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AMERICAN COLLEGE OF LEGAL MEDICINE

FRIDAY FEBRUARY 24, 2017

LAS VEGAS, NV

ASSET PROTECTION

Dr. Monasky is a graduate of Columbia University College of Physicians and Surgeons in New York City and underwent neurosurgery training at Mayo Clinic and University of Maryland followed by a pediatric neurosurgery fellowship at Southwestern Medical School in Dallas, Texas. He is board-certified in neurosurgery. He has practiced neurosurgery for 24 years and law for 15 years. He currently maintains active practices in both law and neurosurgery. He spends half of his time practicing neurosurgery at Sanford Medical Center in Sioux Falls, SD and Rapid City Regional Hospital in Rapid City, SD. He spends the remaining half of his time in the practice of law with a concentration in asset protection, estate, tax and business planning. His law practice is a virtual practice with a focus on drafting trusts and creating business entities utilizing the highly favorable South Dakota asset protection, trust, and business laws. He has many physicians, particularly surgeons, and other high net worth individuals as clients. He has created numerous comprehensive asset protection and estate and tax plans for his clients, and has created many business entities and drafted hundreds of complex trusts to achieve his clients' desires.

He is licensed to practice both medicine and law in North and South Dakota. He is an active member of the American College of Surgeons, American Association of Neurological Surgeons, Congress of Neurological Surgeons, American Bar Association, State Bar Association of North Dakota, and South Dakota Bar Association. He is a member of the Asset Protection Council of the Real Property, Trust, and Estate Law section of the American Bar Association. In addition, he is the only physician member of Wealth Counsel, a National Association of estate planning attorneys numbering approximately 1600, the Financial Planning Association, American Association of Individual Investors, and an affiliate member of the Chartered Financial Analyst Institute. He is board-certified as an Estate Planning Law Specialist by the Estate Planning Law Specialist Board, which is accredited by the American Bar Association. This required him to pass a comprehensive, national examination designed for actively practicing estate planning attorneys. He is currently completing his last course towards certification as a CFP (certified financial planner).

Dr. Monasky has been married to Judy for 35 years. They are the proud parents of Mark Jr., a commercial pilot based in New York, and Heather, an attorney in California. Dr. Monasky can be reached at neurosurgeonlawyer@msn.com.

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I. ASSET PROTECTION BASICS

A. Introduction

Asset protection is about protecting one's assets, not about hiding them or defrauding one's creditors. It is about protecting assets from runaway jury awards and being the lottery jackpot for plaintiff's attorneys. In the majority of cases, it's all about the money. Basic asset protection begins with adequate insurance and risk reduction. I recommend umbrella insurance for everyone. It is cheap for the amount of protection offered. I believe every physician should have at least $1,000,000 umbrella coverage, preferably $2-5 million for surgeons and other high earners. CYA: cover your assets. One's largest asset is their ability to earn income, also known as human capital.

Any physician concerned about asset protection must see an attorney with experience and whose practice concentrates in this niche area. Do not see an attorney who dabbles in asset protection – remember, you get what you pay for! A comprehensive asset protection plan is not a cookie-cutter approach, rather it is a plan uniquely tailored to the physician and his or her family. A comprehensive asset protection plan dovetails with estate, financial, tax, insurance, and retirement planning, and protects assets for both yourself and your heirs after death.

Once adequate insurance and risk reduction is in place, at least one trust and legal entity, such as a partnership, LLC, or corporation is a must. Who to choose as trustee, and the domiciles of settlors (the individual forming the trust) and trustees and beneficiaries must be considered. Conflicts or potential conflicts between federal and state laws, as well as laws of more than one state, must be addressed as well. Just an identical Last Will and Testament does not work for every physician, a great asset protection plan may work well for one physician but may be a disaster for another.

Proper asset protection planning not only protects assets; it discourages lawsuits. It is always open season for physicians and other high net worth professionals. The first thing a plaintiff's attorney will do is a wallet biopsy. A negative biopsy is good for one's financial health. Don't advertise your wealth. Don't own everything in your own name. Live a modest non-ostentatious lifestyle. Live below your means. Marry well. Don't flaunt it. Drive an old car.

Remember, you must be covered by adequate professional liability and errors and omission (i.e. directors and officers) insurance. Asset protection is not about defrauding your victims. Asset protection is not about maintaining negligent habits and always getting away scot free. Asset protection is about not defrauding yourself and your spouse and children and grandchildren of assets that rightfully belong or should pass to them.

Asset protection planning is not about setting up a plan that's on the edge or in a gray zone or draws the scrutiny of the IRS. Rather, it is about using techniques and strategies that are time tested in the courts and have the blessings of the IRS. It is not about tax schemes or hiding or concealing assets in foreign bank accounts. To the contrary, it is about full disclosure to both the IRS and one's creditors or potential creditors. The best time to form an asset protection plan is now. Once you are sued or die, it is probably too late. This is not solely about yourself, it is about your loved ones. What are you waiting for?

Physicians should openly inform their creditors early in the game that they have a robust asset protection plan in place. An attorney who sees an uphill battle to collect from a defendant will oftentimes not be willing to accept a case on contingency, but will rather demand an upfront hefty retainer from their client. This will often stop any potential litigation dead in its tracks. Your leverage in such situations is based not on what you own or control, but on what you can lose. You cannot control whether someone will target your hard-earned assets, but you can control whether a predator will actually get them. You may be thinking "I'm too poor" to engage in asset protection planning. Don't make this mistake – having less is all the more reason you need to protect what you do own. I'm not recommending individuals or couples earning median incomes engage in asset protection planning. What I am recommending is that physicians, who are among the largest targets in today's society, engage in asset protection planning. Even a physician earning less than the median physician income, such as a pediatrician or psychiatrist, still earns several times the median income in the U.S., and needs to be proactive in protecting her hard-earned assets. One does not realize how "wealthy" they are until they lose it.

I've heard physicians say "I'm very careful and risk averse, and it's unlikely I'll ever be sued." This is putting one's head in the sand. One does not have to be negligent, a risk taker, or intentionally harm someone to incur a huge judgment against them. Anyone, through no fault of his own, can get into a car accident on an icy day and someone could get hurt.

Many lawsuits and judgments are not covered by insurance. You are out of luck unless you have proactively protected your assets. Don't become a statistic. Think of asset protection as high net worth insurance. Most physicians wouldn't think twice if they could purchase a one-time insurance policy that covers everything conventional insurance doesn't cover. The same physicians – that shell out $20,000 - $40,000 per year, year after year, to their investment manager – will foolishly not even consider purchasing "high net worth insurance." Think of asset protection as an investment, not an expense. The same way you think about a college education and purchasing a home. From an investment perspective, asset protection is one of the best, if not *the* best, investment you will ever make. If you get sued, the insurance has paid for itself hundreds, if not thousands, of times over. You may say, "What if I never get sued?" The one-time fee and the peace of mind that results are worth something, are they not?

You may question the morality of asset protection planning. Again, I am not advocating nor am I suggesting one defraud his legitimate creditors or not make someone whole in a negligence situation. That's what insurance is for. One purchases insurance on his home in case it burns to the ground. The mentality is that if this happens, the insurance company will provide funds to build another home. With our legal lottery and lawsuit mentality, would it be fair for the person who lost their home suddenly claim the home is worth $5,000,000, though totally arbitrary and capricious, and not the $500,000 it was appraised for? Is it fair to the insurance company to be required to pay an extra $4,500,000 on a home only worth $500,000? Of course not! Asset protection planning is about legally sheltering what one rightfully owns, not subjecting it to the vagaries of an out-of-control legal system with outlandish jury awards based on emotion rather than facts. Asset protection planning for physicians is not about defrauding victims, it is about not becoming a victim yourself.

