THE KIRWAN LAW FIRM

Why The "P.A." Is The Worst Legal Entity To House Your Medical Practice

(And What You Can Do To Fix The "P.A. Problem")

By Adam O. Kirwan, J.D., LL.M.

Article Summary: P.A.s (professional associations) and P.L.s (professional limited liability companies) are the single worst form of legal entity to house your medical practice; and perversely, this is business entity that most physicians have been told to use by their advisers. They provide little to no asset protection, make protecting corporate distributions impossible, and can even prevent a sole practitioner from being able to protect their future wages. With the crash of the Florida real estate market, our depressed economy, and the seemingly never ending cuts of physician reimbursements, protecting the source of your income is more important than ever. Unfortunately, huge numbers of physicians have had P.A.s formed for them by their attorneys and accountants simply out of habit, and not because it best meets their needs. Fortunately, recent laws now make it possible for a physician to convert their P.A. to an entity that provides significant advantages without (i) requiring them to get a new tax ID, or (ii) suffering a break in their cash flow from medicare or insurance companies. This article discusses the problems posed by P.A.s, why so many physicians have them, and what Florida physicians can do to protect the source of your livelihood in these uncertain economic times.

What is a "P.A." and Why You Should Care.

The initials "P.A." when used at the end of a corporations name, Dr. John Doe, M.D., P.A., for example, means "professional association." This simply indicates that the business entity is a corporation. The P.A. will be taxed as a corporation (either S or C) and will be subject to the rules governing all corporations. This also means that if someone sues a doctor who owns stock in a P.A., the stock in the P.A. will be no more protected than any other Florida corporation. And, as most of you have probably guessed, this means NO asset protection at all.[1]

So your stock ownership in your P.A. medical practice is fully unprotected (i.e., able to be taken by your creditors). But the news gets worse. Unlike stock in non-professional corporations

[1] Some physicians have chosen to form a Professional Limited Liability Company or "P.L." Just as the P.A. is simply a corporation, the P.L. is simply an LLC. While LLCs were thought by many attorneys to provide additional asset protection benefits to its owners or "members," the 2010 *Olmstead* case decided by the Florida Supreme Court last year seems to have proved them wrong. For ease of discussion purposes, I will be referring to "P.A.s" in this article, but the information holds just as true for P.L.s. If you are interested in knowing more about the *Olmstead* case, visit my website, KirwanLawFirm.com, and read my article on this unfortunate case.

(corporations whose name ends in "Inc." and LLCs whose name ends in "LLC"), P.A.s are also subject to some additional restrictions set forth under Chapter 621 of the Florida Statutes. One of these extra restrictions is found in Florida Statutes Section 621.09 entitled "Limitation on Issuance and Transfer of Ownership." It reads in part as follows:

> "No corporation organized under the provisions of this act (i.e., P.A.s) may issue any of its capital stock to ***anyone other than*** a professional corporation, a professional limited liability company, or an individual who is duly licensed or otherwise legally authorized to render the same specific professional services as those for which the corporation was incorporated. No shareholder of a corporation organized under this act shall enter into a voting trust agreement or any other type agreement vesting another person with the authority to exercise the voting power of any or all of that person's stock."

So doctors and other unprotected P.A.s, are the only people who can own stock in a P.A. Yet another restriction is found in Florida Statutes Section 621.11 entitled "Alienation of Shares and Ownership Interests; Restrictions." It reads in part as follows:

> "No shareholder of a corporation organized under this act (again, a P.A.) may sell or transfer her or his shares in such corporation except to another professional corporation, professional limited liability company, or individual, each of which must be eligible to be a shareholder of such corporation."

This statute means that you are not allowed to hold the stock in your P.A. in a trust, family limited partnership or LLC, your spouse's name (unless he or she is a doctor too), or any other place to gain an asset protection advantage. Even if you try and do so by filling out stock certificates or signing other legal papers designed to transfer your stock to an asset protected place, since the transfer is prohibited by statute, your efforts will have been wasted and the attempted transfer will be considered void.

I have some people ask, "since I can't transfer my stock to anyone other than a physician, doesn't that mean that a non-physician creditor can't take it?" In other words, unless the <u>creditor</u> is a physician practicing the same type of medicine as the physician being sued, shouldn't it be protected since the above listed statutes prohibits the transfer of stock in a P.A. to a non-physician. Unfortunately, the Florida Supreme Court held to the contrary in the case of <u>Street v. Sugerman</u>. In the <u>Sugerman</u> case, the Florida Supreme Court stated:

> "The fact that the corporation may not voluntarily 'issue' or the shareholders may not 'sell or transfer' their stock voluntarily to a non-professional is <u>not</u> reason to prevent an execution and sale, <u>by law</u> for a judgment creditor. Further, we agree with the District Court that to affirm the holding of the chancellor [who ruled in favor of an asset protection result] would have the discriminatory effect of affording professionals a shelter for their assets, which appears to be inconsistent with the

> spirit of the Act [and would serve] to carve out a judicial 'no man's land' for shareholders in a professional corporation which is not available to shareholders in non-professional groups."

