Asset protection

by Laura Brockway, ELS

Editor’s note: The information provided in this article is not to be construed as legal advice and should not be relied upon without specific consultation with a professional.

It’s an unpleasant fact to face — asset protection is still a concern for Texas physicians. Though the medical liability reforms of 2003 have succeeded in reducing claims, lowering insurance rates, and bringing more physicians to Texas, the reforms did not eliminate the need for physicians to protect their assets. Physicians are still being sued, and with any lawsuit comes risk to a physician’s personal assets. If a judgment exceeds policy limits or if a cause of action falls under the policy exclusions, a physician’s personal assets or a practice’s accounts receivables may be exposed. Without advanced planning, these hard-earned assets could be lost. The solution — asset protection.

“Just as you encourage patients to take preventive measures to ward off health problems, it is prudent to organize your financial affairs and assets to guard against risks in advance,” says Austin attorney Ken Vanway.

For Fort Worth attorney Marvin Blum, asset protection is one part of the overall financial and estate planning process. “You build a structure to protect assets from being taken by future creditors, especially if disaster strikes and there is a substantial judgment against the physician that exceeds his or her insurance limits,” he says.

Why physicians need asset protection

According to Mr. Blum, medical liability is just one risk physicians face. “Physicians can also be sued for other reasons — if a patient is injured in the office or parking lot, slip-and-fall claims,” Mr. Blum says. “Physicians have a reputation as having deep pockets. They are perceived as wealthy. If one party is perceived as having deep pockets, they are more likely to be sued even if it’s an automobile accident.”

Many physicians believe the threat of an excess judgment or jury verdict was mitigated by the medical liability reforms of 2003. According to Mr. Blum and Mr. Vanway, physicians should still be concerned about asset protection for several reasons.

The 2003 reforms placed caps on non-economic damages only. Economic damages — which can include past and future medical expenses and lost wages — were not capped. “If the plaintiff was a high wage earner, the judgment could be substantial,” says Mr. Vanway.

Additionally, the reforms only affected medical liability claims. Other types of liability claims are not subject to the caps on non-economic damages. Mr. Blum also points out that the protection afforded by the caps could be short-lived. “There is no guarantee these reforms will stick. They continue to be controversial, and it is very likely the legislature will be pressured to either raise the cap or repeal the law,” Mr. Blum says. “It’s important for physicians to have asset protection strategies in place before that happens.”

Vulnerable areas

“When deciding on an asset protection plan, we look at a client’s financial statement to first determine what is protected by statute. What cannot be taken away from you,” says Vanway. These “protected assets” can include:

• The physician’s home, if he or she has lived there longer than 40 months. The Texas Property Code provides that a “homestead” is exempt from the claims of the owner’s creditors, other than valid encumbrances properly fixed on the property. In Texas, this homestead protection was unlimited, with no dollar limit on the value of the property. However, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 placed limits on the unlimited Texas homestead exemption. The unlimited Texas exemption only applies if the homestead has been owned for more than 40 months. If the home has been owned for a shorter period, the homestead exemption is limited to $125,000.

• $30,000 in personal property for a single adult and $60,000 in personal property for a family. The personal property eligible for this exemption includes home furnishings, family heirlooms, vehicles, personal property used in a trade or business, and jewelry (not to exceed 25% of the applicable dollar limitation.)

• Qualified retirement plan benefits and IRAs are generally exempt from creditors. The 2005 Bankruptcy Reform Act limited this exemption to $1 million per individual ($2 million for a husband and wife.) IRAs are only exempt to the extent that the contributions were tax deductible when made.

• Annuities and life insurance — Texas has an unlimited exemption for insurance benefits, employer-provided annuities, and annuity contracts purchased by individuals.

“All other assets — other real estate, brokerage accounts, interest in a practice, bank accounts, notes, are subject to creditors,” says Mr. Vanway.

One particularly vulnerable area for physicians — their accounts receivables, which may represent their largest business asset. “A large accounts receivable balance presents an attractive target to a creditor. It is relatively easy for a creditor to collect a judgment because the court can appoint a receiver to open the mail and take the payments made on the accounts receivable balance until the judgment is satisfied,” says Mr. Blum.

“In a multi-physician practice, if any one physician has a judgment against him or her, all of the practice’s accounts receivables are exposed because they are an asset of the practice,” says Mr.
Vanway. This applies even for a judgment against a physician who is no longer with the group.

Accounts receivables are susceptible even if the physician practice operates with an entity that limits liability. “If the doctor is the sole owner of his entity, the creditor can get a judgment against the entity too, which gives the creditor access to the accounts receivable,” says Mr. Blum. “Also, if the doctor operates as a sole proprietor and owns the accounts receivable personally, then a creditor who has a judgment against the doctor can take the doctor’s accounts receivable.”