The legal system for the past two hundred years has recognized that individuals and entities could lose all they have rightfully worked for through no fault of their own. That is why corporations protect their officers' and directors' personal assets from lawsuits against the corporation and from debts of the corporation. That is why limited partnerships and limited liability partnerships and limited liability limited partnerships limit the amount the creditors of the partnership can obtain against limited partners to the extent of their investment in the partnership. That is why LLCs (limited liability companies) limit the liability of members to the extent of their investment in the partnership.

Legislatures on both the national and federal level, as well as federal and state judiciaries, recognize that innocent individuals and entities need protection to prevent grave injustices. Bankruptcy, in both the state and federal context, recognize that individuals and entities should not be wiped out due to the vagaries and inconsistencies of our legal system. Asset protection at its most basic level ensures that victims are compensated, but no more. Just as a person negligently starting a fire that destroys a $500,000 home should not be liable for $5,000,000 just because a judge or jury now arbitrarily says the home is now worth $5,000,000. So, too, should a person who causes negligence worth $500,000 based on credible evidence, not now be liable for $5,000,000 due to an erroneous jury award or a judge who feels the defendant is "rich", has insurance, and will not miss $5,000,000. No physician or high net worth professional will mind losing some assets beyond the reach of insurance, if it's justified.

Physicians spend more time and money planning their vacations, deciding what car to purchase, and where to go out to eat over their lifetimes than they spend on protecting their assets. Think of asset protection planning as a vaccine that provides immunity to and antibodies against a creditor virus. The creditor virus has a much smaller chance of infecting a victim who mounts a robust defense. Any immunization is most effective before the creditor virus infection occurs.

Your plan must pass the sniff test. I do not advocate concealment of assets. This is called perjury. A competent, aggressive plaintiff's attorney or bankruptcy trustee can and will find any assets you have through depositions, interrogatories, or third party sources.

Assets can essentially be left to heirs in two ways – either outright or in trust. Heirs receiving outright distributions are free to do whatever they, or their creditors, wish to be done. Assets left in trust can be provided with almost unlimited protections from creditors and predators, as well as achieving estate, financial, tax, insurance and retirement planning benefits as well. Trusts are sophisticated legal devices. There are as many kinds of trusts as there are models of cars. Each kind of trust can be fitted and retrofitted with an almost unlimited array of provisions, just as a specific car model can be outfitted with a vast array of accessories, subject to public policy exceptions or illegality. Asset protection planning must be coordinated with tax and financial and insurance and retirement planning advisors. The attorney drafting the asset protection plan is the quarterback and must be aware of the complex interaction of the various components.

Failure to plan is not an option. Have you sacrificed your family, your youth, and in many instances your health, possibly your marriage, and postponed your life and delayed satisfaction to the nth degree, in order to go to college, then medical school, then a brutal residency, or even law school, to let your hard-earned assets go to an undeserving creditor due to an unjust lawsuit? Or to a former son- or daughter-in-law after your death because you left assets outright to your son or daughter who got divorced?

It is imperative to keep the overall plan as simple as possible and avoid needless complexity. Having said that, a certain degree of complexity and sophistication is required to avoid unintended consequences and to withstand legal attacks by creditors, soon to be ex-spouses, and other creditors. Flexibility is key so future revisions or amendments can be made without redrafting the entire plan.

Assets can be owned or titled in less than full outright ownership. Examples include present and future interests and fractional interests, or any combination thereof. Such planning should only be done by an experienced estate planner.

Crucial in any asset protection plan is retaining control over your assets. The most fire-safe way to protect your assets is to give them away well before a creditor threat arises. Assets that are not yours cannot be attached by your creditors. So long as such transfers do not constitute a fraudulent conveyance or voidable transfer, you are safe. But you are probably thinking, "I do not want to give away my assets." What if you can still retain meaningful control? Many people are willing to relinquish ownership of assets, provided such assets are not absolutely necessary for retirement purposes, so long as they can still maintain control.

Assets cannot always be fully protected from aggressive collectors. The point is to make the creditor jump through as many hoops as possible and incur huge legal fees. Make no mistake about it – this is a psychological battle and a war of attrition. You want to make yourself as unattractive as possible to a creditor, so that they don't pursue you at all or become willing to settle for pennies on the dollar.

Strategies to be considered include fraudulent transfer issues, as well as timing and jurisdictional and business issues. Cost is a factor, but remember, you get what you pay for! Physicians and high net worth individuals do not balk over or even bat an eye at paying 1-2% of AUM (assets under management) or an equivalent amount in advisory fees on an annual basis. For many physicians, this amounts to $20,000 - $40,000 annually, year after year. The financial industry has done a clever job of hiding, and in most cases, not even disclosing their fees in financial statements. They know their clients would never write a check for such large fees, and that is why the fees are not reflected in the financial statements received by clients. And the fees are charged even if the investments decrease in value. Those same individuals frown at paying a onetime fee of $10,000 for a mediocre estate plan. Of course, there are revisions that have to be made from time to time on an estate plan, but these costs pale in comparison to the initial cost of setting up a proper plan.

Finally, asset protection is predominantly a state law issue. But, bankruptcy is governed by both federal and state law, and federal law primarily governs ERISA protected retirement plans.

B. Fraudulent Transfers

Hot assets for a potential creditor, such as exposed cash, should be used to pay off legitimate debts and favored creditors while the creditor threat remains. Consider swapping your unprotected assets with your spouse's protected assets. Converting nonexempt assets into exempt assets (assets that are protected under federal and state law in a bankruptcy or debtor situation) prior to a known creditor is generally OK, but such a conversion after a creditor is known, or certainly after judgment has been obtained against you, may not be acceptable.

A fraudulent transfer is any transfer "with actual intent to hinder, delay, or defraud any creditor of the debtor." The standard of proof is the lesser legal standard of "a preponderance of the evidence." This essentially equates to a "more likely than not standard."

1. Badges of Fraud

Judges are allowed to look at "badges of fraud" in determining whether or not a fraudulent transfer has taken place. The moniker "fraudulent transfer" is unfortunate, because a transfer that is not allowed may not actually involve fraud as it is otherwise known.

a) *Transfer to an insider*

b) *Debtor retains possession or control*

c) *Concealment*

d) *Lawsuit commenced prior to transfer*

e) *The transfer involved substantially all of debtor's assets*

f) *Debtor absconded*

g) *Concealment of assets*

h) *Consideration received by debtor less than value of asset transferred*

i) *Debtor was insolvent or became insolvent shortly after transfer*

Remember that a judge is given wide discretion in determining whether a fraudulent or voidable transfer has taken place. Many plaintiff's attorneys will often tweak their strategy depending on who the judge is. Despite the claim that the judiciary is unbiased and fair, judges are human beings and are subject to the same unconscious biases that we all are. Many judges are former plaintiff's attorneys. Remember, a judge is merely a lawyer in a robe.

