

Asset Protection for Physicians and High-Risk Business Owners

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CHAPTER ELEVEN

Choosing the Right Plan

Now that you are familiar with the most important asset protection and estate planning concepts how do you create the best plan? Protecting what you have from liability and preserving your estate for your family involves many new concepts for you and it's not always easy deciding where to begin.

In this chapter, we will present a summary of the issues and options available—techniques to think about to frame the building of your overall plan. This is the approach we use with our clients to analyze their particular needs and to build an efficient program for asset protection, estate planning, and tax savings.

Step One: Reduce Your Lawsuit Exposure

You should make sure that you conduct your financial affairs in a manner which will minimize your exposure to lawsuits. There are plenty of real dangers out there which you cannot control. But some of the most troublesome sources of liability can be significantly reduced through sound business planning.

Choose the Right Business Entity

We've seen that a professional practice or the business you own is a Dangerous Asset. Every patient or customer represents a potential liability—threatening whatever savings you have accumulated.

A Limited Liability Company (LLC)—when permitted by state law—is generally the most convenient and flexible format. The LLC avoids many of the tax problems and the maintenance expenses associated with corporations. The law effectively insulates the owners of the company from any liability produced by the business. Personal assets are not subject to the risks of a business operated within the LLC.

In most states, physicians and some other licensed professionals cannot shield themselves from liability with either an LLC or a corporation. In order to protect the family home and savings, an alternative route is needed. If you can't limit your personal exposure to claims, use a strategy such as a Family Limited Partnership (FLP), an LLC, or a trust, which will protect the assets themselves. That way, even though you *can* be sued—it won't be worthwhile for the plaintiff to do so.

A professional practice that cannot be conducted as an LLC should be incorporated. Although the corporation does not offer protection from malpractice claims, it can insulate you from many other types of business risks. When you use a corporation, you are not responsible for corporate obligations unless you have given your personal guarantee. Also, you will be shielded from most types of claims from employees, suppliers, and landlords.

If you have other partners in your professional practice, you can limit your liability for claims arising from *their* negligence by separately incorporating your practice. Your corporation would be a partner with each of the other corporations and you would not be responsible for claims against the others.

Since a corporation is a taxpaying entity, you will have to plan for eliminating a potential double tax on corporate earnings. This can be accomplished by using an S Corporation or by zeroing out corporate income through salaries to officers. To ensure that the corporation will be respected for legal and tax purposes, the corporate formalities of minutes, bylaws, and stock certificates must be observed. All of your dealings with third parties should be conducted in the corporate name, and a separate corporate bank account must be used.

Avoid Business Partnerships

You should never enter into a business partnership with anyone. These types of partnerships can produce huge liabilities for you which are totally unexpected and not your fault. As a co-general partner you are responsible for all partnership debts and any negligent acts of your partners. A business partnership *expands* the scope of your personal liability when you should be trying to limit your risks.

Never Give a Personal Guarantee

Much of the protection which can be accomplished with a corporation will be lost if you give a personal guarantee of a corporate obligation. Many of the problems which we see in our practice are caused directly by needless guarantees for corporate loans and leases for business ventures which were not successful.

We have found, in our practice, that a lender or a lessor will generally not require a personal guarantee if he or she can be persuaded that the business or proposed venture is sound. These days, lenders are anxious to make good loans and lessors want to lease empty space. If you cannot convince them that your company is going to be successful and that they should rely solely on the business for payment, you should not enter into a deal with them.

If you get turned down too many times, perhaps you are not being realistic about your prospects for success. Maybe your business plan is not really as good as you think. If you sign a personal guarantee, you are placing all of your assets at the mercy of a particular business deal and you are undertaking a risk with odds much worse than those offered in most gambling casinos.

Use Multiple Entities

Those who have more than one type of business should use different entities to conduct each facet of the business. The goal is to insulate each separate business from liabilities produced by the other activities.

Physicians operating more than one clinic should never hold ownership in a single entity. Similarly, if you own several real estate properties, use different entities to hold each one. If there is a lawsuit in connection with one of the properties, the others won't be endangered. The same logic would be applied if you owned properties and also performed property management services for others. You would want to separate the management business from the ownership of the properties.

As a general principle, the ownership of Dangerous Assets, those with a high risk of producing liability, should always be separated from Safe Assets, such as cash or securities. These Safe Assets should not be jeopardized by a liability associated with your business or other Dangerous Assets which you own.

For example, a client of ours owned a restaurant and had substantial retirement savings in the bank. If he was sued because of a liability in connection with the restaurant, his retirement savings could be lost. Instead, merely by putting the restaurant in an LLC, we removed the Dangerous Asset from his legal ownership. Then, any lawsuit against the LLC, which owned the business, would not place his other assets at risk.

Step Two: Protect Assets with a Family Limited Partnership

A Family Limited Partnership (FLP) will provide you with four significant advantages that cannot be obtained through any other vehicle.

1. Discourage Lawsuits. Assets that are protected in the Family Limited Partnership cannot be seized by a judgment creditor. It is unlikely that someone will want to sue you if they do not believe that they will be able to collect a judgment.

2. Save Income Taxes. With state and federal combined tax rates of 50 percent, overall family income taxes may be reduced by shifting income to lower bracket family members. This can be accomplished by gifting some limited partnership interests to children or grandchildren who are fourteen years or older. Depending upon the number of beneficiaries and the amounts involved, over a period of years the total savings can be quite substantial.

