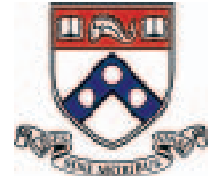
Asset Protection Strategies for Orthopedic Surgeons



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Surgeons have been and will continue to be the target of lawsuits. As a practicing physician, you have probably implemented significant levels of malpractice insurance, first because it is required by law to practice, and second because it helps to combat the negative outcomes of a possible judgment. But protecting what you have accumulated and built—and what you will continue to accumulate and build—may not be completely covered by malpractice coverage. There are also other areas of your lives that may expose your assets and future lifestyle to compromise. Examples include a failed business venture, a child involved in an accident driving a car you own, a suit filed by an employee or employees regarding an incident in the workplace, a person injured on your property (personal or business), and even divorce. Additionally, not all claims of your practice may be covered under your malpractice insurance.

The U.S. Department of Justice stated that: (1) approximately half of all medical malpractice lawsuits are filed against surgeons, even though surgeons represent just 14% of all practicing physicians[1;] and (2) surgeons are perceived by plaintiffs' attorneys as desirable litigation targets as they earn, on average, twice as much as a general practitioner[1]. To that end, many surgeons implement other strategies to help protect against threats of creditors and potential lawsuits. The overall name we can give to any strategy of protecting wealth is "Asset Protection Planning."

A properly coordinated asset protection plan can include many things. At the core of the dozens of structures and methods employed usually lies any one or more of three common themes: (1) transferring assets out of your individual name; (2) utilizing available creditor protected vehicles that are given statutory protection; and (3) using commercial or private insurance. Asset protection essentially involves the structuring of assets to make it impossible, or at least very difficult, for claimants to reach the assets of a defendant. Many well drafted plans can even halt the suit itself if the plan becomes aware to the potential plaintiff. If the assets you wish to protect are shielded well, then a potential claimant may wish to either settle the case on terms that are favorable to you or even not pursue the litigation.

The timing of the planning is important. While it is always possible to engage in asset protection planning after a claim or lawsuit has been filed, it is best to implement an asset protection plan while the waters are calm. Below I'll describe four asset protection strategies that practitioners are using today with surgeons and other clients.

Consider Establishing a Limited Liability Corporation (LLC) As Part of Your Business Planning

An LLC is a business entity formed by at least two "members" (some states allow one member LLC's). The members file articles of organization in the states where they do business and then contribute capital to begin running the business. The LLC offers the owners (members) limited liability like a C-Corporation combined with tax and management advantages that partnerships generally have. LLC's shield members from the liability of the debts incurred by the business. An LLC also allows the members to enjoy the ability to allocate earnings among the members and to avoid the restrictive requirements of S-corporation operations. As the name implies, an LLC structure simply attempts to limit the liability of the owners (members.) A well structured LLC is a separate legal entity that is distinct from the members themselves. But acting as managing members of an LLC, you have the freedom and authority to direct the LLC and to run and manage the LLC. For example, an LLC may enter into leases, borrow money, and purchase goods and services. When transacting business under the LLC, the individual generally is not personally liable for actions against the company. Separating the individual from the business can allow you to protect assets without giving up professional control. If you were to be sued successfully, then the liability of you as an LLC member is typically limited to the contributions you made to the LLC.

Additionally, some practitioners advise clients to form separate LLC's to manage other types of assets such as vacation homes, boats, intellectual property, and real estate investments. This is a very specific area of law and competent counsel needs to be utilized. But when done properly, similar protection may be able to be provided.

Finally, it is also possible to form an LLC to provide a separate corporate structure to handle specific areas of your practice that you may have previously lumped into your general practice. By managing certain activities under a separate LLC, a possible outcome might be that tax and other benefits may become available to you that would not be available otherwise. For example, you may supplement you income from sources such as expert testimony, consulting, research, and speaking engagements. By providing those services under an LLC (which is controlled by the surgeon), the LLC might be able to establish a retirement plan and/or other benefit plans that may be deductible to the corporation. Furthermore, the LLC allows losses of an entity to flow directly to the owner, thus creating a potential deduction against ordinary income.

Qualified retirement plans, IRA's, and permanent life insurance.

Qualified retirement plans, IRA's, and life insurance contracts offer varying degrees of protection from bankruptcy and creditors. Retirement plans that are "Qualified" under Section 401 of the Internal Revenue Code and that also cover at least

one rank-and-file employee should also benefit from the "anti-alienation" provisions of Title I of a Federal law known as ERISA. These ERISA-protected plans cannot be assigned or pledged to anyone other than a divorcing spouse, dependent children, and possibly the IRS (if applicable.) What this really means is that ERISA-protected qualified plans offer some of the highest statutory protection against bankruptcy, lawsuits, and judgment creditors. Most practitioners feel a properly administered ERISA-protected qualified plan offers a virtual bullet-proof asset protection vehicle, inside or outside of bankruptcy.

