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Creditor Exemptions in Florida

CARL S. ROSEN

Asset protection allows individuals to protect their assets and reduce their exposure to future creditors. Utilization of various sophisticated asset protection techniques, such as family limited partnerships, limited liability companies and offshore trusts, can be extremely useful tools in reducing or eliminating the ability of a future creditor to reach the protected assets.

Although the above asset protection techniques are beneficial for many reasons, the state of Florida is one of the most debtor-friendly states in the country, and offers a variety of creditor exemptions for Florida residents. The purpose of this article is to provide a brief overview of the most common and useful creditor exemptions available under Florida statutory and

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Financial Responsibility Laws: What it Means to go "BARE"

MIKE SEGAL AND ANDREW SHAMP

With the cost of medical malpractice insurance skyrocketing and in some cases becoming unobtainable, many physicians are considering, or have determined, not to continue to purchase medical malpractice insurance. This is commonly called "going bare." The purpose of this article is to describe briefly how the Florida financial responsibility laws for physicians operate, and some of the principal consequences involved in ceasing to contract for malpractice insurance.

The financial responsibility laws for physicians, Florida Statute §

458.320, require every Florida licensed physician to demonstrate to the satisfaction of the Board of Medicine ("Board") and the Department of Health ("Department") that he or she has the financial ability to pay malpractice claims. Essentially, an active practicing physician may meet those requirements by either (a) setting aside monies or buying medical malpractice insurance, or (b) "going bare," but promising to pay certain amounts in the event of an adverse judgment and notifying patients that he or she carries no

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The Shifting Sands of Asset Protection

D. MICHAEL BITZ

Florida physicians have long depended on the state's liberal asset protection laws in determining how much or even whether to purchase medical malpractice insurance. There is, however, no certainty that this situation will continue much longer without significant change. The debtor protections provided in Florida and certain other states are perceived by many to unfairly prejudice legitimate creditors. Florida law may be overridden by Federal law, and this may be accomplished by changes to the Federal Bankruptcy laws. Nearly every year, efforts have been made in Congress to pass laws to create uniform national limits on what may be protected from creditors in a bankruptcy action.

Florida physicians have utilized strategies involving homestead protection, life insurance, annuities, and the state's laws on tenancy by the entirety to keep assets exempt from creditors. The use of the latter category has been extended even to joint checking

assumption is that the lack of attachable assets, along with no available malpractice insurance, will make attorneys less willing to sue.

Proposed changes to the bankruptcy laws, if enacted, could change the playing field by limiting what a person may protect from creditors. Although all proposed changes have been unsuccessful to date, there is a movement to limit what are considered abuses of the system. One change proposed in the Bankruptcy Reform Act of 2001 was to place a limit of \$125,000 on the value of an individual's homestead property exemption. Another pending change proposed in the House, would reduce the homestead exemption by the amount of non-exempt property converted to exempt property in the preceding seven years.

Other changes have been proposed in Congress which, if enacted, would affect Florida residents, including limitations on discharging debts that exceed \$750

for luxury goods, the amounts of credit card and unsecured debt that could

be erased, and restrictions on what is considered an exempt property. The debtor's value of his interest in real or personal property that he or a dependent uses as a residence or even for a burial plot for the debtor or his dependents will be reduced equal to the value attributable to property disposed of in the preceding year with the intent to hinder or defraud the creditor.



Finally, the 2002 amendments to the Act, H.R. Rep. 107-3 (2001), proposed to institute a means test which would eliminate the debtor's ability to decide under which chapter of the bankruptcy act to file, thus ensuring that the debtor would repay everything that was within his or her means of repaying.

If any of these reforms are passed at some point in the future, they could radically affect the financial plans of debtors, including physicians. Additionally, as many of the asset protection methods used by physicians are non-liquid, rapid changes in those assets to respond to changes in the law may be costly or impossible.

For these reasons, physicians must create and periodically review a multi-layered, balanced strategy to protect their assets to avoid the uncertainties and vagaries associated with changes in the law.

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IF ANY OF THESE REFORMS ARE PASSED AT SOME POINT IN THE FUTURE, THEY COULD RADICALLY EFFECT THE FINANCIAL PLANS OF DEBTORS.

accounts. These protections are not unlimited, as recent Florida case law has allowed liens to be placed on homestead property where the funds utilized for purchase on improvements were fraudulently obtained from a creditor. The limitations imposed on creditors by Florida law have encouraged some physicians to forego carrying malpractice insurance, i.e., "going bare." The generally held

constitutional law.