2. Techniques to Avoid Fraudulent Transfers

a) *Ensure all transfers are for adequate consideration*

This is especially true for transfers to insiders and after a creditor threat arises.

b) *Transfer assets to separate entity*

A transfer from a non-debtor entity is not considered fraudulent. For example, if you are sued and own an LLC, transfers from you, but not your LLC, may be considered fraudulent.

c) *Do not conceal transfers*

d) *Do not render yourself insolvent after transfer*

e) *Preferentially pay non-hostile creditors first*

f) *Consider a foreign entity*

C. Definitions

The following terms will be used extensively throughout this discussion on asset protection. It is important for the reader to be familiar with the similarities and differences between a partnership, LLC, corporation, and trust. There exist at least 4 different types of partnerships and 2 types of corporations. Though some of the differences are subtle, they are nonetheless crucial in determining whether an effective asset protection plan can be established. The situation is further complicated by variation in state laws, and to a lesser extent federal law, particularly in the bankruptcy context.

1. Sole Proprietorship

A sole proprietorship is the default entity when someone operates a business but does not incorporate or form a partnership or LLC. The liabilities and assets of the business entity are mixed with the personal assets and liabilities of the owner. Any debts of the business subjects the owner's personal assets to any business creditors. A sole proprietorship is recognized by the IRS by attaching Schedule C to one's personal tax return.

1. LLC

An LLC is a creature state law. An LLC is not recognized anywhere in the federal tax code. However, the IRS has allowed LLC's the opportunity to decide whether they wish to be taxed as a C Corporation, an S corporation, or as a partnership under the "check the box" regulations.

2. Partnership

a) General partnership

This is the most common and most dangerous type of partnership. In a general partnership, each partner is jointly and severally liable for all the debts of the partnership and misdeeds of the other partners. Any venture whereby two or more people join together and is not memorialized by any type of partnership agreement is by default a general partnership. A partnership agreement can also be used in a general partnership where the responsibilities of the partners are more specifically spelled out. There is essentially no situation whereby a physician should ever use a general partnership in any type of business planning or estate planning context.

b) LLP

This is a limited liability partnership. This can be considered a hybrid between a general partnership and a limited partnership. All partners in an LLP are in a sense general partners with regards to their ability to control the operation of the partnership, subject to their percentage of ownership interest. This is like a general partnership, but the risk to partners in an LLP is limited to their investment in the partnership.

c) Limited partnership

The two types of limited partnerships are the basic limited partnership, or LP, and a subtype known as a limited liability limited partnership, or LLLP. The term "family limited partnership" is often used. Technically, there is no such thing as a family limited partnership under federal or state law. Rather, a family limited partnership is a limited partnership whereby the general and limited partners are members of the same family. A family limited partnership may be an LP or an LLLP. It is commonly used in estate planning and tax and asset protection planning, and for businesses that are controlled by a family.

Limited partnerships are tax neutral to form or dissolve and do not require the formalities required of corporations. They possess all the advantages without the disadvantages of corporations.

3. Corporation

The IRS definition of a corporation is quite broad and includes "[a] business formed under a federal or state law that refers to it as a corporation, body corporate, or body politic." All corporations have limited liability protection, or inside protection, which immunizes shareholders and officers and directors from business debts, liabilities and judgments. They are separate legal entities created by a state filing of an Articles of Incorporation with the Secretary of State. They have owners, called shareholders, who elect a board of directors, who in turn select the officers and directors. Strict corporate formalities such as holding annual shareholder and director meetings, filing annual reports, adopting bylaws, issuing stock, and paying annual filing fees are required.

a) C corporation

The C corporation is the standard corporation, so named as the statutes governing its taxation are found under subchapter C of Chapter 1 of the Internal Revenue Code. Any corporation by default is a C corporation. There are no ownership restrictions on C corporations. C corporations are separately taxable entities. They file a corporate tax return (Form 1120) and pay taxes at the corporate level. They also face the possibility of double taxation if corporate income is distributed to business owners as dividends, which are considered personal income. Tax on corporate income is paid first at the corporate level and again at the individual level on dividends.

b) S corporation

S corporations are pass-through tax entities – meaning they are taxed at the individual owner's individual income tax bracket. The S corporation has elected a special tax status with the IRS. It gets its name because it is defined in Subchapter S of the Internal Revenue Code. To elect S corporation status when forming a corporation, Form 2553 must be filed with the IRS and all S corporation guidelines met. Despite their many similarities, S corporations and C corporations have distinct differences. An S corporation files an informational federal return (Form 1120S), but no income tax is paid at the corporate level. The profits/losses of the business are instead "passed-through" the business and reported on the owners' personal tax returns.

S corporations have very strict ownership requirements and are restricted to no more than 100 shareholders. Shareholders must be US citizens or resident aliens. S corporations cannot be owned by C corporations, other S corporations, LLCs, partnerships or most trusts. In addition, S corporations can have only one class of stock (disregarding voting rights), while C corporations may have multiple classes. For example, an S corporation cannot have both common and preferred stock, but may have voting and nonvoting common stock.

c) Inside v. Outside liability

Understanding the concept of inside versus outside liability is critical in the specialty of asset protection. Inside liability arises from a cause of action within the entity, whereas outside liability arises from causes of action outside the entity. A slip and fall occurring in an apartment building owned by an LLC is an example of inside liability, i.e. creditors can only attach assets legally belonging to the LLC, and not the owner's personal assets (unless an action is brought by the creditor to pierce the veil of the LLC by alleging the physician member owner is merely the alter ego of the LLC). Professional negligence by a physician resulting in a judgment is an example of outside or personal liability. Assets titled in the name of the individual physician are at risk. The apartment building cannot be seized because it is owned by the LLC, not the physician. All a creditor can do is obtain a charging order against the LLC and wait until a distribution is made to the physician (unless the creditor petitions the judge to dissolve the LLC due to a fraudulent transfer or exercise a judicial foreclosure power if permitted by state law).

D. Divorce

If married, the debtor spouse should pay all the bills and operating expenses of the household to further whittle down his or her assets available to creditors. For physicians, the biggest creditor out there is one's spouse or soon-to-be ex-spouse. Choose your life partner carefully and stay married!

Titling assets in the name of the nondebtor spouse is oftentimes recommended. However, this is risky since divorce may occur, or the nondebtor spouse can be sued.

Special issues arise where both spouses are physicians or in high liability professions. This is a highly individualized situation where unique strategies must be utilized depending on the totality of the facts and circumstances. Tenancy by the entirety (TE) (a special type of joint ownership by married individuals whereby the assets titled as such are protected from either spouse's creditors) is highly desirable for both real and personal property. TE is a matter of state law, and can apply to both real and personal property. Bilateral intervivos QTIP (qualified terminable interest property) trusts offer a unique solution achieving both asset protection for both spouses as well as equitably dividing assets in case of divorce.

II. TRUSTS

A. Revocable Living Trust

An RLT (revocable living trust, also known as a living trust) provides essentially no asset protection. For tax and creditor and debtor purposes, assets within an RLT are considered assets of the individual grantor of the trust, and in fact income and debts of an RLT are reported on an individual's personal tax return. An RLT is not to be thought of as a separate entity as is an LLC or limited partnership with the accompanying protections. Having said this, ownership of assets in an RLT is considered distinct for asset transfer purposes at death. The bottom line is that placing assets in a RLT does not provide protection and does not save taxes.

