

PROPOSITION 12: WHAT TO DO NOW?

As soon as Proposition 12 was enacted into law, it was hailed by many as the needed answer to combat an increasingly litigious society and a way to halt the skyrocketing cost of medical malpractice insurance. While the passage of Proposition 12 may come as a welcome relief to Texas physicians, it is still imperative for physicians to engage in comprehensive asset protection planning for several reasons. **First**, there is a chance that Proposition 12 could be ruled unconstitutional by the judicial system. **Second**, Proposition 12 amends the Texas Constitution by granting the Texas legislature the power to set a limit on the amount of damages which may be awarded for non-economic injuries (i.e., pain and suffering). The new law limits the liability for doctors, hospitals, and nursing homes at \$250,000 each and caps the total award for non-economic damages at \$750,000. Since the Texas legislature has the power to set these limits, a change in the composition of the Texas legislature could lead to a significant increase to these limits. **Third**, Proposition 12 only limits the amount of non-economic damages which can be assessed against a physician. Proposition 12 does not limit a physician's liability for economic damages (i.e., loss of income) suffered by a plaintiff, so it may be possible for a plaintiff with a large income-generation potential to obtain a significant judgment against a physician. **Fourth**, Proposition 12 in no way limits damages against physicians for non-malpractice claims which may arise through their practice or against them personally. **Thus, it is imperative for physicians to incorporate comprehensive asset protection planning for both business and personal assets as part of an overall estate plan.**

There are seven distinct goals in a well-designed asset protection plan:

1. Take full advantage of state law exemptions.
2. Protect personal assets from business claims.
3. Protect personal assets from personal claims.
4. Protect business assets from personal claims.
5. Protect business assets such as accounts receivable and equipment from business creditors.
6. Protect assets of one business activity from claims against another business activity.
7. Protect inherited assets from creditors.

Our law firm specializes in performing a comprehensive analysis of each client's individual situation, developing a strategy to protect assets, and assisting the client in implementing the strategy. There are many techniques which are available, and the decision of which to use must be made on a case-by-case basis. In this newsletter, we are featuring two of the premier asset protection techniques, the S.M.A.R.T. plan and the FLP.

THE S.M.A.R.T. PLAN

Typically, the **accounts receivable** is the largest business asset of a physician practice group or sole practitioner. While the accounts receivable is the largest asset of most physicians, it is not an income-generating asset in that the physician is not earning a return on the balance, which remains relatively constant. From an asset protection standpoint, a large accounts receivable balance presents an attractive target to a creditor. It is relatively easy for a creditor to collect a judgment because the court can appoint a receiver to open the mail and take payments made on the accounts receivable balance until the judgment is satisfied. **For**

physicians in a large practice group, it is important to remember that the entire group's accounts receivable is at risk if there is a malpractice award against any one physician in the group. This applies even for a judgment against a physician who is no longer with the practice group.

The Blum Firm has developed S.M.A.R.T. (Strategic Medical Accounts Receivable Transfer) in conjunction with Physicians Resource Management to assist physicians in protecting their most valuable business asset – accounts receivable – from all types of business claims, including malpractice. S.M.A.R.T. allows physicians to protect their accounts receivable from both business and personal creditors and to monetize the value of the accounts receivable and turn it into an income-producing asset. The implementation of S.M.A.R.T. involves the interplay of three different disciplines: i) legal and income tax expertise to ensure that the desired level of asset protection is achieved as well as structuring advice to maximize the income tax benefits; ii) a bank or financial institution to provide appropriate financing at a reasonable cost; and, iii) a financial advisor to assist in the selection of an appropriate investment vehicle. Our firm has developed the expertise to coordinate all the steps involved in implementing the S.M.A.R.T. plan.

THE FAMILY LIMITED PARTNERSHIP (“FLP”)

An FLP is an excellent vehicle to hold investment assets such as marketable securities and real estate, including the real estate used for the medical practice. A partner's individual creditors cannot reach assets inside the FLP. Instead, they are limited to a “charging order,” which gives the creditors no voice in the FLP but does entitle them to the partner's share of any distributions. In that case, the general partner may refuse to make distributions. Each investment activity that carries its own inside liability risks (such as real estate), should be in a separate FLP. Alternatively, a master FLP can be created, with each activity in a separate LLC owned by the master FLP.

FLPs can also be a useful tool to reduce estate taxes upon death. Recently, the IRS has been successful in denying the estate tax benefits of an FLP in cases in which the taxpayers did not respect the FLP as a separate legal entity by not operating it as such. Most recently, the Tax Court has also suggested that the structure of an FLP may preclude the estate of a deceased taxpayer from taking advantage of the estate tax reduction benefits of an FLP. **We have developed several solutions to thwart IRS attacks that the structure of an FLP may preclude estate tax benefits. It is critical for physicians who have an existing FLP to ensure that it is being operated properly and to investigate whether or not a restructuring of the FLP is warranted in order to maximize estate tax benefits.** For physicians who are contemplating an FLP, we believe that FLPs still provide effective asset protection as well as estate tax benefits if structured properly.

Unfortunately, many physicians do not think about asset protection planning until after a claim arises or a lawsuit is filed. By then, very little can be done. Steps taken at the eleventh hour can be set aside as fraudulent transfers. Although a pending claim does not prevent asset protection planning, asset protection planning is most effective when it is implemented without the threat of a lawsuit or creditor problems on the horizon.