

ON CALL

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The previous article on licensure issues deals with the physician's ability to retain his or her license in the event that the physician goes bare. If a judgment is rendered against a physician it is imperative that the physician has set up a program where the assets of both his or her practice as well as his or her personal assets are protected from creditors. Florida has long been labeled as a "debtors' haven" with very liberal exemptions from creditor attachment.

The laundry list of exemptions is set forth under Florida Statutes §222 et. seq.; under the Florida Constitution; pursuant to the limited liability company laws; and under the limited partnership laws. This article will attempt to discuss (or at least mention) all of the exemptions available to debtors and their current status.

The "granddaddy" of all of exemptions in the State of Florida is the homestead exemption. Article X, Section 4 of the Florida Constitution

absolutely protects the homestead from creditor attachment except in three circumstances. The circumstances in which a homestead would not be

protected would be divorce; from a lender who loans purchase money for the house; or for a mechanics' lien that arises from labor performed on the house. With respect to the homestead exemption, Florida has long been known as the "deadbeat state". This reputation was long ago earned by this State by reference to former Major League Baseball Commissioner, Bowie Kuhn, who when faced with a judgment against him moved to the State of Florida and purchased a large estate home. When the creditor attempted to levy on the home from the newly relocated Commissioner Kuhn the creditors' efforts were effectively checked. Shortly thereafter Florida became known as the "deadbeat state".

Over the last year and a half Congress has sought to limit the homestead exemptions especially in both the States of Florida and Texas. Under the proposed Bankruptcy Reform Bill (the "Bill"), the homestead exemption in all states would be reduced to \$125,000.00 of protectable equity. The Bill got quite a bit of support but was derailed for several reasons last year, including the events of September 11 and the resulting economic instability as well as a controversial abortion related rider to the Bill. Florida had a chance to dispel some of its reputation as a "deadbeat state" with the case of *Havoco v. Hill* but in fact may have made things "worse".

Protection of Assets.

by Mike Singer, Esq.

Most experts expected the Bill to pass, however as of the date of this article, the Bankruptcy Reform Bill has not been passed and in fact had been defeated in the House of Representatives on November 13, 14, and 15th of this year. In a last ditch effort, the House has submitted the Senate's version for consideration in lieu of its own.

One of the key questions in both estate planning and asset protection is "how should I own my house?" The answer "depends" on the family situation. Often the house is

owned in the non-physician spouse's revocable trust for the purpose of funding the non-physician's spouse unified credit exemption. The house then is made

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unavailable to the physician's creditors and serves to fund the non-physician spouse's trust. It is noteworthy that a case exists out of the Middle District Bankruptcy Court which has held that a homestead owned in a revocable trust does not qualify for the homestead exemption. However, this author believes the *Bosonetto* case was clearly "way" off base. The homestead has always been recognized as owned by the individual through his or her revocable trust because of the nature of the trust as a "pass through" entity. In fact, local property appraisers in every county known to this author have always recognized the homestead exemption as long as the debtor has the continuous right to live in the homestead.

Finally, in planning we often make sure that the non-practicing spouse's trust is funded with many assets of the marriage because in the unlikely event the spouse passes away while the physician spouse has a judgment pending, those assets might otherwise be subject to the claims of creditors upon the non-physician spouse's death. If the assets are held in trust, because the instrument becomes irrevocable at death, such assets not become subject to claims by creditors.

The second exemption, which is the only non-statutory exemption, is for property owned as tenants by the entirety. In Florida there are three ways of owning property,



which are tenants in common, joint tenants with rights of survivorship and tenants by the entirety. Under the latter method (which is the only method of affording any asset protection features) each of husband and wife are considered to own 100% of the asset. Under the law, it would be unjust to allow the judgment against the physician spouse for example to cause the forfeiture of property owned 100% by the remaining non-tortfeasing spouse. However, it is significant to note that this particular exemption has been most fragile over time. Earlier this year, the Supreme Court decided the case of *In Re: Craft*. Under the *Craft* case the Supreme Court held that the IRS was entitled to seize one-half of the property owned by tenants by the entirety. Previously the IRS was forbidden, like a normal judgment creditor from seizing any portion of tenants by the entirety property.

While we would argue that a creditor should not be allowed to use the *Craft* case as precedent (because same should only apply to the IRS) it is very uncertain whether the courts in Florida would come to such a conclusion. As such, the mere existence of the *Craft* case should probably discourage physicians for relying on the tenants by the entirety exemption too heavily.

The third exemption is for "wages". In Florida, wages are exempt from creditor attachment if three requirements are met. First, the debtor must be the head of the household which means providing fifty-one percent (51%) of the support for someone else. Second, the wages paid to the physician must be treated as wages for payroll purposes (i.e. taxes are withheld prior to distribution). Third and perhaps most importantly, the physician must have an annual written employment agreement with his or her practice. For example, John Smith, M.D., P.A. would need to have an annual employment agreement with its sole employee, John Smith, M.D. each year in writing setting forth a number of things including compensation, duties and the economics between the practice and the physician. If all three requirements are met then the Physician would be entitled to the wage exemption. This protection would also extend to a separate and distinct "wage account".

