Experts Suggest Asset Protection Methods

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One problem with developing an asset protection plan is it can be difficult to know which assets need protection when no threats are looming, experts say. That's why the best time for ophthalmologists to develop an asset protection plan is when no threats are pending, such as a malpractice lawsuit, divorce, or creditor pressing for a large amount owed.

If an ophthalmologist comes to Robert L. Bolick, an asset protection attorney in Las Vegas, when assets are threatened, "I tell them it's too late," he says. Even when a malpractice lawsuit is just a remote possibility, a court may view a transfer of assets as fraudulent and thus could make them available for creditors.

A Variety of Instruments

In other words, the only time to develop such a plan is when a practice is not under a threat.

At this time, the ophthalmologist will need to meet with an asset protection adviser and discuss what could happen and what protections are available.

The work involves establishing walls around vulnerable assets using a variety of instruments, ranging from simple insurance to complex offshore trusts. None of these walls is impermeable but, taken together, they can either block a legal strategy or be so frustrating that the creditors will give up.

Creditors seek the easy money first, says Stewart H. Welch III, founder of The Welch Group, a wealth management company in Birmingham, Alabama. Therefore, the goal is to make assets difficult to obtain. "The money needs to be readily available because the attorney needs to get his contingency fee," Welch says. "If you make it a maze that he has to weave his way through, he may decide it's not worth his time."

Causes of Action

Ophthalmologists, especially those who perform LASIK surgery, often worry about malpractice judgments that exceed coverage limits. Still, the specialty has a lower risk of being sued than ob-gyns and neurosurgeons. Also, attorneys report that almost all malpractice suits are settled for amounts within the policy limits.

But Welch advises clients that they should not become complacent, saying, "You can no longer assume that whatever your malpractice limits, the judgment won't exceed them."

Others, such as attorneys Jay Adkisson and Chris Riser, writing on their Web site, (at www.assetprotectionbook.com), observe that physicians are more likely to lose their personal wealth through bad marriages, bad investments, bad tax planning, or a combination of these factors.

Edward R. Collins, president of Collins Wealth Management in Parsippany, N.J., says bad investments are common. An ophthalmologist could take out a mortgage to purchase an office building, for example. If the physicians were unable to repay the debt, the creditor could make a claim against that physician's other assets if the ophthalmologist is not properly protected, Collins explains.

Choosing a Planner

As litigation has become more common, demand for asset protection has grown over the past 15 years. "Unfortunately, we live in an extremely litigious society, and an experienced attorney will often seek out the deep pockets when it comes to the filing of a lawsuit," Collins says. Recognizing the need, lawyers, certified public accountants, certified financial planners, and others have made asset protection a specialty.

"An asset protection planner acts as the quarterback," explains Welch. "He creates an overall strategy and brings in experts for various pieces of it: attorney, accountant, life insurance agent, property and casualty insurance agent, and possibly a banker if money has to be borrowed."

John J. Grande, principal at Grande Financial Services in Oakhurst, N.J., advises that an asset protection plan must be made for legitimate business purposes or to accomplish legitimate estate planning objectives. "These objectives should be carefully documented," he says.

Rather than using one single form of asset protection, experts recommend several different layers. The most basic layer of asset protection is insurance, such as coverage against malpractice claims and disability, and coverage for property, life, medical, and long-term care for the ophthalmologist. The practice also should have employment practices liability insurance, which would cover claims for wrongful firing, age discrimination, and harassment, advisers say.

One way to improve existing liability coverage is to purchase umbrella insurance, which adds $1 million to $5 million in extra coverage. But Collins says claims from so-called former friends, such as disgruntled former employees, former business partners, and an ex-spouse, can be particularly difficult to cover. These plaintiffs are the most common litigants and it is difficult to offset such risk to an insurance company, Collins explains. Therefore, other layers of protection are needed.

Statutory Protection

One such layer of protection comes in the form of federal and state laws. Such statutory protections can cover one's home, wages, certain personal property, motor vehicles, retirement plans, prepaid college tuition plans, the cash value of life insurance benefits, and proceeds from life insurance policies and annuities, Grande says.

Home protections vary widely by state. In Florida, Iowa, Kansas, South Dakota, and Texas, the entire value of a debtor's home is exempt. But other states exempt only $10,000 to $50,000 worth of equity.

A family home is usually safe, says Welch. "It takes an awful lot of work to go after a physician's home," he adds. Also, few litigants seek to throw a homeowner out of his own residence. But to be safe, Welch suggests mortgaging the home heavily to make it unattractive. He also suggests putting a home into a qualified personal residence trust (QPRT), which has the added value of reducing estate taxes. In a QPRT, the trust owns the house. After a certain number of years, the deed is transferred to the holder's heirs and the holder pays rent to the heirs.

Meanwhile, federal law protects retirement plans such as qualified retirement plans, 401(k), defined-benefit, defined-contribution, profit-sharing, or Keogh plans. And 45 states protect individual retirement accounts (IRAs) and 35 states protect Roth IRAs.

Transferring Assets

Asset transfers, such as those involving a QPRT, are common in asset protection plans. Often, a physician will transfer assets to a spouse or legal entity. Bolick advises against spousal transfers, however. A court may pierce this protection if the spouse works in the practice or many assets have been transferred at once. Also, the couple loses one estate-tax exemption if all the money is under one person's name. The spouse holding the asset is at risk, and, in a divorce, could take the money.