Therefore, physicians with P.A.'s get (i) all the additional statutory restrictions that non-professionals don't have to worry about, and (ii) none of the means to protect the stock in their businesses that are freely available to everyone BUT professionals. In short, P.A.s and P.L.s are probably the **worst choice** of legal entity to house your medical practice.

What Exactly Are The Downsides of Having a P.A?

Ok, you may say. So the ownership of my medical practice is wholly unprotected from creditors and I can't even transfer it to an asset protection vehicle. Why do I care? If I am sued for medical malpractice, the judgement creditor will usually be able to obtain a judgement against my practice entity directly and take all of its assets anyway, right? While this is true, there are at least three reasons why a doctor will still want to protect his or her ownership interest in their practice. Before moving on, however, I want to provide you with an example about Dr. John Doe to make these three reasons more understandable.

> Assume Dr. Doe has formed "John Doe, M.D., P.A." to hold his medical practice. The P.A. owns computers, tables, chairs, some five year old x-ray machines, and some other medical equipment which he needs to run his practice but which have been depreciated to nothing for tax purposes. The P.A. also typically carries about $300,000 in accounts receivable at any given time. He was advised by an attorney to take out a $300,000 loan and pledge his P.A.'s accounts receivable as collateral to protect them from creditors[2], which he did.
>
> Unfortunately, Dr. Doe purchased several homes, lots, and other real estate when the market was at its peak and now the money he owes the bank in mortgages exceeds what the properties could sell for by at least $500,000. Dr. Doe decides to stop making payments, and the banks foreclose on the property. The banks end up getting a $500,000 deficiency judgement against Dr. Doe and start collection efforts.[3]

---

[2] There are better ways to protect a medical practice's accounts receivable, by the way. To learn more about this subject, read my book, *The Asset Protection Guide for Florida Physicians*, which I recently updated through 2011 and which can be read for free on my website, KirwanLawFirm.com.

[3] If you or someone you know are upside-down on real estate, please read my article on this topic before you stop making payments or go out and hire an attorney to defend a foreclosure action. The article can be read on or downloaded from, my website, KirwanLawFirm.com. The vast majority of the attorney's doing foreclosure defense work know nothing about asset protection, and oftentimes end up doing more harm than good. By intelligently implementing asset protection strategies (and doing so in concert with, rather than just in addition to, your foreclosure defense efforts if a law suit has already been brought), you can dramatically increase your likelihood of (i) protecting your valuable assets from the bank (yes, there are legitimate last minute asset protection strategies that really works), (ii) avoiding foreclosure altogether, and (iii) getting a deficiency waiver from the bank meaning that the bank takes back

<u>Reason #1 - Banks, Other Creditors, Assets, and Inconvenience</u>. Many physicians who decided to engage in asset protection planning assumed at the time that their only real creditor risk stemmed from practicing medicine. The poor economy, reduced income from lower reimbursement, and the failing real estate have made people rethink this assumption in recent years. Just like Dr. Doe, many physicians are now faced with the risk of being sued by banks in addition to their patients. Even if you did not invest in real estate or have anyone "out there" wanting to sue you, why would you want to leave this asset unprotected? Especially since the solution (discussed later), is relatively simple. The future is always uncertain and being prepared is almost always better than leaving things to chance. As the Christian Slater character aptly put it in the movie, *True Romance*, "One thing this last week has taught me; it's better to have a gun and not need it than to need a gun and not have it."

If a physician like Dr. Doe is sued for something other than medical malpractice (e.g., an automobile accident, a child's automobile accident, deficiency judgements, a business venture gone bad, etc.) and the person suing ends up getting a judgement, the physician's ownership interest in his or her medical practice could be a prime target once the creditor mounts their collection efforts. To understand why, lets go back to the Dr. Doe example. After the banks get their judgement against Dr. Doe, he will be required by the court to disclose all his assets first through interrogatories (written questions posed by the bank's attorney's about his assets, how they are owned, if he transferred anything before or after the lawsuit, etc.), and then perhaps through depositions (where Dr. Doe will sit in a room with the bank's attorney and answer his questions about his assets). If there are any easy to collect assets on the table (e.g., bank accounts, brokerage assets, etc.), the bank will typically go after them first. But what if these aren't enough to satisfy the judgement? Answer; they will start to look at the P.A. Why?