B. Irrevocable trusts

As a general rule, irrevocable trusts provide superior asset protection over RLTs. This is because an irrevocable is considered a different legal entity than the settlor owner for creditor purposes. Two major categories of irrevocable trusts are grantor and nongrantor trusts. This distinction is only useful for income tax purposes. The income of a grantor trust is taxed to the grantor, whereas the income of a nongrantor trust is taxed at the trust level. In both cases however, gifts to a properly drafted grantor or nongrantor irrevocable trust are considered complete and generally are out of reach from creditors).

There are many different types of irrevocable trusts, i.e. gifting trust, marital trust, QTIP (qualified terminable interest trust), credit shelter trust (also known as bypass trust), dynasty trust, ILIT (irrevocable life insurance trust), grantor trust, non-grantor trust, third party special needs trust, retirement plan trust, GST (generation skipping tax) exempt trust, living QTIP trust, spendthrift and discretionary and support trust, and others. Such trusts can be combined in a myriad of combinations and are customized to the individual client to meet his or her tax, estate, asset protection, insurance, and retirement purposes. An irrevocable trust may provide varying levels of asset protection depending on the provisions included and state law, as well as the laws of the jurisdictions where the trustees, settlors, and beneficiaries reside. The laws governing interpretation of the trust document itself, which may be stated separately in the trust, may be different as well from the laws of the jurisdictions where the trustee, settlor, and beneficiaries reside. It is evident from the above discussion that drafting trusts can be very complex and a specialist is needed.

Irrevocable trusts are not always irrevocable. This is not a misprint. Most states provide statutory authority to change or otherwise modify an irrevocable trust to varying degrees. A trust protector and trust decanting statutes are other ways to modify an irrevocable trust.

As can be seen, it can become quite complicated. This is why an attorney with expertise and experience in asset protection planning must be consulted for document drafting. No hard and fast rule can be stated as to how well an irrevocable trust protects assets.

Consider a CRAT (charitable remainder annuity trust) if you are charitably inclined. You can kill two birds with one stone. A CRT has superior asset protection features under federal law, as the charity has a remainder interest which is generously protected from creditors under federal statutes. If such a trust is set up so that 10% of assets go the charity, which is the minimum required by law, a fraudulent transfer is hardly a big issue. The annuity component may otherwise be protected under state law. If not, the creditor must wait for annuity distributions before assets can be seized.

C. DAPT (Domestic Asset Protection Trust)

There currently are sixteen states that have passed statutes allowing individuals to place assets in a special type of trust, without giving the assets away, with protection of such assets from specific creditors. Such a trust is referred to as a self-settled domestic asset protection trust, or DAPT, which is to be distinguished from a FAPT (foreign asset protection trust). There are time restrictions after which assets are placed in trust before such protections are granted. The protections are not absolute, and vary statewide as to which specific creditors are shielded. Since creating such a trust is done to address not only asset protection but also estate, tax, financial, and retirement issues, such trusts must be customized to achieve the client's unique objectives. So long as the appropriate state statutes providing asset protection are included in the trust, an almost limitless array of other provisions can also be included to fit the client's situation. An "asset protection" trust can be revocable or irrevocable, grantor or nongrantor, contain spendthrift and dynasty provisions, be a marital or credit shelter trust, etc.

The sixteen states currently allowing self-settled asset protection AK, DE, HI, MO, MS, NH, NV, OH, OK, RI, SD, TN, UT, VI, WV, and WY. State statutes vary as to income taxation of trust assets, statutes of limitations for pre-existing and future creditors, spousal and child support exception creditors, fraudulent transfer provisions, and decanting provisions.

D. International or Offshore Trust

Historically, the gold standard way to protect domestic assets, without giving them away, is to go offshore. The fact that internationally known asset protection havens are not subject to the jurisdiction of US courts can be both an asset and a liability, no pun intended. If the foreign trustee absconds or otherwise misappropriates assets, the settlor may be out of luck. To ask a US court to intervene on behalf of a trust that was designed to thwart a US court does not leave many options. To be fair, there exist reputable and stable offshore situses and companies. The US government now subjects offshore trusts and bank accounts to ever increasing scrutiny and burdensome penalties for noncompliance, however innocent. The trend in the US is away from international trusts and toward domestic trusts, particularly with the increasing numbers of states providing statutory protection.

III. PROTECTING YOUR HOME AND OTHER REAL ESTATE

There is considerable emotion attached to all one's home. It may not be one's most valuable asset, but it is the one that is most difficult to lose as that is where you and your spouse and children live. There is a basic, but nevertheless, important distinction between a personal residence and all other types of real estate. Rental real estate is considered a hot asset to a creditor because significant liability can occur from slip and falls, exposure to lead paint, negligent maintenance, discrimination lawsuits from tenants, and issues dealing with nonpayment of rent and eviction of tenants.

A. Homestead exemption

This represents the amount of equity in your home that is protected from creditors. Homestead protection may not work for debts incurred after a homestead exemption is claimed. In bankruptcy, the debtor must have lived in the home for a period of 40 months before homestead protection applies. Florida and Texas have unlimited homestead protections. It is recommended to use nonexempt assets to maximize the homestead exemption. This exemption may or may not work for non-bankruptcy debts incurred prior to the time the homestead exemption is claimed.

No homestead is available for real estate in which the debtor or his spouse do not reside. A homestead exemption may not work for claims by ex- or soon to be ex-spouses, plaintiffs with claims of intentional torts such as fraud or deceit, or for lenders holding a mortgage.

B. Joint Tenancy

This is the most common form of home ownership and asset ownership in general for married couples. Each party is considered to be a 50% owner of the asset. A joint tenancy can be severed by either party. There is unity of time, title, interest and possession. Upon the death of the first joint owner, real estate is owned 100% by the other surviving joint owner, known as right of survivorship. Joint tenancy assets pass by operation of law, and thus supersede any language in a will or trust. Joint tenancy must be considered when forming an estate plan as this may result in the surviving joint tenant inheriting a greater share than the other beneficiaries. If one intends to leave a joint tenancy asset to someone other than the joint tenant, a will or trust will be ineffective, thus defeating the testator's intention.

Joint tenancy is never recommended for ownership of real estate other than the primary residence. Your creditor or your spouse's creditor's interest can be seized by a creditor, and they now become a cotenant. A forced sale can result, but only the proceeds from the debtor's joint owner's interest can be seized. If the non-debtor spouse has a homestead right in his or her one-half joint interest, then the creditor's remedy is far from certain.

C. Tenancy by The Entirety

Many states have tenancy by the entirety, also known as TE. This is a special type of joint tenancy whereby the creditor of one spouse cannot attach it to assets owned by both spouses as tenancy by the entirety. This includes the four unities of joint tenancy; i.e. time, title, interest and possession; as well as the unity of marriage. So long as a couple is married, assets in tenancy by the entirety are completely protected against either spouse's creditors. If the nondebtor spouse dies, the debtor spouse's protection is lost. Be aware that upon the death of the first spouse, the home passes to the surviving spouse and supersedes any language in a will or trust. A tenancy by the entirety cannot be undone by either spouse; both spouses' consent is required. Some states have tenancy by the entirety only for the primary residence, while other states also include personal property.

Tenancy by the entirety may or may not be available for real estate not used as the primary residence. If available, use it, but have the underlying properties owned by an LLC or partnership, to provide additional layers of protection.