To prevent one spouse from leaving with all assets in a divorce, Grande advises that couples agree in writing to a division of assets.

Another kind of asset transfer involves securing the practice's accounts receivable as collateral for a loan. Accounts receivable are prized in many malpractice suits. But plaintiffs' attorneys may not be interested in unwinding the debt if it is encumbered by a loan.

LLCs and Partnerships

One of the most effective asset protection strategies involves establishing a limited liability company or LLC. An LLC combines a corporation's limited liability for business debts with a partnership's tax efficiencies and operational flexibility. In theory, a creditor could access an LLC's assets by obtaining a charging order from a court, entitling the creditor to any income paid out to LLC members. In reality, the managing member can simply stop making payments until the creditor goes away.

The costs of an LLC range from $1,500 to $2,000, plus initial filing fees and costs of $400 in some states, Bolick says. Also, there is an annual fee to maintain the entity, he adds.

In addition, a limited liability partnership, a cousin of the LLC, can be established for the medical group to insulate each ophthalmologist against the other's liabilities. An ophthalmology group also could create a separate LLC to protect valuable equipment, such as laser-vision machines.

LLCs should hold risky assets, such as rental property, because LLCs protect members from claims against the LLC, Bolick says. Physicians should put safe assets, such as stocks and mutual funds, into another instrument, such as a family limited partnership (FLP), he adds. While the FLP can effectively protect these assets, it cannot protect the managing member against lawsuits arising from risky assets, he says. Costs to create an FLP are about the same or somewhat higher than those of an LLC, he adds.

"Assets held in an FLP are beyond the reach of creditors," Bolick says. "No creditor can attach your assets, force you to distribute your assets or dissolve your FLP."

Offshore Trusts

The most controversial layer of asset protection is the trust, financial advisers say. Traditional third-party trusts have limited usefulness. When designating assets to an heir, these trusts allow a physician to unload money without making it subject to estate taxes when the physician dies, Collins says.

But to protect these assets from creditors, the donor must give them away irrevocably.

In the 1980s, however, a new kind of trust emerged called the first-party or self-settled trust, in which the donor can name himself or herself as the beneficiary. The trustee has wide latitude to pay as much or as little of the trust assets to the beneficiary. But since this mechanism contradicts the basic concept of a trust (meaning, the trustee gives up control of assets) they are controversial.

One form of self-settled trust, the offshore trust, is legal in certain countries such as the Cook Islands, the Cayman Islands, and the Isle of Man. It is expensive and time-consuming for creditors to reach these assets. They must enter a claim in that country's courts; engage a local attorney, who typically must be paid up front; and pay a surety fee, which will be kept if the creditor loses the lawsuit.

U.S. courts have broken offshore trusts simply by jailing the trustees until they agree to return assets to the United States. Despite these considerations, foreign trusts still can be effective, especially when the trust is moved from one nation to another, one step ahead of a creditor, Welch says.

Offshore trusts can cost as much as $20,000 to $30,000 in legal work to establish, however. One rule of thumb is that there should be at least $500,000 in liquid assets (including stocks, bonds, or mutual funds) to make them worthwhile. And since some offshore deals are scams, physicians should investigate them thoroughly.

Domestic Asset Protection

In the late 1990s, as legal holes in offshore trusts became apparent, some states created domestic asset protection trusts. These trusts are legal in Alaska, Delaware, Nevada, Rhode Island, and Utah. Only a few creditors, such as the Internal Revenue Service or a spouse seeking child support, can reach the assets in these trusts.

There is a waiting period of two to three years before the trust is operable, Bolick says. "Although these mechanisms have been around for six or seven years, there have not been any court decisions on them yet," he adds. Still, he does not rule out their use.

Welch is less positive. "The idea behind domestic asset protection trusts is that the creditor has to sue in the state where the trust is located and it's extremely difficult to get to the money," he says. "But there is a big question about what protection they give you if you don't live in one of those states."

No strategy is foolproof, says Collins. “The goal of a good asset protection plan is to discourage a creditor or litigant from taking the time and making the expense of pursuing repayment or litigating a claim,” he says. “But if a creditor or litigant is determined to spend the time and money, he or she might work around any obstacles you put in the way.”

—Reported and written by Leigh Page, in Chicago.

Many Types of Asset Protection
Asset protection advisers have a number of strategies to use. Here are some of the most common:

• Malpractice insurance: Court orders rarely exceed the $1 million, $3 million limit.
• Employment practices liability insurance: This policy covers claims filed by disgruntled employees.
•Umbrella insurance: Adds $1 million to $5 million to liability coverage.
• Encumber accounts receivable: Physicians can use accounts receivable as collateral for a loan.
• Homestead exemption: Shields all or part of home equity, depending on the state.
• Retirement accounts: Protection for 401(k), defined-benefit plans, and IRAs in most states.
• Assign assets to spouse: Common practice, but comes with risks.
• Limited Liability Company: It is difficult for creditors to reach one’s assets in an LLC.
• Family limited partnership: Similar to an LLC but for family only; good for safe assets.
• Irrevocable trust: It is shielded from creditors, but grantor totally cedes control of assets.
• Offshore trust: Protected under foreign law, but U.S. courts can jail trustees.
• Domestic asset protection trust: Protects assets in certain states, but legally untested.

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