A wage account is simply a checking or savings account which would bear the name, in our hypothetical, of John Smith, M.D., Wage Account. The wage account would

receive the wages paid to Dr. Smith. Funds could be paid out of such wage account but nothing other than wages could go into such wage account. The statute provides protection for wage accounts for up to six months. As such we advise our clients to sweep the wage account down to zero at least twice a year (i.e. June 29th and December 28th).

The fourth and fifth exemptions are for life insurance and annuities. The cash value and proceeds of life insurance and annuities are by statute exempt from creditor attachment. In the case of *In re: Goldenberg*, the trustee made a weak argument that the cash surrender value of annuities are somehow seizable by creditors.

The sixth exemption extent is for individual retirement accounts. This exemption would also apply to Roth IRAs. The seventh and final exemption (contained in the same

Statute as the IRA exemption) is for qualified retirement plans. While discussion of the evolution of this exemption as well as its fragility is beyond the scope of this paper, it is clear that a qualified plan with common law employees that is compliant with federal tax laws would be exempt from creditor attachment.

However, the exemption for qualified plans may extend only to plans that are "ERISA qualified". ERISA qualified means that the plan participants include employees other than the

shareholder and the shareholder's spouse. As such, if Dr. Smith maintained a pension plan in which only he and his spouse participated (or for example only Dr. Smith and his partner, Dr. Jones and their spouses participated) those plan balances might not be exempt from creditor exemption under current law.

There are other statutory vehicles which provide protection from creditors in the State of Florida such as limited liability companies and family limited partnerships. None of these vehicles provide an absolute exemption from creditor attachment instead they provide a mechanism to deflect creditor's rights and abilities for getting at the underlying assets. Offshore planning is also often used as a creditor protection technique.

Armed with the exemptions and planning tools set forth above, the physician must then undertake an analysis of whether the assets of the practice and his or her own per-

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sonal assets are protected. Many of the personal protections are easy to achieve by simply re-titling assets. Often in the funding of the physician and the physician's spouse's estate planning documents, such as their revocable trusts, asset protection is achieved. However, it is very important to consider all tax and estate planning aspects as well as the consequences of transfers between spouses. The physician also needs to analyze whether the assets of the practice are protected. Typically, the practice may have only three or four assets. The practice may have cash which would be obviously dissipated in payment of ordinary business expenses prior to the collection on a judgment. Second, the practice may own its building. This would be very unfortunate planning and something that should be rectified immediately. If a judgment is achieved against the physician, the judgment is also likely to be achieved against the physician's practice under the theory of respondeat superior (the entity is liable for the acts of its employees). Most often the building should be owned in a limited liability company as a means of asset protection.

This third asset that a practice may have is equipment. If the equipment is of value either in terms of actual value or in terms of a prohibitive cost to replace such equipment, we might employ use of a technique called a "sale-leaseback" technique. Under this planning technique, equipment is sold to an exempt form of ownership (perhaps an LLC) and the practice leases the equipment from the LLC. The LLC would be responsible for the collection of sales tax but the assets would be owned by a Florida "exempt" entity. A word of great caution however should be heeded because the sale of the equipment to the exempt entity may trigger tax which would make the transaction cost prohibitive.

Finally, the most attractive asset to the creditor is the accounts receivable. Although not cash presently, accounts receivable will eventually be cash (i.e. at whatever collection rate the practice has been able to achieve). The goal with accounts receivable is to achieve what is often referred to as "equity stripping". Under this planning technique the equity is stripped out of the accounts receivable by pledging them, for example, to purchase a building (for example should an orthopaedic practice wish to open its own free standing or contiguous surgery center). However, when that type of planning is not feasible or desirable, we often use a technique employing non-qualified deferred compensation. In this technique the physician enters into a non-qualified deferred compensation agreement with his or her practice which acknowledges that physician's labor (or labor of his or her employees) has produced the receivables of the practice and that it would pay the accounts receiv-

able to the physician if it was able to collect same today but cannot. The practice and the physician enter into a non-qualified deferred compensation agreement under Section 83 of the Internal Revenue Code which provides for postponement of tax until such time as the asset is actually distributed to the physician (where the corporation would get a corresponding tax deduction).

The corporation then goes to the bank and asks for and obtains a loan in the amount of the "good" receivables of the practice. The proceeds of the loan are then used to purchase an annuity or life insurance contract (or combination thereof) to fund such deferred compensation program. When the creditor comes along, the receivables are owned by the bank, the proceeds have been invested in an exempt asset and the bank holds first and secondary positions on both pieces of collateral. Typically the loans are written at the rate of "Prime" or slightly less than Prime. The practice's obligation is to pay interest only for a period of years, making sure the loan is not an "evergreen loan", while the annuity or life insurance contract (s) are growing a tax deferred basis. There is some conjecture as to whether or not the interest payable on the loan is deductible. There are other tax issues as well which also need to be discussed and considered.

Clearly, techniques exist in the State of Florida to allow physicians and their practices to attempt to achieve maximum asset protection. It is imperative, however, that the advice of the attorney specializing in asset protection be employed. The techniques are highly tax sensitive and the laws relating to same have been changing on a daily basis. ⊗

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