

Asset Protection 101 – Basics Every Doctor Must Know

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Good financial advisors seek to create safe, steady growth and help you avoid losses and exposures to things like market risk and income and estate taxes. A natural extension of that stewardship is making sure that the growth you are fostering, as well as the balance of your assets, are safe from exposure to an increasingly predatory and hostile litigation system. Not only is litigation against doctors **more common than ever** (as is evidenced by the heated debate on this topic in the context of our national healthcare debate), it's **more dangerous than ever** given the multiple attacks on the wealth of the thousands of doctors we serve including:

- Current Economic Conditions
- Decreasing Compensation and Insurance Reimbursement Rates
- Increasingly Hostile Litigation System that Targets YOUR wealth
- Stalled or Negative Investment Momentum
- Increasing Overhead and Liability Insurance Costs
- Decreases in Liability Insurance Protection due to large awards, *consent to settle* and *defense inside the limits* clauses in your current coverage
- Increasing Employee Lawsuit exposure; suits against medical employers have tripled in the last ten years!
- Increasing burdens of Income and Estate Taxes; the death tax will be 55% of everything over \$1MM in 2011 as of the time of publication

Most of our clients have obvious exposures, such as a physician's potential malpractice exposure or the enduring liability that a large commercial contractor faces. Other sources of exposure are more insidious, such as merely being wealthy and visible, owning income property, or something as simple as you (or your kids) owning and driving a car every day. The numbers are staggering; we are at a point in our litigation system where we have *over 70,000 lawsuits filed per day in the United States alone*, many without any real merit. Unfortunately being "right" or careful is not enough to keep you safe, nor is relying on your skill and experience.

What we and our clients must take to heart is that litigation attorneys are in *business*. Just like any business, including yours, they have weekly meetings in which they examine growth, cash flow, revenue goals and new leads or opportunities. This economic motivation is a key and explains in part why we see awards rising and why plaintiffs' attorneys regularly seek and obtain awards above the limits of applicable liability insurance policies. The average medical malpractice *policy*, as just one example, is \$1MM, whereas the average national malpractice *award* is about \$3.9 million. This leaves the physician "holding the bag" for the other several million dollars. The average doctor simply can't survive that kind of a loss and maintain their financial goals.

Why are your advisors concerned?

As illustrated by the numbers below, awards continue to spiral out of control, fueled by litigation attorneys who have become partners in lawsuits and who are economically incentivized to create and magnify adversarial relations between parties who might otherwise reach some reasonable, if not amicable, settlement.

WHAT ESTABLISHES THE NEED FOR ASSET PROTECTION?

Facts about our litigation system for you:

- We live in a society that files some 70,000 lawsuits per day, many without merit;
- The average medical malpractice award is \$3.9 MM, some authorities put this number substantially higher;
- The average legal costs of settling a frivolous lawsuit is \$91,000 – plus the actual settlement amount itself;
- The average sexual harassment suit against a small business produces a verdict of \$530,000. Employees are suing more often, winning more often and winning proportionally larger judgments. They win 75% of the time;
- Only the top 5% of Americans have a net worth of over \$1MM. Using that as a baseline, it's pretty easy to see where even a client who is worth only a few million dollars fits in on the food chain.

COMMON RISK FACTORS OF OUR CLIENTS – some combination of any of the following:

- They are high net-worth, high liability, or they will be soon (i.e. new doctor)
- They are highly visible, traceable, and or collectible
- They have assets that would be difficult to replace if lost or reduced
- They have employees
- They own their own business
- They have professional liability
- They own liability generating assets, i.e. rental property
- They have children

Can't we just insure our way to safety?

No, unfortunately, for a number of reasons. **First**, it's impossible to insure yourself against every possible contingency and exposure. There will always be many exposures for which no insurance exists or which are not adequately covered by the amount of coverage the client has in place or can afford. **Second**, the liability insurance business model is simple: Take lots of premiums in and pay as few claims as possible. The difference equals profit. When an insured contacts their own carrier to report a claim, a number of the questions asked by the insurance company seek to determine if coverage can be reduced or excluded due to the contributory negligence of their own insured. Think about the questions, "Were you wearing your seatbelt? Were you smoking or on your cell phone at the time of your accident? Do you wear corrective lenses? Have you ingested drugs or alcohol within the previous 24 hours?" **Third**, the holy grail of

the “umbrella policy” and policy limits are rarely fully understood by clients and advisors. To the consumer, “umbrella” means “everything”. To the insurance company it means specific occurrences to specific limits under specific conditions. Add to that the fact that many liability insurance policies are inclusive of defense costs and the actual amount left for the award is reduced, again exposing the insured person personally. For example, your physician or small business owner client has a \$1 million liability policy in place and gets sued. The insurance company spends \$400 thousand on defense costs and loses, resulting in an award of \$1.2 million. In this scenario, only \$600 thousand is available from the policy to put towards the claim itself. Our advice: buy as much insurance as you can afford, assume it won't work and have a good back up plan.