D. Tenants in common

I believe tenants in common to be preferable to joint tenancy, but not as good as tenancy by the entirety. With a tenancy in common, each spouse will own 50% of the home. The entire homestead exemption of the debtor spouse applies to his or her 50% ownership in the home as a tenant in common. The other spouse will also have a homestead exemption so this is a way to effectively double the exemption available on the home. This would make it more difficult for a creditor to force the sale of the home. A forced sale would be very difficult for creditor if the nondebtor spouse is living in the home because the nondebtor spouse has every legal right to continue to live in the home in which he or she has a fractional ownership. If a creditor did succeed in obtaining the debtor's fractional interest, they would have to share the home with the nondebtor spouse, which would significantly diminish its appeal to the creditor. But upon the death of the debtor spouse, his or her interest is not automatically passed to the surviving spouse, thus making it potentially available to a creditor. If the nondebtor spouse dies first, it would be wise to leave his or her share to a child or other person friendly to the debtor.

Real estate, other than the primary residence, should never be owned as tenants in common, because the liability of any one owner can potentially accrue to the other owners. A creditor of one co-owner can successfully bring an action to partition the cotenancy and force a sale.

E. Spouse's Name

In a stable marriage situation, this may be a simple way to protect one's assets. This is generally done by titling the assets in the name of the poor spouse. However, nothing will stop the former spouse from being sued or from having his or her own creditors. This would put such assets at risk. Also, in the event of divorce, these assets would be considered the sole property of the spouse, and depending on the state, may not even be considered part of the marital estate to be equitably divided. It would be very difficult for one to argue, in the event of divorce, that the assets do not really belong to the spouse but rather were placed in the spouse's name simply to defraud the other spouse's creditors if he or she became a debtor.

This strategy may work for the personal residence and investments, subject to the pitfalls listed above, but should never be done for hot assets such as rental real estate, unless the assets are owned by an underlying LLC, partnership, or other legal entity that has inside liability protection.

F. LLC or a limited partnership

Placing one's home in an LLC or partnership is sometimes recommended. I personally do not recommend this since there is no legitimate business purpose for a home, unless a portion of it is rented out. If there is more than one member of the LLC, or if the home is placed in a partnership (which by definition includes two or more parties), the section 121 capital gains exclusion and mortgage interest deduction and possibly the homestead exemption may be lost. In addition, if there is a mortgage on the home, many lenders will not consent for the home to be placed in another entity, even though the entity may be wholly-owned by the physician and his or her spouse. A single-member LLC would make the most sense, as the IRS considers single-member LLCs see-through entities, and the interest deduction is not lost. Single-member LLCs are the easiest to unwind by a creditor, as there are no other members or partners that can be harmed inadvertently.

There are definite advantages of placing real estate, other than a primary residence, into an LLC. Transferability of membership shares can be restricted according to the operating agreement. A member of an LLC can only lose up to their investment and is not jointly and severally liable for other members. Under the “check the box” regulations by the Treasury Department, an LLC can be taxed as a C Corporation, an S corporation, or partnership, providing tax benefits depending on the specific circumstances.

If there is a slip and fall accident in a building owned by an LLC, the owner’s personal assets are protected unless a veil piercing action is sought. Each piece of real estate should be in its separate LLC. Lumping all real estate into a single LLC places all the real estate at risk if there is an incident that occurs on only one of the properties. Some states have what is called a series LLC, whereby a parent LLC holds subsidiary LLCs, each with its own separate protections.

The remedies against owner members of an LLC are much more restricted than owners of a corporation. Generally, a creditor who is successful in obtaining a judgment against an LLC can obtain what is called a charging order. This means that the LLC remains intact and the creditor can only avail themselves of distributions that are made to an owner member. Some states have more liberal remedies available to a creditor, such as judicial foreclosure and unwinding of the LLC. A single-member LLC is much more likely to be unwound than a multimember LLC, particularly a multimember LLC that involves at least one owner member outside of the family. If a creditor obtains a charging order against an LLC debtor member owning 50% of the entity, the creditor will be responsible for paying taxes on 50% of the annual income to the LLC, even if it is not distributed. This is a poison pill and makes this a very unattractive asset to a potential creditor. Unlike a creditor seizing shares of a corporation in which they can obtain voting rights, a creditor of an LLC who obtains a charging order will have no voting rights or even rights to inspect the financial records of the operation. Further protection can be added by placing the LLC in a limited partnership, thus obtaining a double wrapper.

Real estate other than the primary residence should always be owned as an LLC or as a limited partnership, whichever provides the greater protection under state law. One general note of caution: the general partner of the limited partnership should never be an individual person, but rather an LLC or partnership or corporation where liability is limited. For this reason, it is best to place real estate, other than the primary residence, into an LLC, unless state law grants superior protection to a limited partnership. An LLC can be owned as tenancy by the entirety by each spouse if this is allowed under state law. The newer form of LP, the LLLP or limited liability limited partnership, essentially insulates the general partner from unlimited liability, and provides protections similar to a member operated LLC. Another layer of protection can be added by forming an LLLP, and having its general partner be an LLC.

G. QPRT (qualified personal residence trust)

A special provision of the tax code allows one or both spouses to place a primary or vacation residence in what is known as a qualified personal residence trust. This provides that the grantor of the trust live in a home for a specific term of years, and then, afterwards, the home passes to a designated beneficiary. This is an estate planning technique whereby a home that is rapidly increasing in value can be transferred for less than the then current value of the home, because the grantor retains a current interest and only the value of the remainder or future interest passes to the beneficiaries. Therefore, a creditor can only attach the current interest which expires after a term of years. Of course, this must be done prior to a judgment to prevent a fraudulent or voidable transfer. If the grantor decides to live in the home after the term of years expires, he or she must pay a market rental rate to the beneficiaries, who now own the home.

This technique does not apply to real estate other than a primary residence or vacation home, and, therefore, cannot be used for rental real estate.

H. Equity stripping

If the equity in a home is greater than the homestead protection available, then obtaining a second mortgage on the home and using the funds for purposes that would convert them to exempt assets (so long as the funds are not given away, which would be a fraudulent or voidable transfer), is another way to protect the home. Another option would be to obtain a line of credit on your home for any equity in excess of the homestead protection. Either a second mortgage or line of equity would need to be recorded in the county register and would reduce the equity in the home making it a much less attractive asset. Other creative ways to depress your property's value is to contractually grant a third party the option to buy on very favorable terms at a price on the lower end of market value. A long-term low rent lease that survives sale of the property is another option.

Keep in mind that in non-community property states, also known as common-law states, a nondebtor spouse can legitimately encumber the debtor spouse's property.

Equity stripping is also available for real estate, other than the primary residence, but if the real estate is owned by an entity such as an LLC or limited partnership, it results in greater inside protection but does not change the charging order protection available for claims arising outside the partnership or LLC.

I. Sell and Lease back your home

A potential debtor can sell their home and lease it back, provided adequate consideration is received, and then take the cash and convert it into exempt assets.

IV. PROTECTING YOUR INVESTMENTS

A. Cash, Equities and Mutual Funds

Cash, stocks, bonds, and mutual funds are considered desirable assets for creditors. They are more difficult to encumber than real estate and can be readily liquidated by creditors. Opening an out of state bank account will place yet another obstacle in front of a creditor, as the creditor must record his or her judgment in another state before levying upon out of state funds. Notch it up a level and open bank accounts in multiple states that do not have branches in the other states. Prepay expenses with loose or exposed cash. Consider pledging your investment accounts as collateral for securing loans.

