

Understanding Asset Protection and Family Limited Partnerships



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The assets of physicians have always been at risk to predators and this disastrous trend has recently been confirmed. In a recent survey, 600 practicing physicians and surgeons nationwide were queried on their asset protection practices. The survey found that approximately twenty percent of the nation's physicians have either lost personal assets in civil litigation or personally know a colleague who has. In all fifty states, a court has the ability, to varying degrees depending on the state, to seize the personal assets of physicians to pay for malpractice judgments. Some states protect a physician's primary home, life insurance policies and/or retirement plans. The trial lawyers continue to claim that there is no proof that any physician's assets are being seized post-judgment. They continually deny the disastrous impact of multi-million dollar jury awards and the resulting double-digit malpractice premium increases in their wake.

It is no secret that a responsible physician must guard against these predators and protect the hard-earned assets for the family. In this regard, a useful mechanism in the protection of assets from malpractice suits is the creation of an entity known as the Family Limited Partnership, or "FLP." This mechanism allows for the transfer of assets without creating undivided interests and incurring transaction costs. The transferred assets are protected from malpractice suits because the assets, as well as the future appreciation in the value of these assets, are removed from the donor's gross estate. In addition, the FLP confers certain tax benefits.

To create an FLP, a limited partnership is first formed under the laws of the state of New York. Such an entity provides the limited partners with protection from liability to third parties for actions taken in operating the entity's business (like a corporation) but is taxed on a "pass-through" basis. The FLP confers a layer of protection from malpractice suits because the assets of the entity may not be seized by or ordered to be paid to creditors. Furthermore, the general partners cannot be ordered or compelled to transfer the assets of the company or a limited partner's interest therein to creditors. However, a court is permitted to award a charging order in favor of a judgment creditor. This means that if the general partners order a distribution to be paid to partners, the debtor partner's share of the distribution must be paid to the creditor, pursuant to the charging order.

In the FLP mechanism, the donors (usually the parents) and a wholly-owned "S" corporation formed by the donors transfer designated assets (real estate, stocks, bonds, etc.) to fund a capital contribution to the FLP in exchange for voting general partnership interests and non-voting limited partnership interests in the entity. The voting interest would represent only 1% of the total value of the company, and would be owned by the corporation. The donor would own the 99% non-voting interest. The interests transferred to

children and grandchildren are non-voting minority interests, and children, generally, do not have any management or voting interests in the company. Under this approach, the corporation controls the company by reason of its ownership of all the voting general partnership interests. It is critical that the donors give up their voting rights, in order to avoid IRS rules and court holdings that may nullify or reduce valuation discounts.

In addition to providing a layer of asset protection, the FLP provides additional benefits including: 1) consolidating management responsibility over diverse family assets; 2) maintaining controls over the future disposition of gifted assets to children and grandchildren through restrictions in the company's partnership agreement; 3) facilitating family investment planning and promoting the appreciation of the family's assets to children and grandchildren; and 4) reducing the administrative expenses appurtenant to the giving of gifts and assets.

In these days where the hard-earned assets of physicians are threatened on a nearly daily basis, careful assessment management and the creation of layers of asset protection is a prudent course. A family limited partnership can form an integral part of such protection. However, though a simple mechanism in principle, it is highly recommended that an experienced attorney specializing in asset protection be consulted to set up the FLP.

If you have any questions about the family limited partnership, leases, contracts, or transactional matters of any kind, please contact Mathew J. Levy, Esq. at 1-800-445-0954.