A little proactive medicine goes a long way

We are all aware that there is a ton of **offense** out there. You can't drive across town without seeing ads for contingency fee attorneys plastered on billboards, bus stops and without hearing their ads on the radio. “Were you injured at no fault of your own? Have you been treated unfairly at work? Did you take a medication that may have injured you? Call us; we will get you compensated at no cost to you”. An interesting experiment is for you to Google “personal injury” and add the name of your city. The number of listings for attorneys will be staggering to you, especially when you consider that all those attorneys are in their offices right now waiting for the phone to ring, or thinking of ways to *make* it ring. Remember *your wealth* is the product that they sell and advertise.

The question is what kind of **defensive planning** have you examined? You insure your homes, cars, personal property, health and even your very life, but what level of planning and forethought have you, invested in *insuring your net worth*? Typically very little forethought, other than liability insurance, has gone into this area. This lack of planning can be disastrous, especially for clients who have reached the pinnacle of their career and who are looking towards retirement. What option would a 58 year old doctor have if he or she lost a substantial portion of their net worth to a car accident in which there was a fatality, because their child had a party and another teenager died or was injured, or because they were accused of sexual harassment by a disgruntled employee (all issues I've addressed for clients recently)? Think you or your locality are immune? Just turn on the nightly news and realize that every fatal accident you see reported that day will likely be accompanied by a seven figure lawsuit.

A great deal of the defensive planning involves the proper titling and compartmentalization of assets into acceptable and easily manageable units of risk. It's easier than it sounds but still needs experienced guidance. The mantras we teach our clients are simple:

1. Own nothing, control everything;

2. **What you don't own can't be taken from you;**
3. **The best defense is being an uncollectible target, take steps to remove the economic incentive to pursue you.**

As is illustrated below, moving the title of assets to various appropriate and legitimate entities can dramatically reduce the amount of the exposure you face, and can actually help make the liability insurance you have in place more effective. How? It removes the economic incentive to pursue you beyond the limits of the policy and forces settlements into a reasonable range. Why pursue someone for more than the limits of their policy through a long and expensive court proceeding if they didn't have any assets that can be reached? For the plaintiff's attorney this is a losing proposition and he will likely encourage his client to settle so that he can move on to the next case after taking his share of the award.

In most cases, collectible assets can be sheltered or reduced by over 90% with the use of well tested and established tools like LLCs, Limited Partnerships, Asset Protection Trusts and Receivables and Income Protection plans, to name just a few examples.

BEFORE - EXPOSED

Home	\$1MM Equity	- own name
2 nd home	\$500K Equity	- own name
Office	\$375K Equity	- in RLT
Cash	\$100K	- own name
Securities	\$500K	- in RLT
Art & jewelry	\$275K	- own name
Receivables	\$2MM	- in Single member LLC
Personal Ck	\$50K	- own name
Ins. Cash	\$1MM	- own name
Qualified	\$400K	- in plan

NET WORTH \$6, 650,000 **COLLECTABLE \$6, 250,000**

AFTER - PROTECTED

Home	\$1MM Equity	- in AP TRUST
2 nd home	\$500K Equity	- in AP TRUST
Office	\$375K Equity	- in LLC owned by FLP
Cash	\$100K	- in FLP
Securities	\$500K	- in FLP
Art & jewelry	\$275K	- in FLP
Receivables	\$2MM	- in AR PROGRAM
Personal Ck	\$50K	- own name
Ins. Cash	\$1MM	- in AR PROGRAM
Qualified	\$400K	- in plan

NET WORTH \$6, 650,000 **COLLECTABLE \$50K**

As you can see, the vast majority of a client's collectible assets are accounted for and sheltered in this example. The best tools used are legal, tax neutral and have a legitimate business purpose. The numbers scale easily up or down.

I already have a "Revocable Living Trust". Doesn't this make me safe?

No, this is a dangerous misconception that the majority of the public is working under. The Revocable Living Trust or RLT is a wonderful estate planning tool. However, like most tools it has a specific purpose; in this case, primarily the avoidance of probate and estate taxes.

