defendant appears in the action or unless personal service is had on him within the State.

(b) Upon failure of compliance with the applicable provisions of subsection (a) of this section, either the clerk or the judge shall, upon the motion of the defendant or any other interested party, make an order dissolving the attachment, and the defendant shall have all the rights that would accrue to him under the provisions of G.S. 1-440.45, the same as if the principal action had been prosecuted to judgment and the defendant had prevailed therein. (1947, c. 693, s. 1; 1967, c. 954, s. 3; 1971, c. 1093, ss. 14, 15.)

Emphasis added.

IV. Conclusion

Key elements of asset protection planning include intent, timing and technique. Timely, well-advised and well-executed estate planning can make for effective asset protection planning. However, cautionary tales abound. To borrow verbiage from the United State Bankruptcy Court for the Central District of Illinois, "The published case law is replete with cases where a transferor cries 'estate planning' when accused of transferring with the intent to hinder, delay or defraud a creditor. Sometimes that defense is successful. Sometimes the defense of estate planning fails. But it is always a factually intense analysis." Such facts may include whether "an experienced estate planning attorney specializing in estate planning would have recommended that the transfers be made, given the assets owned by each spouse prior to the transfers" and as proven by expert opinion testimony. In re Grube, 462 B.R. 663, 665 (Bankr. C.D. Ill. Jan. 19, 2012).