Cash, equities, and mutual funds do not generate much liability and hence can be lumped together in a single entity. There must exist a legitimate business or tax or estate planning purpose for placing quiescent assets into a business entity. Forming an entity for asset protection, alone, increases the probability the entity will be unwound or the assets exposed. Legitimate reasons include: centralized control of investments, passing of fractional interests to heirs as part of an estate plan, hindering spendthrift individuals from accessing assets, and promoting family cohesiveness.

The generally recommended entities to protect such assets are either the limited partnership or LLC, whichever affords the greatest protection under state law. It has been earlier stated that the general partner of a limited partnership assumes all the liability of the partnership, but since these assets are unlikely to result in litigation, this is not a serious issue. To the extent this is an issue at all, an LLLP (limited liability limited partnership) solves the problem of the general partner, whose liability is now limited to his or her investment in the partnership.

To avoid fraudulent transfer laws, the partnership or LLC interest must be valued commensurate with the assets transferred into the entity.

Asset protection planning with such assets must take into consideration the physician's tax, estate, and financial planning objectives. There must be communication between the physician's tax and insurance and financial planning advisors. It is optimal if the asset protection attorney also drafts the physician's estate plan, or is at least integrally involved in the process.

B. Life Insurance

Life insurance often has its own inherent protections. In the estate planning context, an ILIT (irrevocable life insurance trust) is a tremendous way to eliminate estate taxes entirely, and a byproduct is a nearly bullet proof asset protection device as well. Though the physician settlor may "give away" their cash value insurance to an irrevocable trust, with proper drafting, the physician and his or her spouse can still benefit from the cash value either through a loan or a partial surrender of the policy as discretionary beneficiaries of such a trust.

The protection of cash values or death benefits of insurance policies are state specific.

C. Annuities

Protection of annuities varies widely from state to state. One must research specific state law to determine protection level afforded. No hard and fast rule can be made. Remember that annuities placed inside an IRA may provide additional protections from creditors.

V. RETIREMENT PLANS

Retirement plans are categorized in two primary ways: 1) qualified and nonqualified, and 2) defined contribution and defined benefit. Qualified plans are treated specially by the IRS. Defined contribution plans have segregated accounts for individual participants, whereas defined benefit plans target a specific amount of benefit upon retirement, and in a sense work backward to fund the account to meet that target. Contributions can be made by either the employer or the employee, or a combination. There are no hard and fast rules to remember how a specific type of plan is characterized. For example, a defined contribution plan or a defined benefit plan can be either qualified or nonqualified. Furthermore, nonqualified plans are subdivided into either eligible or noneligible, resulting in ever more tax treatment nuances. For example, 457 plans are nonqualified. 457(b) plans are eligible nonqualified plans, and 457(f) plans are noneligible nonqualified plans.

A. Qualified Retirement Plans

A qualified retirement plan is covered under Section 401 of the Internal Revenue Code, and is subject to ERISA (Employee Retirement Income Security Act of 1974). The well-known 401(k) and 403(b) plans, as well as profit-sharing, money purchase, stock bonus, defined benefit, and other pension plans are qualified plans.

ERISA is a two-edged sword: on the one hand strict requirements in setting up the plan and enrolling participants is required, on the other hand significant protection of assets from creditors results. ERISA mandates vesting, participation, funding, and contribution requirements, as well as protection from discrimination and setting restrictions for highly compensated and key employees.

Retirement plans, particularly ERISA qualified plans, under federal law, and more specifically the Internal Revenue Code, have very robust anti-alienation and spendthrift provisions, making them one of the best asset protection devices available against judgments arising at both the state and federal level. A qualified plan has nearly bullet proof protections in the bankruptcy context and for civil judgments at both the state and federal levels. An ERISA qualified retirement plan is a trust by definition. Strict spousal consent provisions are also mandated by ERISA.

Segregated accounts are required in such plans and assets are protected from a company's creditors as well. The only way a qualified retirement plan can be penetrated is where there are super creditors such as the IRS, or a judgment for child or spousal support. Keep in mind that an ERISA plan may not be protected if only one individual (and his or her spouse) participates in the plan. It is best to have at least one nonfamily employee included in the plan.

B. IRAs

IRAs are not qualified plans, nor are they ERISA protected. IRAs do not have the federal protections afforded other plans, except in bankruptcy. The IRAs cousins, such as SEP IRA (simplified employee pension plan), Roth IRAs, SIMPLE IRAs (savings incentive match plan for employees,) though protected in bankruptcy, also do not have ERISA protection. In a bankruptcy situation, IRAs are protected up to $1 million.

Protection of IRAs in a nonbankruptcy situation is state specific. For state civil judgments, protections vary widely from state to state, but, generally, IRAs are protected only in so far as what is needed for the debtor's reasonable comfort and support. This is a moving target and gives judges great discretion. An IRA can be rolled back into a qualified retirement plan (what I refer to as a reverse rollover), thereby achieving greater asset protection. An IRA that was funded from a qualified plan rollover has all the protections as if such funds were still in a qualified plan. It is extremely important to segregate one's IRAs based on source of funds so as not to mix assets directly contributed to an IRA from those that were rolled over from a qualified plan. This may cause the IRA to lose its asset protection. Always open a new IRA if funds are rolled over from another plan, and do not have an IRA with comingled funds from consisting of direct contributions and rollover contributions.

For physicians who have already retired and have an IRA but not have a qualified plan, in many cases it would be fairly simple for that physician to create a consulting business and form their own qualified plan and then do a reverse rollover of their IRA into that plan. So long as there is even a minimal amount of income to the consulting business, the IRS allows a qualified plan to be set up. Technically a new business entity does not even have to be created. One can operate by default as a sole proprietor so long as a Schedule C is filed with the personal tax return. One is now allowed to have their own retirement plan. If the income of your consulting business is not enough to justify a direct contribution, create a profit-sharing plan with 0% contributions, then reverse rollover your non-ERISA protected IRA into the profit sharing plan. Reverse rollovers cannot be done with Roth IRA. So if you wish to convert an IRA consisting of direct contributions to a Roth IRA, but desire ERISA asset protection in the Roth, first reverse rollover the IRA to the qualified plan, thus obtaining the ERISA asset protection, then rollover the qualified plan to a Roth IRA (income taxes are due on the transferred funds). The Roth IRA funds now have come from a qualified plan and arguably have ERISA protections.

Inherited IRAs used to have the full asset protection accorded to the original IRA owner. In a United States Supreme Court decision on June 12, 2014, (*Clark, et ux v. Rameker*, 573 U.S.

(2014)), the United States Supreme Court held that inherited IRAs are not “retirement funds” within the meaning of federal bankruptcy law. This means they are therefore available to satisfy creditors’ claims. This can be avoided by the estate and asset protection attorney recommending that the contingent beneficiaries of your IRA not be your children outright, but trusts with your children as beneficiaries. The IRS and Treasury Department have very strict requirements for such trusts, but if done correctly, they can totally protect retirement plan assets left to children, from divorce or other creditors, and even bankruptcy.

Stash away as much cash as possible by maximally funding qualified retirement plans. Create additional defined benefit plans for your business entities that allow contributions of up to $200,000 or more annually. This is not a fraudulent transfer, if done before a creditor threat arises, and may not be considered a fraudulent transfer if done after a creditor arises, if one has consistently funded such a plan year after year. Consider transferring your IRAs’ funds to an LLC, if the custodian permits. If the custodian does not permit, roll your IRA over to an institution that has a friendlier custodian that will allow this.