The RLT is, as the first word in the title suggests, REVOCABLE during your lifetime. This means that during your lifetime you can easily be ordered to revoke the trust and tender trust assets for the payment of a judgment by a court. This is a common occurrence. *The trust becomes irrevocable only upon your death.* Thus, during your lifetime it does not shelter you from any sort of lawsuit exposure. Conversely, Asset Protection does not replace or duplicate good estate planning, but rather works in conjunction with it.

What exactly can be protected?

Non-qualified investments, cash, stocks, both personal and investment or commercial real estate, business equipment, intellectual property, interests in non-liability generating businesses, valuable collection such as art and cars and even future income and business receivables are just a few examples. We typically exclude the personal checking accounts, personal “daily driver vehicles” and personal property.

Some Basics of Good Asset Protection Planning

1. **Do Something today.** Asset Protection is like Net Worth Insurance. You can't insure against a loss after it's already happened. The only good attack against a properly drafted Asset Protection Plan is TIMING – that it was done too late and with the intent to “delay, hinder or defraud” a specific plaintiff.
2. **Be realistic about the possibility of exposure and about the effect that a six or seven figure judgment would have upon the financial plan you have in place.** The most common and egregious mistake made by advisors of all types is telling clients who are worth “only” a few million dollars, or who are working hard to get there, that they are not “big enough” to justify doing this kind of planning; this is nonsense. Of course a client worth five or ten or even \$100 million needs this type of planning. But who will be affected more? The ten million dollar client can take a hit for a million or two and keep the cars, house, lifestyle and the kids in college, but our more average client would be financially devastated. *They need it even more.* Some of the smartest clients we have are typically new physicians with little more than six figures in student debt, a leased car and an apartment. Why? Because they understand that every day that passes strengthens the tools they have in place: “the longer it cooks, the harder the shell”. They also know that they need to have a safe place *to put* every dollar they make, have a safe place *within which* it can grow and *from which* to re-invest it and put it to work for their family.
3. **Have Top Counsel In Place In Three Core Areas: Asset Protection, Financial Management and Accounting.** A good team will help nurture your success, help protect you from loss, mistakes and scams and make sure that you get to keep the money you earn in a legal, efficient and ethical way. These team members make sure that you keep a larger portion of every dollar you make, pay as little in tax as the law allows and that your money works as hard for you as you did to get it.
4. **Use the right tools.** Asset Protection is part art, part science, just like your business. There are certain proven methods and tools that work and others that do not. Be wary of promoters, do it yourself kits and promises of domestic jurisdictions that will make you safe and save you money on

taxes. Each tool has a specific business purpose that protects specific types of property, they are not all interchangeable.

5. **No, Nevada Corporations do not work.** In fact, they are increasingly viewed as presumptively fraudulent due to a long history of abuse and tax fraud. Thousands of consumers have purchased them under false promises of secrecy, bearer share anonymity and tax advantages. Almost all these promises are completely fictional. Our information shows us that the term “bearer shares” does not even exist in the statutes of the state of Nevada. Unless you live there, do business primarily from or in the state of Nevada and have the assets in question housed in the state, a Nevada LLC will not help you, especially if it lacks a real business purpose as explained below.
6. **Maintain a legitimate business purpose for all legal tools.** We commonly see good tools misused by clients and inexperienced planners which do more harm than good. In order to take advantage of the full protection the law affords we must maintain an essential business purpose for the tools we use. The use of limited partnerships for investment management and LLCs to hold investment or commercial real estate are two examples of well proven and tested business usages.
7. **No, transfers to a spouse, child or relative are not effective.** This is especially true if the transfer is made after an exposure has occurred. A thinly disguised “gift” will easily be reversed and the property seized by the court in the event of a judgment. Further, these types of transfers are rarely legitimized by the appropriate recording and tax reporting formalities. If you gave your 17 year old your \$1 million home at full equity, you better have a gift tax return illustrating that, and it better have been done well in advance of the harm complained of. Even if the gift is effectively made, all you have done is given away something you want to protect and exposed it to *another person’s* liability.
8. **“Just” an S-corp. or an LLC is not enough.** Single member or closely held corporations with just one or two owners are exactly they type of entity you commonly hear referred to when you hear the phrase “piercing the corporate veil”. If a business has only one or two owners who closely manage and control the operations of the business on a daily basis, or even worse, who are also directly responsible for a harm or injury, it is relatively simple for a court to pierce the veil and grant access to the owner’s personal assets. This is especially true with successful small businesses and family businesses that often don’t maintain the formalities of keeping personal and business expenditures completely separate, bolstering the argument that the person and the corporation are one and the same.
9. **Get professional, individual help.** There are a wide variety of skill levels in every profession, including the law. Many so-called Asset Protection professionals are not attorneys, or are attorneys who apply bits and pieces of knowledge from other fields of practice that may actually diminish legal protections in existence. Every plan must be uniquely tailored to the