Individual Retirement Arrangements (IRA's) enjoy different levels of protection than ERISA plans. That level of protection is dependent on the specific type of IRA, the nature of the creditor (bankruptcy or not) and the state of jurisdiction. The general security provided to IRA's has increased due to federal legislation passed in 2005. Note that creditor protection for IRA's is generally only provided in bankruptcy, but the type of IRA created will also impact its protection. Section 224(e) of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) provides for a $1million inflation adjusted cap in bankruptcy cases for traditional and Roth IRA's. The BAPCPA also provides for an unlimited exemption for eligible rollover IRA accounts such as PS Plans, 401k and 403b plans, and Defined Benefit Plans. So many commentators feel, as do I, that all roll-over assets should be kept segregated in their own IRA's and be kept distinct from any contributory IRA's.

Cash value life insurance is a financial product that may offer significant levels of creditor protection, as well. The keys are the state of residence of the debtor, and the relationship among the policy owner, insured, and beneficiary. All states offer some form of statutory protection of the "proceeds" of a life insurance policy tool that can be used to shield assets from creditors. In many states, death benefits from life insurance, as well as the cash value of a life insurance policy, are exempt from the claims of creditors. The insurance death proceeds are also statutorily exempted from creditors if paid to the spouse, children, or certain other designated beneficiaries.

Umbrella Coverages—A Deeper Look at Your Property & Casualty Insurance

An important yet often overlooked asset protection strategy is the utilization of available commercial insurance products. In particular, an umbrella policy (aka "excess policy") is one of those products that are often overlooked. An umbrella policy provides protection above the general limits of your underlying property and casualty insurance policies. Generally, umbrella policies add excess coverage on top of policies like home, car, boat, motorcycle, commercial property, and other physical property insurance.

Umbrella policies may provide coverage for damages caused by you, your dependents, or even your pets. It may also protect you from claims arising from others while on your property. Working with a competent P&C agent, you can ensure there are also no gaps between the underlying policies and the umbrella policy. This is important because umbrella policies generally don't kick in until a certain dollar amount of claim has been paid to a claimant. For example, an excess auto policy may provide coverage only if damages are above, say, $500,000. If the underlying base policy provides a maximum of $300,000 then there might be a $200,000 gap that you would be responsible for prior to the umbrella policy kicking in. It is critical to make sure the underlying policy and the umbrella policy are coordinated.

An umbrella policy can also offer more than just higher limits. Some policies provide greater liability protection in the event of a lawsuit. Umbrella policies are often designed to protect you not only from property damage caused under your control or ownership, but also for personal injury liability – caused either by you or caused as a result of events under your control or ownership. Additionally, an umbrella policy may also pay for more than just the physical damages and liability. Many umbrella policies also pay for legal fees and defense costs associated with defending yourself in larger judgments.

Finally, a rule of thumb used by many P&C agents in the area of umbrella coverage relates to the amount of coverage. Many agents recommend carrying amounts at least equal to your current net worth. Policies typically come in increments of $1million and are priced relatively inexpensively.

Foreign Trusts as Asset Protection Vehicles

A trust is simply an entity created by a person or persons for the benefit of others. (Note that there are also "self-settled" trusts that are for the benefit of the persons who created them.) Many trusts have provisions that prevent creditors from reaching trust assets. If the trust is established domestically, it is often referred to as a "domestic asset protection trust." If created outside the United States it is often referred to as an "offshore" or "foreign" trust. Foreign trusts used for asset protection purposes are generally irrevocable trusts that are governed by the laws of a foreign country. This area is contentious among commentators but should not be ruled out after discussing this with your counsel.

In the best foreign countries, the laws are not favorable to U.S. creditors. Also, the cost of pursuing the assets may be increased due to technical, legal, and other issues relating to the processes of the foreign country. Foreign trusts can provide several obstacles to deter or eliminate potential creditors: First, a foreign country might not recognize a legal judgment from any other country, including the United States. If a judgment obtained against a U.S. doctor is reached, it may prove difficult for the claimants to seize assets held in a foreign trust. Next, several countries may require a plaintiff's attorney to be licensed to practice law in that foreign country. If not, local counsel may need to be retained. Third, the selection of trustee is critical. Countries often used for foreign trusts (like Nevis, the Cook Islands, Belize, Turks & Caicos, e.g.) typically have trust companies domiciled in the respective countries, and these countries cater to this type of foreign business. Choosing an independent foreign trustee is often advised by experts in this area of planning. It may prove to be an advisable choice to demonstrate the removal of your control of the assets as perceived by claimants.

Assets transferred to a foreign trust include liquid investments such as investment accounts, but can also include intellectual property and other intangibles. Most foreign

trusts are established with the input of a complex legal team, but in the right situations they may offer additional layers of protection not obtainable domestically. Foreign trust planning is perfectly legal, and it may offer tax neutrality and effectiveness in protecting assets from lawsuits and judgment creditors.

References

1. U.S. Department of Justice, Bureau of Justice Statistics, Medical Malpractice Trials and Verdicts in Large Counties, 2001.

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