

# Create a barrier between your family and creditors

THESE FOUR STEPS CAN HELP YOU PROTECT ASSETS AND AVOID RISKS [ By **STEVEN PODNOS, MD, MBA, CFP**, and **HARRY A. JONES, JD, CPA** ]

Perhaps no issue related to your financial life is as prominent as that of asset protection. Many physicians regularly subject themselves to the threat of malpractice lawsuits, simply because of the nature of their career.

In addition, doctors' families also are subject to

the same liability concerns as other families, such as automobile accidents, failed business ventures, and divorce. Many times, families with members working in the medical field have a relatively high income and/or significant assets, which makes them attractive targets for plaintiffs.

JEFF SANTIAGA

Although the topic of asset protection is complex and deserves entire volumes of strategies and discussion, this article will attempt to summarize some of the important concepts for you and your family to understand.

## A LAYER OF FENCES

Think of asset protection strategies as a layer of fences between the creditor and your possessions. It is rare that any one strategy is foolproof, and a combination of plans in parallel and in series will provide you with some resilience.

The courts often frown on the very concept of asset protection. Planning structures and concepts that appear to be put in place solely for asset protection also may be viewed as an attempt to defraud the creditor. It is, therefore, a general recommendation that any efforts made to protect assets have other reasons, such as business planning or estate planning, behind their implementation.

It's wise to have specific asset protection planning discussions with an attorney; such discussions falling under the safeguard of attorney-client privilege. Estate-planning specialists tend to have the greatest knowledge on asset protection issues.

Both federal and state legal statutes govern asset protection issues. Your advisers must understand how your particular state (and any states in which you own property) allows you to guard your possessions.

Bankruptcy is a federal process and has its own rules, and federal "super creditors," such as the IRS and the Securities and Exchange Commission, can override state protection of assets under certain circumstances.

Attempting to protect assets after receiving notice of a pending lawsuit (or later on) puts you at risk for a charge of fraudulent conveyance. Such a claim may unwind your efforts after the fact. In some states, however, money can be moved into certain protected structures even after notice of a lawsuit with the possibility of success. An expert opinion is vital in such cases, but the earlier the asset protection effort is taken, the better.

## PROTECTED, UNPROTECTED, AND IN BETWEEN

Some assets are protected by state and/or federal laws, whereas others are not. Let's review which assets fall under both categories.

- **Retirement plans.** In most states, individual retirement plans are protected from lawsuits in state courts. Inherited IRAs are variably protected. The cash value in life

insurance and annuity policies often is protected as well.

- **Homestead.** Each state has variable protection for your homestead. At times, this protection may differ depending on whether you live in an incorporated city.
- **Retirement plans.** Federal law protects most qualified retirement plans, such as 401(k), 403(b), and qualified defined benefit plans.
- **Shared assets.** In many states, all or some types of assets acquired and titled in joint marital name also may be protected from the creditors of only one spouse, but they may be subject to the other risks of divorce or death of the other spouse.
- **Living trusts.** Living trusts do not have any asset protection characteristics. This is the most misunderstood aspect of these otherwise frequently recommended estate-planning vehicles. Living trusts are revocable, that is, they allow assets to be put into and taken out of the trust (most often by the grantor-owner). Accordingly, a court may force you to take assets out of a living trust to satisfy a creditor.
- **Solely owned assets.** Solely owned assets are likely open to creditors. If an irrevocable trust has the beneficiary or the original owner as sole trustee, then it may be vulnerable to creditors. Estate-planning attorneys often add co-trustees to such trusts for this very reason.
- **Mandatory trust distributions.** These distributions are potentially open to creditors. The authors commonly see trusts with mandatory distributions of principal to adult children at certain ages. If the adult child is having marital, business, or accident creditors on the horizon near the time of mandatory distributions, the asset is at risk.

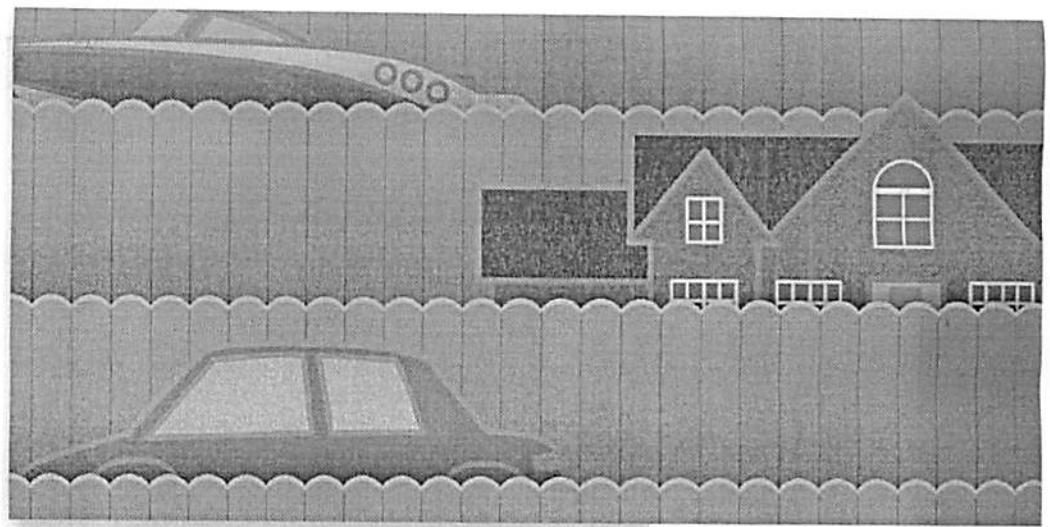
## AN ASSET PROTECTION STANCE

The following is a step-wise approach to taking a proactive asset protection stance, which includes the identification of liability risks, understanding laws, using avoidance measures and protective structures, and adding risk-sharing insurance.