individual, their activities and the unique nature of their assets. There is no one-size-fits-all solution, even though clients with similar assets may have similar looking plans.

10. **The legal tools used are typically tax neutral.** Don't try to combine tax planning and Asset Protection. In most cases, the tools used are taxed neutral and do not provide tax advantage or tax liability. Many times abusive tax structures are disguised as Asset Protection, often promising tax free growth offshore in various trusts or captive insurance plans. Putting money into a plan tax free, growing it tax free and pulling it out tax free is rarely if ever possible; you can't have all three.
11. **Don't forget about income and receivables – protect the source.** Very often we see doctors that are concerned about protecting everything they have been fortunate enough to accumulate while ignoring ways to protect their future income. We find that many doctors, even those with a very high net worth, often have fixed business and personal overhead commitments based on the expectation of a certain income level. If they suddenly had that cash flow tap turned off, they would not be able to sustain their current monthly expenditures. This scenario would force them into a situation where they were selling off assets or going into qualified plans early and making substantial lifestyle changes. There are options available for qualified physicians that can securitize that income stream.
12. **Don't draw liability in.** In many cases physicians unintentionally escalate their value as a target. For instance, how many of your peers have vehicles that they or their spouse drive titled in the name of their business? Which of the following three defendants is most exciting to a plaintiff: John Smith, Dr. John Smith, or Smith Surgical Inc.? As you can see, the corporate defendant is often the most exciting and deepest pocket. In order to fix this we simply transfer the vehicle back to the client's name and have them take a car allowance from the business. Remember, with a good plan in place you won't have substantial exposed assets anyway.
13. **Have Adequate Levels of Insurance** on everything: malpractice liability, auto, home, life, long term care and disability. Buy every dollar of liability coverage you can afford, assume it won't be fully adequate and have a back up plan.
14. **Protect your credit; it is one of your most enduring and valuable assets.** As credit markets have tightened, even the wealthy are having trouble obtaining credit for every day issues like home and auto purchase or leasing. This means check your credit reports regularly and take steps to protect your identity.

This introduction is just that, an introduction to the most basic concepts behind legal and effective Asset Protection planning and provides only generally applicable rules and issues to be aware of. When you are ready to explore the solutions available, seek qualified counsel that has a proven record of experience in this specific field.

ABOUT THE AUTHOR

Ike Devji, J.D. – Executive Vice-President, The Wealthy 100, Of-Counsel, Lodmell & Lodmell, P.C.

Asset Protection attorney Ike Devji helps to protect thousands of doctors with over \$5 billion dollars in assets nationwide often at the referral of their advisors, CPAs and local attorneys. He was recently named one of only 24 "Leading Wealth and Legal Advisors" in the country by Worth Magazine and is the Executive V.P of the Wealthy 100™, a Phoenix based wealth management and wealth strategy and preservation firm with a network of advisors across the U.S.

Before joining the Wealthy 100, Mr. Devji, a litigator by training, acted as the Managing Attorney of the law firm of Lodmell & Lodmell, one of the nation's leading Asset Protection only law firms. Mr. Devji currently maintains an of-counsel relationship with the firm and selectively consults and provides Asset Protection services to high-net worth, high liability clients including business owners, real estate developers, C-level executives and professional athletes and entertainers.

Ike has spoken on Asset Protection to literally thousands of physicians and other high-net worth clients across the country. He continues to teach continuing legal education on this subject to other attorneys and regularly lectures at the request of leading medical practice management and investment management groups including Blue Chip Planning, Mosaic Financial Advisors, CFO Advisors, Christenson Wealth Management, MultiFinancial Securities, Greenbook Financial, ING, ING TRUST, numerous banks, and both Lorman and the National Business Institute.

Mr. Devji also consults on a number of other wealth and estate preservation and maximization strategies for qualified individuals including premium financing, real estate depreciation and income and receivables protection strategies. Ike Devji may be reached at ID@thewealthy100.com.