

SHIELDING YOUR HOME FROM POTENTIAL LIABILITY



This is one asset you want to protect. Here's how.

BY DAVID B. MANDELL, JD, MBA

In working with physicians as an attorney and wealth manager for more than 25 years, I understand that, for many doctors, the family home is often at the top of the list of assets they would like to protect. This real estate may be one of the most valuable assets on a doctor's balance sheet—and it nearly always has an emotional value for the physician.

In this article, I discuss several risks that can create potential liability threats to a physician's home and home equity; I also offer strategies and tools you can use to protect your most valuable asset.

SHIELD FROM OUTSIDE RISKS

Outside risks to the home are potential claims against the retina specialist (or their spouse) for any reason. These types of risks, which are typically more common and top-of-mind for physicians, include potential claims for medical malpractice, automobile accidents, and contractual liability or claims arising from personal guarantees, to name a few. Physicians have several tools that can help shield the home and its equity from these types of potential claims, including the following:

State Homestead Law

Every state has some type of homestead protection law that stipulates that some amount of home equity is exempt from lawsuits and creditor claims. In a few states, homestead laws protect an unlimited value, although there may be some geographic limitations. In Texas and Florida, for example, doctors need only to confirm that their home qualifies, and their home equity is fully protected.

However, in most states, including Illinois, New York, and California, the value protected by the homestead rules is very low compared with the actual worth of the real estate. On average, state homestead laws protect less than \$100,000 of equity—typically much less than the value of most physicians' homes. In those states, physicians should explore additional protection options.

Tenancy by the Entirety

Often described as a *quasi-exempt* asset class, tenancy by the entirety (TBE) is a form of joint ownership for married couples that is available in several states. In essence, in the states that protect real estate through TBE, the home will not be subject to any claims *against one spouse*. This can be quite valuable to a married couple when one spouse has significant exposure (ie, physicians) and the other does not. Inherent in TBE, however, are some limitations, including providing no protection for joint risks.

Trusts

There are many types of trusts that can be extremely valuable in asset protection planning. When shielding a home, the two most popular are a domestic asset protection trust (DAPT) in states that allow them and a qualified personal residence trust (QPRT) in all states.

About 20 states, including Ohio, Connecticut, and Nevada, have adopted DAPT legislation. In these states, a physician can set up an irrevocable trust and be a beneficiary of the trust. When there is no lawsuit concern, you can access the trust assets as the beneficiary, but if you have lawsuit claimants pursuing the trust assets, the trust can be written so that the trustee—who must be independent (ie, not a family member) in most states that allow DAPTs—cannot make distributions to you, as you are *under duress*. Because there are no distributions, a DAPT can protect the home extremely well. Additionally, the DAPT can be set up as a grantor trust, which means the trust, for tax purposes, is treated as if it were owned by the doctor.

A QPRT can be created in all states. While the primary purpose of the QPRT is to remove the property from the taxable estate of the trust creator, or grantor, it has the side effect of protecting the property from the grantor's creditors. This trust is strong medicine, however, as the home is no longer owned by the grantor; it has been given away, irrevocably, to the trust and beneficiaries—typically, children or grandchildren.

For these reasons, physicians must use experienced legal advisors when implementing both DAPTs and QPRTs.

Debt Shields

In states where homestead, TBE, and trusts are not viable options, a debt shield can be an effective way to shield the equity of a home. Essentially, a debt shield is a loan against the equity in the home. For many homeowners, this is counterintuitive, because they want to pay down the mortgage as much as possible.

In some cases, using a debt shield does not require a new loan on the home. Rather, it may mean implementing a strategy of not paying the mortgage down more quickly than is required. The decision on whether (or to what extent) to pay down an existing mortgage can be examined from the asset protection perspective (could the funds be invested in another, better-protected, asset?) and the wealth accumulation perspective (could the funds be invested in another, better-performing, asset?). You can use this same analysis when getting a new loan as a debt shield.

From an asset protection perspective, the homeowner can simply use the debt shield to move the equity from the vulnerable asset (the home) to a better-protected asset. From an economic perspective, the decision process is to consider whether the cost of the equity move (ie, the after-tax interest cost) is higher or lower than the return that the asset ultimately purchased with the loan proceeds can generate, along with the safety of the asset in which you are investing.

PROTECT AGAINST INSIDE RISKS

Inside risks threaten the home because of potential liability created by the home itself. This would encompass injuries sustained on the property, such as slip-and-fall or pool accidents and even liability for guests drinking at the home and then driving (including guests of teenage or college-age children). While these risks are rare, they can be significant in terms of potential liability.

The best way to shield the home (and other high-value assets) from inside risks is to use insurance—specifically, homeowners and umbrella coverages. Homeowners insurance is often required by lenders if you have a mortgage on the property, but minimum required coverage amounts may not be adequate for sufficient protection.

Physicians should also consider umbrella coverage as essential, even if it is not required by lenders. Given its low cost (for example, millions of dollars of coverage can often be obtained for approximately \$1,000 annually), umbrella coverage is an efficient asset protector. You should be sure that the terms of the umbrella policy fit with your homeowners and automobile policies to ensure that there is no gap in coverage.

PROTECT WHAT'S IMPORTANT

For most retina specialists, there is no asset more financially valuable and emotionally significant than the family residence. Some states offer robust homestead protection, but most provide an inadequate shield. Additional options to consider, such as TBE, trusts, and debt shield strategies, can help you sleep better at night knowing your home is protected. ■

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