1. Homestead Exemption

Florida's broad homestead law provides that an individual's "homestead" is generally exempt from creditors (See article on page 6 of this issue of Estate Planner). There is no dollar limitation for the homestead exemption.

The three exceptions to the general rule that a homestead is exempt from creditors are: (i) for the payment of taxes and assessments; (ii) for obligations contracted for the purchase, improvement or repair thereof, and (iii) for obligations contracted for house, field or other labor performed on the homestead property.

2. Retirement Plans

Currently, assets held in IRAs, Roth IRAs and most multiple employee ERISA plans (including 401K's, pension plans and profit sharing plans) are exempt from claims of creditors. The law is not clear whether assets held in SEP IRAs and other single employee plans are exempt.

3. Life Insurance and Annuities

Florida law provides that the cash surrender value of life insurance policies issued on the life of a Florida resident is exempt from attachment by such resident's creditors. However, the exemption does not apply to a life insurance policy owned by such resident on someone else's life. In addition, the proceeds of a life insurance policy are not exempt from the beneficiary's creditors.

Proceeds of annuity contracts payable to a Florida resident are also exempt from such resident's creditors.

4. Wage Accounts

The disposable earnings (including wages, salary, commission or bonus) of a Florida resident who is the "head of family" are generally exempt from such person's creditors for six months after the earnings are deposited into a financial institution. The wages of an independent contractor can qualify for the wage exemption if the independent contractor renders personal services. Since wages are exempt, investments such as annuities and life insurance policies that are purchased with such wages within six months of deposit into a wage account should also be exempt.

For purposes of this exemption, the "head of family" is considered a natural person who provides more than one-half of the support for a child or other dependent. In order to qualify for the wage exemption, it is recommended that the family breadwinner deposit only his or her earnings into a separate bank account. No other assets or deposits should be made or commingled with this account.

Although the exemptions discussed above are powerful asset protection tools which may be used by Florida residents, each such exemption may be set aside if the debtor has entered into a "fraudulent transfer" or "fraudulent conversion," both of which topics are beyond the scope of this Article. It is important, however, to note that if an individual desires to take advantage of Florida's exemptions, he or she must properly structure his or her financial affairs within a reasonable amount of time before incurring a liability.

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SPOTLIGHT:

The Ten Most Common Asset Protection Planning Mistakes

SCOTT G. MILLER

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The need for asset protection planning has never been greater. With the costs of malpractice and other insurance rapidly escalating and ever-increasing legal exposure, one needs to plan defensively and take advantage of available opportunities to legally protect against potential creditors. Avoiding common planning mistakes is critical. The following is an overview of some common planning mistakes.

1. Assuming There is Something Wrong or Illegal in Asset Protection Planning. Any individual is free to structure his or her affairs in the most advantageous manner possible. Asset protection planning is only considered fraudulent when done with intent to hinder, delay or defraud creditors. Courts have recognized that

no current threat from existing or subsequent creditors. The individual intends to protect him or herself from possible future creditors. With respect to this individual, significant planning protection vehicles are available.

Fewer planning opportunities exist for individuals who are concerned with specific matters even though they are acting before the matter is resolved by a court (i.e. a malpractice claim exists, but a judgment has not been entered). With respect to these individuals, the amount of potential exposure must be quantified so that any asset protection planning can leave the individual solvent at least to the extent of the exposure. Effective planning may be accomplished.

Certain actions can even be taken for individuals with judgments against them

or where judgment is imminent. Estate plans for the individual's spouse and relatives can be revised to

avoid outright bequests to the debtor. Spendthrift trusts should be considered.

3. Lack of Analysis as to Who is the Most Likely Creditor. Asset protection planning is most effective if individuals determine who is the most likely creditor and then create and implement a strategy to protect against the claims of such a creditor. Individuals need to limit exposure by



taking basic steps such as avoiding certain high risk real estate and other investments; exercising extra care in hiring employees; refusing to loan cars, boats and other dangerous instruments; not titling cars, boats and other dangerous instruments in joint name; structuring investments in a manner consistent with limiting exposure; providing for indemnification language in contracts, and entering into prenuptial and post-nuptial agreements.

4. Failure to Properly Title Assets. Title controls the legal rights of parties to property. Some assets are exempt per se (see #7 below). Other assets are exempt by reason of title. Property owned as tenants by the entirety ("TBE") is protected from the claims of either spouse's individual creditors (such an asset is subject to the claims of a mortgage holder on such asset or joint creditors). TBE is the legal status that can apply to property that is

IN THE CHALLENGING ARENA OF ASSET PROTECTION,

"FAILING TO PLAN IS PLANNING TO FAIL."

asset protection planning implemented prior to any creditor issues is acceptable.