Aggressive tax planning with the FLP often includes a nonprofit organization as a partner in the FLP. Properly designed, significant tax savings can be generated and overall family wealth can be increased with this structure.

3. Save Estate Taxes. Limited partnership interests, which are transferred by gift to children or other family members, will not be included in your estate for estate tax purposes. A small percentage could be transferred each year which would not be subject to gift tax under the annual exclusion of \$10,000 per donee. Greater value, up the exemption amount, could be transferred for additional savings. The amount of the gift plus appreciation of the underlying assets would escape estate taxes. An estate of \$2 million can grow to \$15 million or \$16 million—invested at 7 percent per year, for someone in their early or late 40s. Potential estate taxes of \$8 million can be avoided—with no inconvenience or loss of control. Under current law, the value of the interests transferred will be discounted in value to account for the lack of marketability and control. Significant estate tax savings can be generated by taking advantage of this technique.

4. Protect Assets. The most valuable feature of the Family Limited Partnership is the ability to protect and shield assets from potential claims. The law is well-established that a creditor of a partner is not permitted to seize assets of the partnership to satisfy the debt. That means that business interests, savings, and investments can be safely insulated from potential liabilities in this manner. The Family Limited Partnership is the proper method for owning and holding valuable assets for anyone who has any possible lawsuit or liability exposure.

Step Three: Use Trusts For Advanced Planning

Trusts can be designed to compliment and enhance the asset protection, estate planning, tax saving, and privacy goals which you have. The following is a summary of a few of the trust options available.

Revocable Living Trust

Property in a trust is not subject to probate fees and delays. Trust assets pass instantly to designated family members. A revocable living trust is a popular format for avoiding probate and carrying out basic estate planning strategies.

Limited Term Trust

Property can be placed in trust for a designated term of years. The support or educational needs of a child or other family member can be satisfied from trust income or principal. Assets can be protected from potential claims during the period of the greatest liability. The property can be returned to you for retirement or other needs at a later period in your life—when you are no longer working and your liability concerns are diminished. One good strategy is to place FLP limited partnership interests in this type of trust.

Life Insurance Trust

Insurance is used to provide adequate funds for family living expenses; cash to meet business liquidity needs and necessary amounts to pay estate taxes—without a loss of accumulated savings. To avoid estate taxes of up to 55 percent on the insurance proceeds, a Life Insurance Trust must be used to hold the policy. Amounts transferred into this plan have the added advantage of building cash value free of income tax and fully protected from any lawsuits or claims against you.

Estate Freeze Trust

Investments that are likely to appreciate in value should be moved into the Estate Freeze Trust. Real estate, stocks, and ownership in a new business venture are often used to fund these trusts. Amounts up to the exemption amount can be transferred without gift tax. This amount plus future increases in value—perhaps millions of dollars—can escape taxation with the proper planning.

Personal Residence Trust

Your largest source of savings may be the equity in your home. A loss would be disastrous from an emotional as well as a financial standpoint. You need to protect your home—but at the same time preserve the tax benefits of the mortgage interest deduction and the ability to avoid gain on the sale. The Personal Residence Trust is an excellent technique for accomplishing asset protection without losing the unique tax advantages of home ownership.

Privacy Trust

Privacy for what you own may be an important issue to you. When others can easily locate your bank accounts and real estate, dangers are created. Lawsuits and claims against you are encouraged when you hold property in an accessible and unprotected form.

A Privacy Trust can be created which will allow you to hold bank and brokerage accounts and real estate without revealing your ownership. You can control the information about yourself which is available to others. The Privacy Trust can be combined with a Family Limited Partnership or LLC to satisfy asset protection as well as privacy concerns.

Asset Protection Trust

The Asset Protection Trust (APT) acts as a safety valve—providing the ability to move funds into an overseas trust account—shielded by favorable asset protection and bank secrecy laws. The APT opens up the world of offshore planning opportunities for sophisticated individuals who are willing to bear some additional expense for the enhanced options which are presented. Because it provides great legal and practical flexibility, the APT is often an important component of a complete estate and asset protection plan.

Step Four: Get Competent Professional Advice

Designing your overall plan and preparing the documents necessary for asset protection, tax efficiency, and estate planning must take place under the guidance and supervision of an attorney who specializes in these matters. A successful strategy involves a careful analysis of your business structure to make sure that potential liabilities are properly controlled with Dangerous and Safe Assets insulated from each other. The operation of your business or professional practice should be evaluated to minimize taxes through specially designed individual strategies. Asset protection and estate planning choices and alternatives should be presented to you and clearly explained so that you can make sound and informed decisions.

Your asset protection plan must be created in advance of any claim or threatened litigation. Every state has laws prohibiting the transfer of assets to avoid paying existing or anticipated claims. If you make a transfer when you know or have reason to believe that there may be a case against you, the other party has the right to set aside the plan. Address your asset protection needs before difficulties arise in order to accomplish the best results.

Although the number of qualified attorneys—experienced in creating a comprehensive plan— has been limited in the past, a growing number throughout the country are developing the necessary expertise. If you need assistance in finding an attorney in your area or would like to discuss your personal situation, please feel free to call our offices at (800) 223-4291.
