Insert. Traditional Asset Protection Planning Concepts for Business/Corporate Entities

It is crucial for physicians and other health care professionals to seek professional advice in the establishment of a private practice or professional service corporation; a discussion of the various business structures and related business issues for physicians is beyond the scope of this article. It is important to note that despite the various available entities offering creditor protection, state statutes and judicial decisions consistently provide that professionals such as physicians, dentists, and attorneys face personal liability in connection with legal actions brought against them for malpractice.[1]

Of course, a medical practice such as a professional corporation and its individual professionals will carry malpractice insurance as protection for such situations. Nevertheless, there always is the possibility that: 1) a judgment may be rendered that exceeds the malpractice insurance coverage limits on a given policy; 2) the insurance carrier may disallow coverage of a claim; or 3) the insurance carrier becomes insolvent. Thus, it is crucial for physicians and other professionals to explore asset protection strategies to insulate their personal holdings from their professional liabilities. Accordingly, the following discussion concerning limited liability achieved through business entities does not pertain to claims based upon professional liability:

Corporations. A longtime estate planning and asset protection technique involves the use of a corporation in an attempt to limit liability for it owners (the shareholders). In general, a corporation is treated as a separate legal entity distinct from its owners, and, absent special circumstances, the owners' personal holdings are not subject to exposure for the debts incurred by the corporation. As a general rule, the shareholder's liability for corporate debts is limited to the amount of the shareholder's investment in the corporation.

Nevertheless, there are several circumstances under which a corporation's shareholders are subject to personal liability. Shareholders personally are liable if they personally guarantee a corporate obligation and if it can be demonstrated that they are conducting business in their individual (rather than corporate) capacities.

"Piercing the corporate veil" refers to a judicial willingness to ignore the corporate structure and hold a shareholder's personal assets accountable for the corporate liabilities. Examples of where creditors generally are successful in piercing the corporate veil involve situations in which egregious conduct on the part of the shareholder would produce a great inequity for a creditor. In addition, limited liability will be set aside if it can be established that the shareholders did not recognize the corporation as a distinct entity by maintaining minutes of corporate meetings, mandatory state recordings and annual filings were ignored; or that the shareholders commingled corporate assets with their individual assets.

Limited Partnerships. Limited partnerships are a longstanding asset protection planning technique and have been employed by practitioners for their asset protection and tax advantages. In recent years, plans including limited partnerships have become slightly less popular due to the advent of limited liability companies *(see p. 2)*. Like a shareholder in a corporation, a limited partner's exposure for the debts of a partnership is limited to the amount of the limited partner's investment in the entity. Thus, a creditor of a partnership attempting to satisfy a debt of a partnership cannot execute upon the personal assets of a limited partner in an effort to satisfy the obligation. The general partner, however, is liable for the partnership debts while maintaining control of the entity. Thus, plans involving a limited partnership often use a corporation or other entity as a general partner.[2] In addition, many strategies contemplate a general partner giving the majority of the value in the partnership to the limited partners while retaining control.

Additionally, a limited partnership has an added advantage in that state law limits the remedies available to a creditor of a limited partner. Specifically, a charging order is the exclusive remedy of creditors of the limited and general partners of a limited partnership. This means that if a creditor is successful in securing a judgment against a limited partner, that partner can merely "assign" the partnership interest to the creditor. As an assignee, the creditor does not obtain the rights of a partner but only obtains the ability to receive distributions (if any) that the debtor would have received. In the context of a properly drafted family partnership agreement with "friendly" partners, a judgment creditor's ability to satisfy a debt through receipt of the debtor's partnership distributions can be prevented.

Limited partnerships or family limited partnerships have long been touted for their distinct estate and gift tax planning advantages. The IRS has consistently permitted individuals to obtain steep discounts in valuing gifts of limited partnership interests to family members. This is because the governing limited partnership agreement often restricts the rights of the limited partners, thereby allowing minority interest and lack of marketability discounts to substantially reduce the value of the underlying partnership interests that are transferred.

Limited Liability Companies. A limited liability company (LLC) is a statutory entity governed according to the applicable state LLC statute. An LLC's owners are referred to as members and an operating agreement is the primary instrument governing an LLC. LLCs have both of the asset protection advantages afforded to a limited partnership (limited liability and charging order remedies for a creditor of a member). However, LLCs have an added advantage in that its members actively can participate in the management of the company without risk of exposing the member's limited liability (in contrast to a limited partnership where only a general partner maintains the ability to manage the entity).

LLCs provide the similar estate and gift tax-planning opportunities available through limited partnerships.

Endnotes

1. Spero P. *Asset Protection Legal Planning and Strategies,* § 9.05. *See also* statutes relating to professional service corporations such as 805 Ill. Comp. Stat. Ann. (West 1998); Fla. Stat. Ann. §621.07 (West 1998); NY Bus. Corp. Law §§1501-1516 (McKinney 1986, Supp. 1991).
2. Such techniques involving "layering" entities such as partnerships, corporations, and LLCs frequently are implemented in sophisticated asset protection plans to add an additional layer of protection to the arrangement.