### STEP 1

**Identify liability risks, including malpractice, automobile accidents, business liabilities, divorce, and rental properties.**

The list of potential creditors is large, especially for physicians. Malpractice lawsuits, marital



liability, and automobile accident liability (especially for minor drivers) are the most common source of liability concerns for most of our physician-clients.

Physician families tend to overlook concerns related to owning rental properties and being in a partnership relationship for owning real estate, however. We have seen problems arise in relation to miscellaneous sources of liability, such as recreational vehicles and boats co-owned with friends, as well as the employment of non-bonded laborers to do work at one's home. A session with a good adviser will help you make a list of potential liability concerns.

## STEP 2

### Understand how state and federal laws protect your assets.

Owning assets in certain legal structures may significantly reduce exposure of those assets to creditors. As mentioned previously, some states allow significant protection for homestead property. Both state and federal law afford significant protection for IRA and qualified plan assets in most, but not all, cases.

In other cases, the titling (the way ownership is legally described) of real and personal property may strongly affect its exposure to creditors. As noted previously, in some states, spouses owning various properties in joint marital name, known as "tenants by the entireties" (but not "joint right of survivorship" titling), have specific asset protection against a creditor of only one spouse (including malpractice lawsuits).

Our home state of Florida allows both real property and investment assets this protection. Some other states allow the protection only for real property. Conversely, owning assets solely or in a living trust may expose them to both joint creditors and sole creditors.

A specific concern of those physicians choosing to protect assets by titling jointly or in the sole name of their spouse is what happens if the nonphysician spouse dies prematurely. Various estate-planning structures will serve well to allow benefit of these inherited funds without exposing them to creditors.

Corporate ownership does not usually in itself protect assets, because the creditor may take the corporate shares owned by the doctor. Limited liability companies (LLC) and limited (family) partnerships may offer significant protection for assets depending on the state law and the elements of formation.

Irrevocable trusts most often are created for tax-planning purposes but also may offer very strong asset protection if structured correctly. A physician expecting a substantial inheritance may benefit if that inheritance is designated to an irrevocable trust.

It's important to understand the concepts involved in irrevocable trusts, however, when the trusts are created to benefit the physician's own heirs. For

example, even with an irrevocable trust, it is important to understand that mandatory distributions of assets (often based on attained age of children heirs) and distributions allowed by beneficiary demands give openings to creditors.

Several states currently offer "self-settled" trusts, which are designed to allow one to form an asset protected vehicle for oneself. These are not yet well-tested, however, and they may be susceptible to judgments from other states.

We have seen other methods of "protective structures" that appear unwieldy, unwise, and/or expensive. Some attorneys and advisers promote offshore trusts for asset protection reasons, but we are wary of increasingly aggressive actions by courts seeking to compel repatriation of offshore assets and the many IRS tax-reporting requirements. We also are skeptical of accounts receivable financing with life insurance.

#### POWER POINTS

Attempting to protect assets after getting notice of a pending lawsuit (or later on) puts you at risk for a charge of fraudulent conveyance.

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Irrevocable trusts are most often created for tax-planning purposes, but they also may offer very strong asset protection if structured correctly.

**STEP 3**

**Consider avoidance measures, avoid direct risks, and use protective structures.**

Understand how titling of assets may offer protection or make you open to more liability.

Business liability can be mitigated in part by the use of various structures such as corporations or LLCs. These forms of business structures are useful to at least partially avoid a general partnership liability for physicians working or investing together.

Business risk also can be approached by having well-reviewed contracts. Employees should carefully adhere to guidelines designed to minimize liabilities created by behaviors such as sexual harassment. If you participate on a nonprofit board, the parent organization should provide risk insurance or indemnification.

A variety of behaviors and choices may reduce the risk of medical malpractice claims, which can be reviewed through other sources, including malpractice insurance companies.

By not owning automobiles, boats, and similar vehicles jointly, one often can at least partially avoid accident risk liability. We have seen several parents pulled into lawsuits only because they left their names on an adult child's car title. Spouses should consider owning cars in sole title to avoid joint liability for accidents.

Liability for divorce is a pressing concern, but it is one of the hardest to plan for. You may wish at least to understand the concepts of separate property and the ownership characteristics of property acquired in community property states. Doctors who put their assets into a nonphysician spouse's name to avoid malpractice liability (even in a living trust) expose the assets to joint liability, sole liability of the spouse, and marital liability.

**STEP 4**

**Add risk-sharing insurance.**

Insurance is important to help guard against the small chance of a large loss. It certainly is possible that having more insurance could make you a "target," but chances are, you already are viewed in this fashion. Having a large insurance policy between you and creditors certainly can help you sleep at night.

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When it comes to malpractice insurance, having coverage over minimally required amounts has become too expensive for those in many medical specialties in many states. Protecting your assets in other ways becomes vital.

We almost always recommend that our clients have umbrella liability insurance in large amounts. This insurance picks up where standard automobile and homeowner's coverage ends for liability purposes. It usually is priced at a few hundred dollars per \$1 million in coverage, one of the few remaining bargains in the insurance world. Note, however, that this umbrella coverage will not cover excess malpractice liability.

**GETTING STARTED**

We have discussed a step-based approach toward assessing your asset protection risks and some methods to discuss with legal counsel on increasing your level of comfort. It is important to think proactively about taking on new risks (such as adding child drivers or buying rental properties) and also important to review your existing plans on a regular basis. In our experience, most physician families are able to enjoy life with a reasonable degree of comfort in this area after the plan is in place. ■

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