

Protecting Your Assets From Malpractice Claims

Three mechanisms can prevent malpractice creditors from seizing your assets.

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All signs indicate that the prevalence of litigation against physicians for malpractice is in a continuing upward spiral across the US. Although some malpractice claims are meritorious, far too many are not. In such an atmosphere, even the most skilled and diligent physicians are subject to an unacceptable level of risk. Aggravating this problem for physicians is the fact that even in those instances in which liability for malpractice might be clear, the extent of the injury (and the dollar amount of the damages) often remains subjective and can therefore be grossly inflated by an overzealous judge or jury.

Thankfully, the old adage that to be forewarned is to be forearmed still rings true, at least for those physicians who take heed before the onset of litigation. This article will demonstrate specific steps physicians can take to safeguard assets from future malpractice (and other) claims. Moreover, these steps can supplement and in some instances even replace professional liability insurance. Such steps are often referred to under the umbrella term *asset protection planning*.

TRANSFERS TO OTHERS

One of the most basic techniques used in asset protection planning is simply transferring assets to one's spouse or to (or in trust for) one's children or other family members. Although generally protective, such transfers involve surrendering (1) all rights to control the transferred assets, and (2) any certainty that the transferor can continue to enjoy the benefits of the transferred assets. Transferring assets to one's spouse also subjects the owner to the possibility of losing assets as a result of divorce. Additionally, such transfers (for

less-than-adequate consideration) have sometimes been held to be subject to attachment by the transferor's creditors where the transferor earned most or all of the family's income. Using a legal fiction known as a *constructive trust*, the courts have sometimes held that the transferee spouse is merely holding the property as a trustee for the benefit of the transferor spouse, thus permitting a creditor to attach

the transferred assets. Finally, to the extent that the transfer is later deemed a *fraudulent conveyance*, the transfer will be unwound by the courts and the transferred property will be paid over to the transferor's creditors.

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Other traditional planning techniques include the use of the homestead exemption, the use of exemptions for life insurance and annuities, and holding property with one's spouse as tenants by the entireties. Each of these techniques, however, is limited in its protectiveness and varies from state to state; the details are beyond the scope of this article.

LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES

Transferring assets to a limited partnership or limited liability company is another fairly common asset protection technique. Under this technique, the owner of the property contributes it to a limited partnership in which he or she is the general partner, wherein other family members (including the transferor) are named as limited partners. As the general partner, the transferor retains control over the assets in a fiduciary capacity for the benefit of all of the partners. At the same time, the assets are generally secure from the claims of the creditors of any individual partner because the assets are owned by the entity, rather than by the individual partner. Under what is known as the *charging order protection*, a creditor of a limited partner is generally only entitled to attach the interest of the limited partner in

the partnership, and thereby receives distributions only if and when distributions are made. Of course, if the general partner of the limited partnership is a family member, he or she is unlikely to make any such distributions until after the debtor partner has successfully settled the creditor's claim, which itself provides the debtor partner with the necessary leverage to do so.

In addition to the asset protection benefits that a limited partnership can provide, it can also prove beneficial for more traditional estate planning purposes such as saving estate and gift taxes. For example, if a parent is the general partner and transfers a limited partner's interest in a limited partnership to his or her children, the value of the transferred interest will likely be entitled to a discount from the value of the underlying assets of the entity because the transferred interest is (1) noncontrolling and (2) has no public market. Moreover, because the parent, as general partner, retains total management control over the assets held within the entity (albeit in a fiduciary capacity for the benefit of all the partners), the oft-cited fear of a child obtaining access to substantial sums of money immediately upon attaining majority (as would be the case with a Uniform Gifts to Minors Account or a Uniform Transfers to Minors Account), is not an issue.

THE OFFSHORE ASSET PROTECTION TRUST

Where the liability risk warrants additional protection (at additional cost and complexity), and where the physician desires to retain an interest in the property, the partnership technique can be married to an offshore asset protection trust. As implied by its name, such a trust takes advantage of the law of certain select foreign jurisdictions. These jurisdictions have enacted legislation aimed at attracting trust business by protecting the trust fund from creditor claims, even where the person who established the trust is also a beneficiary thereof. The trust must generally be established offshore because the law of most of the US posits that where a person establishes a domestic trust, and is also a beneficiary of that trust, the trust fund is available to that person's creditors to the full extent of his or her beneficial interest. This principle of domestic trust law holds true even where the trust was established at a time when no creditors existed and even if the future potential for such creditors was wholly unforeseeable at that time. Although four states have enacted legislation enabling such creditor protection for self-settled trusts, significant

uncertainty remains as to their effectiveness.

Interestingly, the term *offshore trust* is somewhat of a misnomer in this context. Although an asset protection trust must provide that it is to be governed by the law of an offshore jurisdiction in order to receive the benefits of the asset protection trust, the assets of the trust can actually remain in the US. To avoid losing control over the property, the trust can be combined with a limited partnership wherein the physician is the general partner retaining a 1% interest and the trust receives a 99% limited part-

nership interest. If the trust only holds a limited partner's interest in the limited partnership, the trustee has no "day-to-day" authority over the transferred assets in any event. Instead, the general partner maintains control

over the partnership investments until such time that an actual transfer of the partnership's assets offshore may be warranted due to a more imminent threat.

THE PROBLEM OF FRAUDULENT CONVEYANCES

The transfer of assets in anticipation of a creditor problem might be deemed a fraudulent conveyance under the law of most states. Accordingly, asset protection planning must be sensitive to avoid circumstances in which the transfer of property appears to have occurred with the intent to hinder, delay, or defraud creditors. Certainly, no transfers can be made that would have the effect (after consideration is given to any pending or threatened litigation) of rendering the transferor insolvent. Under all other circumstances, the issue boils down to how little time elapsed between the time of the transfer and the time of the subsequent creditor's claim. It is therefore imperative that asset protection planning is undertaken as far in advance of a potential creditor claim as possible—physicians should ideally structure their affairs for asset protection before the patient who ultimately becomes a plaintiff ever walks through their office door. Given proper planning, asset protection can be an achievable goal. ■

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