Consider buying annuities in your IRA. Under new legislation, up to $125,000 of annuities in an IRA does not have to be counted in calculating an RMD (required minimum distribution), thus making a creditor wait longer for a distribution to seize. Select a deferred annuity that does not payout until a later age, say 75 or 85, when your creditors may no longer be around, or you will be in a lower income bracket and such assets cannot be garnished. Invest your IRAs assets in a 412(i) plan by funding life insurance premiums, which now provides protection from creditors under ERISA. If your IRAs are over $1,000,000 and bankruptcy is contemplated, consider reverse rolling over your IRA into a qualified plan just enough to get your IRA limits under the $1,000,000 threshold. If you have a $1.5 million IRA, consider a Roth conversion, pay approx. $500,000 in taxes, and now you are left with a $1,000,000 IRA, which is now protected, if allowed under state law.

C. Nonqualified Retirement Plans

Nonqualified plans for nonprofit nongovernment employees (i.e. hospitals), including 457(b) plans (nonqualified eligible plans), and nonqualified plans under section 457(f) (nonqualified noneligible plans, also referred to as 409A plans) also provide varying degrees of asset protection in the event of bankruptcy and civil judgments. Such plans are subject to the general creditors of the business entity. At first glance this may appear an insurmountable risk, but this is not as great a risk as it appears. The employer can also set up what is called Rabbi or secular trusts to minimize an employer’s creditor seizing assets in such plans.

Nonqualified plans do provide excellent asset protection in the personal bankruptcy context and from civil judgments. Beware that 457 plans cannot be rolled over into IRAs or other qualified plans when leaving one’s employer (the exception is government 457(b) plans). They must be distributed upon termination of employment for any reason. The penalty for early withdrawal applicable to qualified plans does not apply. They can only be rolled over into other

457 plans, but the language in the former employer's plan must allow for a rollover into another 457 plan, and the language in the new employer's 457 plan must allow rollovers from another 457 plan. There exist time constraints as well. The rules can be unforgiving for even innocent mistakes.

VI. PROTECTING YOUR PRACTICE OR BUSINESS

A. Liability producing assets

Hot assets are those that may incur significant liabilities. Rental real estate has already been discussed above. Other real estate such as lake cabins are also considered high liability assets. Airplanes, boats, snowmobiles, firearms, taxicabs, and other dangerous assets can generate significant liability and must not only be segregated from low liability or cold assets, but should be segregated from each other to the greatest extent practical. Layering various protections together will further frustrate would-be creditors.

Businesses must also be in separate legal entities, and in many cases, the assets of the business must be segregated from the business transactions.

This is highly state specific.

B. Sole Proprietorship

Do not do this ever, ever. Personal and business assets are comingled and business debts and personal debts are one and the same. This also greatly frustrates tax and estate planning.

A. LLC

An LLC is the best option, particularly for dangerous assets, especially if a creditor's sole remedy is a charging order. An LLC member has no personal liability. See the discussion in part III.F. of this paper for LLCs owning real estate other than a personal residence.

B. Partnership

1. General partnership

Never ever form a general partnership for any reason. There is absolutely no asset protection for either partner. Both partners are jointly and severally liable for all the debts, creditor claims, liability, and predators of the partnership. If you find yourself in the unfortunate position of being a general partner, attempt to convert your general partnership ownership interest to an LLC or corporation completely owned by yourself. This can usually be done without running afoul of any fraudulent or voidable transfer rules, unless very late in the game. This way, the LLC or corporation becomes jointly or severally liable on behalf of the partnership. But, if done correctly and the formalities of the LLC and corporation have been followed, liability to the former partner's personal assets are limited, or at least made more difficult for a creditor to seize.

2. Limited Liability Partnership

An LLP can be thought of in simplistic terms as a general partnership, but with limited liability to the partners. There is no joint and several liability amongst and between the partners. In other words, the partners are not liable for each other's debt or misconduct, but do remain responsible for debts and liabilities of the partnership itself. In fact, the most a partner can lose is his or her investment in the partnership, without jeopardy of his or her personal assets outside of the partnership. All partners in an LLP are equal – there are no general or limited partners.

3. Limited Partnership

A limited partnership, or LP, contains both general and limited partners. General partners are involved in management, whereas limited partners are not. There exists a specific subtype of limited partnerships known as an LLLP, or a limited liability LP. An LLLP, like an LP, has both general partners and limited partners. In both entities, the limited partners are only liable to the extent of their investments and are not liable for the debts and obligations of the partnership or other partners. In fact, the only difference between an LP and an LLLP is that an LLLP has limited liability of the general partners.

Limited partnerships are used extensively in estate planning, and are also great for asset protection provided one is a limited partner, and not a general partner. The general partners are jointly and severally liable for the debts and liabilities of the partnership and the other partners, and, hence, possess limited asset protection.

Creditor's remedies against limited partnerships (and LLCs) involve primarily a charging order, and in limited cases judicial foreclosure powers and dissolution of the partnership (or LLC). A partnership must consist of two or more members. Single-member LLCs are most at risk, unless specifically protected by state law. A charging order is merely the right of a creditor to attach to distributions from a partnership (or LLC). The creditor has none of the rights that a substitute partner (or LLC member) would have, i.e. no voting rights, no right to audit partnership (or LLC) books, or any right to sell or otherwise foreclose on the partnership (or LLC) interest or property owned by the entity. The creditor is nothing short of a mere assignee.

A poison pill for a creditor who obtains a charging order is that the debtor assignee is responsible for the pro rata amount of tax due on profits received by the partnership or LLC, even if no distributions are made.

There exists a strong public policy in favor of the charging order arrangement. It is to protect the nondebtor partners or LLC members who have not incurred any of the debts of the debtor partner or LLC member from undue interference or a dissolution of the entity resulting in unfortunate economic hardships to innocent partners and LLC members and other employees of the entity. This would explain why single-member LLCs are most vulnerable to attack, since there do not exist other partners or members who may be harmed by their dissolution or seizure of their assets.

This is in contradistinction to a corporation whereby a creditor may seize the shares of the debtor and, in essence, step into the debtor's shoes and become a legal bona fide stockholder with all the rights possessed by the debtor shareholder. If a creditor possesses a majority of the corporate shares, he may vote in a new friendly board of directors, who in turn will select a new friendly CEO and President, who in turn may terminate the corporation and/or allow corporate assets to be seized.

The difference is that an LLLP protects the general partners by providing them with a liability shield similar to that of a partner in a limited liability partnership (LLP). Therefore, the general partners are not liable for the debts and obligations of the partnership or the negligence or misconduct of the other general partners, unless they violated their fiduciary duty to the partnership or other partners. Think of an LLLP as a limited partnership with special liability protections for the general partners. A limited partner of either an LP or an LLLP is treated the same. If one wishes to form a partnership and wants to maintain control and therefore be considered a general partner, it is best to form an LLLP over an LP, or alternatively to form an LP, but have the general partner be either an LLC or corporation, rather than an individual.

One can be simultaneously both a general and limited partner. Partner interests are protected by the creditor's charging order remedy. An LLLP with the nondebtor spouse as general partner, or better yet for the nondebtor spouse to own an LLC or partnership as the general partner of the LLLP is viable option.