Physicians who are married and hold their assets as community property should be aware that 100 percent of community property is vulnerable in a claim against either spouse. “Many physicians believe that only their half of the community property can be taken. But a creditor can take 100 percent of the property, wiping out both the physician and the spouse,” says Mr. Blum. (Texas is one of 10 states that follow the community property system, meaning that property acquired by spouses during a marriage is viewed as one total “community” of property.)

**Strategies**

Fortunately, a number of strategies can be employed to protect a physician’s vulnerable assets.

“The process can go from simple to very complex. I usually lay out the continuum to clients, and they pick how far we go by what it takes for them to sleep well at night,” says Mr. Blum.

An example of one simple strategy is partition planning which can be used to protect community property. “With partition planning, the husband and wife agree to partition community property into separate halves. This is a simple document that protects the separate property of the innocent spouse from exposure to claims against the other spouse,” says Mr. Blum.

Physicians can also take advantage of state law exemptions and pay off their home mortgage, if they have owned the home longer than 40 months. Another option is to put money in qualified retirement plans, though the protection is limited to $1 million per individual. Physicians can also purchase life insurance or annuity products, which are exempt from creditors’ claims.

Physicians can also set up trusts for children or grandchildren. “By setting up trusts, physicians can gift assets into them and get them off their balance sheet,” says Mr. Vanway.

**Asset protection tips**

**How to find an attorney**

Both Mr. Vanway and Mr. Blum recommend that physicians employ an attorney who is Board Certified in Estate Planning and Probate Law and who has extensive experience in this area of law. “Physicians should look for a board certified attorney with good references and 10 or more years of experience in asset protection,” says Mr. Vanway.

**Time involved**

According to Mr. Blum, the time involved in setting up a plan depends on the complexity of that plan. For the simplest plans, it is a 3-meeting process with the attorney. At the first meeting, which would last about two hours, the physician and attorney discuss the physician’s assets and financial situation. The attorney would then analyze this information and make recommendations. These recommendations would be reviewed at a second meeting, which would take about one hour. The attorney then begins to implement the recommendations, and there is a third meeting to review and sign documents. This meeting may take about two hours. For more complicated plans, it could take several meetings.

To prepare for the initial meeting, the physician needs to bring a list of his or her assets. The physician’s CPA or financial planner can help collect this information.

**Cost**

How much an asset protection plan will cost also varies with the complexity of the plan. Mr. Blum estimates the cost for partition planning and using state law exemptions to be $2,000. The cost to create trusts could be $3,000. The cost to create an FLP and implement a complex plan could range from $5,000 to $10,000. According to Mr. Vanway, the investment in an asset protection plan is generally a one-time expenditure and will be fully or partially income tax deductible.

“The cost is very individualized and clearly this is a situation where you get what you pay for,” says Mr. Blum.
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One strategy along the middle of the complexity spectrum includes creating a Family Limited Partnership. “One way to protect personal assets is to create a Family Limited Partnership [FLP] and transfer title of those assets to that entity. If there is a judgment against the physician, the assets in this entity cannot be touched,” says Mr. Vanway.

Under an FLP, a creditor holding a claim against a physician has limited rights to satisfy that claim with respect to the partnership interest held by that person. “Creditors can end up waiting and waiting for years. This tends to make creditors frustrated and inclined to settle for less than the judgment amount,” says Mr. Blum. “It also makes the personal injury attorney less likely to take the case because it is more difficult for them to recover their fees and expenses.”

To protect accounts receivables, Mr. Blum implements a strategic medical account receivable transfer or SMART plan. “For this, you borrow funds from a bank and then use the proceeds to purchase an asset that is exempt from creditor claims, such as an annuity. The receivables are pledged as collateral for the loan and cannot be reached by creditors,” Mr. Blum says.

Successful asset protection

According to both Mr. Blum and Mr. Vanway, the key to successful asset protection is to do it early. It is very difficult to protect assets against existing claims, but it is relatively easy to protect assets against future claims. “Procrastination closes the door on all these strategies,” says Mr. Vanway. “Once you have knowledge that a lawsuit or judgment is pending, it is considered fraud to transfer the assets after a suit has been filed.”

Additionally, physicians should understand that the process is very individualized and how complex or simple a plan will be depends on the physician’s individual circumstances. However, when asked if physicians could implement only one asset protection strategy, what should it be, both Mr. Blum and Mr. Vanway said creating a Family Limited Partnership.

Physicians may be hesitant to begin an asset protection plan for a number of reasons including a lack of understanding of the process or a lack of time. “I think there is always a mentality that it will never happen to me. But statistics show that over a physician’s career, the odds are very high that he or she will lose sleep over a potential claim,” says Mr. Blum. “When a claim arises and you have this in place, you know it will not wipe you out.”

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