Ten Rules for Asset Protection Planning

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The question of whether a medical malpractice lawsuit will be commenced is not a matter within the discretion of the physician, but rather within the discretion of the patient and the patient's lawyer. Therefore, although making oneself "lawsuit proof" is simply not possible, making oneself "judgment proof," or nearly so, is often very possible, provided only that there has been sufficient advance planning.

There is a gambling saying that goes something like, "If you want to be a winner, you have to walk away from the table a winner." One time-honored method of reaching this result is to systematically take your chips off the table as you win them, so that your potential for losses stays small.

Asset protection planning is all about taking chips off the table in good times, so that you still can walk away from the table a winner, no matter what happens in bad times. Technically, asset protection planning is the debtor's side of creditor-debtor law. Whereas creditors are concerned about the strategies and techniques of collection, debtors are interested in the strategies and techniques for protecting their most valuable assets from potential creditors. However, in this calculation, it is not just about protecting assets but also about making sure that one does not end up in jail for contempt of court or bankruptcy fraud for engaging in the process.

Keeping in mind the law school adage that "general rules are generally inapplicable," the following 10 rules should always be considered when you try to take your chips off the table.

1. Start planning before a claim arises. Many things you can do will effectively provide asset protection before a claim or liability arises, but few things will provide this protection afterwards. That is because what you do after a claim arises could be undone by "fraudulent transfer" law. Moreover, the point at which a claim arises is earlier than a layman might think—it is, for example, usually much earlier than when a demand letter or a process server shows up at the door.

2. Late planning usually backfires. Asset protection planning after a claim arises is apt to make matters worse; think of it as getting a flu shot while you have the flu, and the shot itself is making you even more woozy. It is a common misconception that the only thing a judge can do is to unwind a fraudulent transfer, leaving a debtor who unsuccessfully tried late planning no worse off than if the debtor had done nothing. To the contrary, both the debtor and whoever assisted in the fraudulent transfer can become liable for the creditor's attorney fees, and the debtor can lose the hope of getting a discharge in bankruptcy.

3. Asset protection planning is not a substitute for insurance. Asset protection planning should not be a substitute for liability and professional insurance; rather, this should supplement insurance. It is a myth that asset protection plans invariably scare away plaintiffs, and an asset protection plan does not pay legal fees to defend against a lawsuit. Insurance also supplements asset protection planning, because it can help a debtor survive a fraudulent transfer claim. If you get sued, let the insurance company pay to defend it and pay to settle it—that is what you are paying the premiums for.

4. Personal assets are for trusts; business assets are for business entities. Business entities, such as corporations, partnerships, and limited liability companies (LLCs), are meant to be vehicles for commercial operations, not to act as personal piggy banks. When personal assets are placed into a business entity, the potential for the entity to be pierced by a creditor, based on one theory or another, such as alter ego, increases dramatically. The place to put personal assets is in a trust. A long and solid body of law protects trust assets, when the trust is properly drafted and funded. And please do not name the entity the "Family" partnership or LLC, unless your family is famous for making sausage or some such other commodity.

5. Too much control is a bad thing. Asset protection planning attempts to reach a balance between giving the client sufficient control so that the assets do not disappear, but at the same time not so much control that a creditor can successfully argue that the debtor and the asset protection structure are effectively one-and-the-same and thus should be disregarded, based on alter ego or a similar theory.

6. Asset protection planning and tax and estate planning do not always jibe. Asset protection planning and estate planning often work together, but sometimes they are at odds, and what may be a good idea for tax and estate planning may not be such a great idea for asset protection. For example, the making of gifts (to children and other prospective heirs) is common in estate planning but anathema in asset protec-

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tion planning, because gifts are often easy to set aside as fraudulent transfers. Meanwhile, homestead exemptions are a very powerful asset protection planning tool, but their use usually traps the value of the home in the debtor's estate.

7. Your money may be offshore, but you are here. Recent cases have recognized the power of courts to require debtors to bring their offshore money back to the United States through what are known as "repatriation orders." If the debtor does not comply with a repatriation order, a court may issue a bench warrant for contempt of court and hold you in contempt (and in jail) until the money comes back, or for many years. The record? It is 14 years in jail served by former corporate lawyer H. Beatty Chadwick, who refused to repatriate money from overseas to pay alimony to his ex-wife.

8. Don't count on bankruptcy as the last refuge of a desperate debtor. Once upon a time, bankruptcy was akin to a warm shower that allowed a debtor to wash all debts away, while still retaining a goodly amount of assets. This is not true anymore. In 2005, the bankruptcy laws changed to become a cold acid bath that leaves debtors with bare bones and little flesh. State homestead exemptions have been substantially limited, and other new provisions in the bankruptcy code and new bankruptcy case law can make parts of asset protection plans very difficult to protect in bankruptcy. In addition, bankruptcy judges have some of the strongest powers to make debtors cough up assets.

9. If you can't explain it, it will never work. Many asset protection plans become so complicated that even the client cannot explain how assets are held or how those assets were transferred. However, such questions can be expected in depositions or a debtor's examination, and a failure to fully and clearly explain what happened and why will make the court very suspicious and potentially give the court grounds to begin disregarding entities or setting aside transfers. Most judges start asking themselves, "What is really going on here?" If the structure and transfers are too complicated and not well explained, there is a much higher chance that the judge will find fraud on creditors. Indeed, the best asset protection plans are often simple plans, such as creating and funding an irrevocable trust for the benefit of your children.

10. Usually everything sees the light of day. Asset protection planning should be based on the presumption that the entirety of the planning and its purpose will eventually become known to creditors, because one way or another it usually does. Asset protection plans that require secrecy will face a plethora of problems, from how not to disclose the structure or activity of these plans on tax returns, to how to keep a mad ex-spouse or disgruntled employee from talking to creditors. And do not even think about going into bankruptcy without making a full disclosure about assets and transfers. The failure to make a full disclosure will usually lead to a denial of discharge, and the failure to make a truthful disclosure can amount to charges of perjury and bankruptcy fraud.

A Final Caution for Physicians

Asset protection protects assets but not necessarily income streams. Physicians are often sued not based on what assets they have or do not have, but rather based on their future income potential. Despite the often Pollyannaish claims of some asset protection marketers, it is extremely difficult, if not impossible, to protect from creditors one's future earnings derived from professional fees. Although federal law limits the amount of wages that a creditor can garnish to 25% of the net after taxes, this can still be a very substantial amount.

Often, the only effective way to protect those future earnings is through bankruptcy. If, however, the physician has engaged in asset protection that is defective, too aggressive, or—most frequently—started only after the claim has arisen, then the most likely result will be that the physician's discharge will be denied, or the creditor's claim excepted from discharge. If that happens, the result is that the claim will not go away until it is fully paid, and the creditor will have little incentive to settle by that point.

The lesson from this is, similar to so many medical treatment procedures, do not engage in asset protection planning unless you are prepared to do it in a timely fashion, and the right way. Or, to borrow a phrase, "First, do no harm." ●

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