2. Failure to Take Action Prior to Problems Arising. The most effective planning is done well before any claims of creditors arise. The ideal candidate for asset protection planning is the individual who is acting far in advance of any potential problems. Such an individual is solvent and faces

owned jointly with rights of survivorship by a husband and wife. All real property owned by husband and wife is presumed to be TBE. However, personal property titled jointly with survivorship may not be considered to be owned as TBE pursuant to Florida law unless such designation is affirmatively made. Joint bank and brokerage accounts are not automatically protected as TBE unless such account is specifically titled as such or the married couple can prove they intended such account to be TBE.

TBE is not a panacea for asset protection planning. If one spouse dies, the surviving spouse will individually own all the formerly TBE property. Such assets would then be exposed to the surviving spouse's creditors. Additionally, TBE ownership may be improper for estate planning as the deceased spouse may not have enough assets in his or her name to utilize such individual's unified tax credit. This could cause detrimental estate tax consequences for a family.

5. Relying on Your Friend's Plan. Planning should be customized to fit each individual's needs. No one strategy is successful in all cases and each plan is structured on a case by case basis. What works for a colleague will not necessarily work for you. There are benefits and costs associated with different strategies and techniques. Individuals need to carefully consider various options.

6. Utilizing the Wrong Entity.



If an individual is operating a business as a sole proprietor or is a partner in a general partnership, such individual may be unnecessarily exposing himself or herself to potential creditor claims. Other entities should be considered to insulate such individuals from particular risks.

There are numerous misconceptions as to what type of trusts provide asset protection. Revocable living trusts do not protect the person who created such a trust from any creditor claims. Irrevocable trusts may exempt the property transferred to such a trust from the claims of creditors if there are no fraudulent conveyances to such a trust. However, in most states, including Florida, if the person funding the trust is a potential beneficiary, then the creditors of such person can attach trust assets.

Foreign offshore trusts may offer creditor protection depending on the specific facts involved in a potential debtor's circumstances. Such trusts have recently come under substantial scrutiny from United States Courts. Certain creators of such trusts have been held in contempt of court, and sent to prison for failing to repatriate assets to the United States. Great care should be given in considering and implementing such planning.

7. Not Fully Taking Advantage of What Florida Statutes Protect. Florida law is liberal in its allowance of exempt assets from claims of creditors. Generally homestead real estate, individual retirement accounts, pension plans, cash value of annuity contracts, cash value of life insurance contracts, proceeds from disability insurance contracts and wage accounts are exempt from the claims of creditors.

8. Not Respecting the Formalities of an Entity. Certain entities such as limited partnerships ("LP") offer significant creditor protection. An LP is similar to a corporation.



The LP is owned by one or more general partners and one or more limited partners. Generally, the ownership interest of a limited partner cannot be directly seized by creditors. Similarly, assets within the LP cannot be seized by creditors of an individual partner. However, if a partner pays his or her individual bills directly from partnership accounts, it is less likely that the entity will be respected by the courts and that creditor protection will be afforded.

9. Improper Planning of Gifts.

Transfers to donees should be carefully structured to maintain control and protect donees. Preferred strategies provide control and protection.

10. Lack of Proper Estate Planning. Potential inheritances from parents and relatives are frequently overlooked from a planning perspective. Careful consideration should be given so that such bequests are structured to provide maximum flexibility as well as creditor and divorce protection.

In conclusion, in the challenging arena of asset protection "failing to plan is planning to fail." We recommend that you consult your advisors as to the path best for you.

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Homestead: Florida's Chameleon

PATRICIA LEBOW

Homestead is known as Florida's legal chameleon because it has different meanings depending upon its context. The purpose of this article is to provide a broad overview of the multiple types of Homestead available under Florida law.

Under Article X Section 4 of Florida's Constitution, Homestead property of Florida residents is protected within certain limitations from unsecured creditors. To qualify for this creditor protection, the Homestead can occupy not more than one-half acre in a municipality and up to 160 acres outside a municipality. Titling the home in your own name (or as tenants by the entirety) is the only way to truly ensure this protection. In a recent case styled: *In Re: Bernadine L. Bosonetto, Debtor, Gregory K. Crews, Trustee, Plaintiff, v. Bosonetto, et al.*, 271 B.R. 403, (M.D.

asset protection purposes. Moreover, it should be noted that since ownership of a residence by a Qualified Personal Residence Trust (QPRT) is even one step further away from personal control than a Revocable Trust, a court could also deny Homestead status to real property titled in a QPRT under the reasoning the court applied in *Bosonetto*.