The Partnership Agreement or Operating Agreement of the LLC must be drafted by an attorney familiar with complex estate planning concepts to ensure it includes language authorizing the general partners' full discretion to withhold distributions of profits for any reason they deem appropriate. Advisable language may include strict prohibitions on transferability of limited partnership interests without the consent of a supermajority of the general and limited partners, calls by the general partner to assess limited partners and their assignees to make capital contributions, strict limitations on limited partners withdrawal of capital contributions, and absolute prohibitions of assignees from withdrawing capital accounts for any reason. Care should be taken to choose a favorable situs. For example, there is no prohibition on titling a building located in California in a South Dakota LLC, and then transferring the LLC into a trust sited in South Dakota or other state with favorable asset protection laws. Of course, one must be aware of conflict of law issues and choose a South Dakota trustee, and preferably own some property or have a bank account in a South Dakota bank.

C. Corporations

This discussion applies to both C and S corporations.

A corporation provides asset protection against one's personal assets for any incidents or acts or lawsuits or judgments arising from within the corporate context, i.e. inside liability. However, the corporate veil can be pierced in situations where an officer or director can be held personally liable for the acts of the corporation. If one is personally sued, the shares of the corporation that he or she owns can be seized by creditors, and then the creditors become the new shareholders Board of Directors who then vote in new officers and thereby take over control of the corporation. The new officers can then liquidate the corporation if needed to pay any personal debts. Consider transferring shares of a corporation to the lower liability spouse, or to an irrevocable trust with the children as beneficiaries. C corporation shares can be transferred to an LLC or partnership. Title S or C corporation shares as tenancy by the entirety, if state law allows. The best option, of course, is to avoid a corporation, but if desired for non-asset protection reasons, the strategy of forming an LLC taxed as a C corporation discussed in the following paragraph should be considered.

C corporations therefore provide a little more flexibility when starting a business, if you plan to grow, expand the ownership, or sell your corporation. Asset Protection planning can include both the protection benefits of an LLC and the tax benefits of a C corporation creating an entity as an LLC for its superior asset protection over that of a corporation, while using the "check the box" election by filing a form 8832 electing the LLC to be taxed as a C corporation for taxation benefits, while avoiding the inferior asset protection features of a corporation.

Be aware of the restrictions on S corporation ownership. An LLC (except a single-member LLC) or partnership or a foreign person cannot own S corporation shares. Allowable S corporation owners include individuals, grantor trusts, or a QSST (qualifying subchapter S trust) or ESBT (electing small business trust). Since it is harder to protect S corporation shares, consider converting the S corporation to a C corporation or pledging your S corporation shares as security for a loan.

D. Foreign Entities

A foreign asset protection trust or foreign LLC, or combination of the two, can provide superior asset protection. Such entities are often tainted with money laundering and illegality, but such is not always the case. There are legitimate arrangements whereby going offshore makes sense. However, unless a physician and his or her spouse are from a foreign country with strong ties, or have enormous wealth, which is not the case for most physicians, going offshore may not make the most sense. Sixteen states have passed favorable asset protection legislation allowing creation of domestic trusts with varying degrees of creditor protection.

VII. PROTECTING ASSETS FROM LAWSUITS AND BANKRUPTCY

The threshold question is whether the physician anticipates filing for bankruptcy. This is determinative of which exemptions apply. Bankruptcy is generally at the discretion of the debtor, but a creditor can force a debtor into an involuntary bankruptcy. There exist both federal and state exemptions in bankruptcy. Usually one or the other applies, but it is state specific. The debtor, within limits, can oftentimes choose which exemptions to take.

A. Exempt Assets

Only exempt assets should be titled in the name of the physician.

1. Homestead

Homestead laws vary widely from state to state. The following states have no homestead dollar limitations, although acreage limitations may apply: Florida, Texas, South Dakota, Kansas, Iowa, Oklahoma, and Arkansas. Kentucky and Tennessee homesteads are protected only up to $5,000 in equity. Recent federal bankruptcy law establishes its own homestead exemption on newly acquired property. The purpose of this federal statute is to prevent a person from moving from a state with a small homestead exemption to a state with a high homestead exemption – thereby shielding one's assets from creditors. The 2016 federal homestead exemption only affects individuals in states where the state homestead exemption exceeds the federal exemption, i.e. the seven states listed above plus Montana, Minnesota, Rhode Island, Massachusetts, and Nevada.

2. Retirement Plans

Qualified retirement plans have nearly absolute perfection in both the bankruptcy and nonbankruptcy contacts, with the exception of super creditors such as the IRS or state judgments for child or spousal support.

3. Life Insurance and Annuities

Protection of life insurance and annuities are very state specific.

B. Nonexempt Assets

Nonexempt assets should not be titled in the name of the individual physician. Rather, they should be titled in entities such as LLCs, limited partnerships, corporations (S or C) or various trusts. Assets can be in either domestic of foreign entities.

VIII. ASSET PROTECTION PLANNING AND ESTATE PLANNING

A. Physician Inherits Assets

There are limited options available to assets that are inherited from parents or others. The determining factor is the estate plan of the one who died. If a physician is in a high risk specialty that would expose inherited assets to creditors, or the inclusion of such assets in the physician's estate would result in estate taxes, then he or she should consider working with their parents' attorney whereby such assets can be received in trust, which would provide both asset protection and protection from estate taxes, if this is an issue. This is often a very delicate issue.

B. Physician transfers Assets to Others at death

At death, there is a 3-level hierarchy determining the priority of how assets pass. At the lowest level are assets that pass by will. Dispositive provisions in a trust override provisions in a will to the extent of any conflict. Assets that pass by operation of law, such as TOD or POD designations, beneficiary designation forms governing retirement plans or insurance policies, override language in either a will or trust. Furthermore, within each of the three levels of this hierarchy, assets can either pass outright or in trust. Assets passing via a will, and also in the case of no will, pass via a legal process called probate. Assets passing in trust or by operation of law bypass probate. A creditor has enforceable rights in probate court to levy upon assets in a probate estate, but has much more limited rights over assets passing in trust or by operation of law.

Assets left to children should be in an irrevocable trust with spendthrift provisions and discretionary distributions by the trustee. Assets left to a spouse should be left in a marital or QTIP (qualified terminable interest) trust with adequate spendthrift safeguards to preserve the assets. This is even more important if one has been married before and has children from a prior marriage. If a physician wishes to provide for children from a prior marriage and at the same time provide for a surviving spouse, even if he or she does not have a large estate, then a QTIP trust with the children from the previous marriage as beneficiaries is appropriate. A QTIP trust is also advisable where there is concern a surviving spouses may become senile, and a point in time comes where they are unable to manage significant assets and they can be taken advantage of or make poor decisions. A competent trustee will prevent this from happening. Do not overlook the portability exemption, which is not automatic, and can only be claimed by filing an estate tax return form 706.

C. Business Entities in Estate Planning

A detailed discussion of business entities in estate planning is beyond the scope of this outline. Suffice it to say that limited partnerships, LLCs, corporations, and trusts are integral to the estate planning process. LLCs and partnerships allow centralized management and passing of fractional interests of assets, along with discounts obtained due to minority control and lack of marketability. Trusts allow spendthrift and creditor protections not available with business entities alone. Beneficiaries of trusts created by a third party, as opposed to a self-settled trust established by the settlor, provide the best asset protection and tax savings possible. For example, a dynasty trust containing an LLC established by a settlor at his or her death, sited in a favorable jurisdiction, provides superior asset protection against almost any conceivable creditor. Such a trust is forever free from both estate and generation-skipping tax and is Perpetua, if established in a state that has abolished the Rule Against Perpetuities.