In a second context, Florida's Homestead chameleon changes its meaning to allow Floridians a tax benefit with an annual real property tax exemption and a percentage limitation on real property taxes in connection with their primary residence. Florida residents can avail themselves of this constitutional and legislative protection so long as their residence is titled in their own name or in the name of their Revocable Trust or QPRT. The owner must register for Homestead prior to the deadline set by the property appraiser of the county in

which the property is located in order to obtain the Homestead tax benefit. Married couples who

choose to own two Florida residences, but live separately, can each own his or her personal Homestead for property tax exemption purposes.

Thirdly, in the world of devise and descent, the Homestead chameleon takes on another color and establishes a life estate right for a spouse and other rights for minor children who reside in their home at the time of decedent's



death. This result will occur despite the provisions of the decedent's will which may be to the contrary.

Finally, in its fourth change of persona, the Homestead chameleon surfaces in the area of family law. Homestead in this context provides leverage for one spouse over the other in connection with selling or refinancing the family home, regardless of how it is titled. When the home is the primary residence for a Florida resident, both spouses must sign to convey legal title or mortgage its equity. By titling the primary residence in his or her sole name, one spouse cannot convey title without the joinder of the other because of the Homestead right. Clients are often surprised to learn of this limitation.

One technique used to avoid the complications inherent in Homestead issues, whether due to death, estate planning or marital issues, is a postnuptial agreement. Often a husband and wife cannot face the multiplicity of issues involved with an all-encompassing postnuptial agreement. In that case, a postnuptial agreement dealing only with Homestead may be desirable as it can fix rights both in the present and future as to a known asset.

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TITLING THE HOME IN YOUR OWN NAME IS THE ONLY WAY TO TRULY ENSURE THIS PROTECTION.

Fla. 2001), the U.S. District Court for the Middle District of Florida rejected the Homestead status of property titled in the name of a Revocable Trust. This case has not been appealed on the Homestead issue and presents troublesome issues for clients and lawyers who seek to utilize a Revocable Trust to avoid probate in the event of death, but do not wish to risk losing their Homestead for

FINANCIAL *continued from cover*

malpractice insurance.

If the physician does not choose to “go bare” (or is not allowed to do so by the Department), in order to be able to practice medicine in Florida he or she must either:

(a) establish and maintain an escrow account with cash or eligible assets to satisfy claims;

(b) obtain and maintain an irrevocable letter of credit to satisfy claims; or

(c) obtain and maintain professional liability insurance.

The escrow, letter of credit or insurance to be maintained is \$100,000 per claim and \$300,000 in the aggregate, except that if the physician is on a hospital medical staff (as most are) the numbers are \$250,000/\$750,000.

To “go bare,” a physician must complete a form supplying information required by the Department, and the Department must then agree to allow such physician to do so. So, for example, if the physician has had large judgments against him or her in the past, or has filed for bankruptcy, the Department

might deny the physician's request.

In submitting the form, the physician must agree that, if a final judgment for a medical malpractice claim is entered against the physician, he or she will pay the judgment creditor the lesser of (a) the entire amount of the judgment with all accrued interest, or (b) \$100,000 (\$250,000 if a physician maintains hospital staff privileges), within 60 days after the date such judgment becomes final and subject to execution.

There is no aggregate limit to such potential payments. If the physician does not pay the claim timely, the Department will immediately suspend the physician's license, and then have the ability to take other actions if necessary or reinstate the license after acceptable payment terms have been negotiated.

If the physician “goes bare,” he or she must also prominently display a sign in the reception of his or her medical office, or provide a written statement to any person to whom medical services are being provided, which states:

“Under Florida law, physicians are generally required to carry medical malpractice insurance or otherwise demon-

strate financial responsibility to cover potential claims for medical malpractice. YOUR DOCTOR HAS DECIDED NOT TO CARRY MEDICAL MALPRACTICE INSURANCE. This is permitted under Florida law, subject to certain conditions. Florida law imposes penalties against non-insured physicians who fail to satisfy adverse judgment arising from claims of medical malpractice. This notice is provided pursuant to Florida law.”

There are many other considerations in making a decision to cancel one's malpractice insurance, such as contractual obligations to carry such insurance (e.g., managed care contracts and hospital staff by-laws) and the costs of defending a claim. If you need more advice regarding this very difficult decision, we are available to assist you.

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