First of all, since Dr. Doe is a sole practitioner and owns 100% of the stock in his P.A., the creditor can take the whole corporation, which includes every corporate asset. Even though the assets may not be worth much for tax purposes, they may still be worth something if sold. If Dr. Doe's x-ray machines, computers, and medical equipment, for example, would bring $70,000 on the second hand market why not take them? Its $70,000 more than they had before. More importantly, if the attorney is being paid on a contingency fee, one-third to 40% of everything they collect goes to him or her. In addition, most good collection attorneys recognize that while a physician's computers, furniture, medical equipment, etc. may not bring huge sums of money if sold, if the doctor had to ***replace*** all those things to keep his business going, it would cost him or her a pretty penny. Therefore, since the doctor is faced with the threat of losing these things, the creditor gains increased negotiating leverage.

Another thing that will give the creditor increased negotiating leverage is the fact that if they take Dr. Doe's P.A., he will have to form a new legal entity in order to continue running his business of practicing medicine. This entails getting a new tax ID number with the IRS, being reapproved by

the property (or approves the short sale) and you're done; you own them nothing else. If you fail to grasp the importance of asset protection planning as part of this process (or were told it was too late to do so), you could end up with a judgement that could haunt you for years.

medicare, renegotiating his managed care contracts with insurance companies, filing out new payroll forms for his employees, and all the other things Dr. Doe had to do when he first set up his practice. As you physicians well understand, this will also interrupt his cash flow; maybe for several months. But what about that loan? Doesn't the bank's lien protect the practice assets? The bank will get paid before the creditor, but ask yourself this. Do you honestly think the judge who gave the creditor their judgement in the first place will simply throw up their hands when they learn about Dr. Doe's bank loan and let him continue to see patients, collect fees, pay himself a salary, make corporate distributions, and pay himself bonuses without giving anything to the creditor? Of course not. This just isn't the way our "justice" system works.

Even if Dr. Doe has one or more partners, he is still in trouble. If Dr. Doe's stock is not enough to give the creditor voting control, they still become a shareholder and as such, get certain rights like access to the P.A.'s financial books and records, the right to vote, etc. Also, most standard "shareholder agreements" used by business lawyers contain some buyout provision if a shareholder loses his or her stock to a creditor. This can lead to the corporation having to come up with the cash necessary to buy back the shares from the creditor which hurts the business and Dr. Doe's partners.

<u>Reason #2 - Corporate Distributions Are Reachable</u>.
The second reason why a P.A. or P.L. is a bad choice of legal entity to house your medical practice stems from the fact that even if Dr. Doe's earnings are protected under Florida's wage protection statute[4], any distributions that would normally be paid to the physician, could end up going straight to his or her creditor. Physicians often pay themselves a "reasonable salary" and take the rest of their compensation as distributions to avoid paying self-employment taxes (including the 2.9% Medicare tax). Even if the practice was a limited partnership or Delaware LLC so the entity received "charging order protection,"[5] these distributions can still be taken by a creditor. I have seen some practices where annual distributions are several hundred thousand dollars. Something very interesting to most creditors. Since distributions are paid to the company's shareholders (i.e., owners), if a doctor could transfer their P.A. stock to an asset protected trust[6], for example, the trust becomes the shareholder so the trust is entitled to receive these distributions. This allows distributions to continue to be made and still remain protected since they will simply flow into a protected place and not through the hands of the doctor. And, as you will see below, there may also be estate tax benefits if the practice is held in a trust.

---

[4] If you want to learn more about Florida's wage protection laws and "wage accounts," consider reading my book, *The Asset Protection Guide for Florida Physicians*. I have devoted an entire chapter of the book to the subject of protecting your wages. It can be read for free on my website, KirwanLawFirm.com.

[5] Again, my book describes what "charging order protection" is and what its strengths and shortcomings are.

[6] Please note that all trusts do not provide asset protection benefits. A doctor's revocable trust, for example, does nothing to protect his or her assets.

Reason #3 - Wage Protection.
As mentioned above, Florida has a statute that allows many physicians to protect their future earnings from being taken by creditors. One big exception to this rule is that a sole practitioner cannot avail him or herself of the wage exemption despite the fact that they otherwise meet all the other statutory requirements. The Florida courts in deciding as such have focused on whether a person has an “arms length agreement” with their employer. Since a sole practitioner or a person who owns a controlling interest in the corporation or other legal entity that employs him or her cannot make an “arms length agreement,” they lose the protection of the wage exemption. While I feel that this conclusion is bad law, it has been upheld in several Florida court cases. If a physician operating as a sole practitioner could avoid owning a majority interest in his or her P.A., they would have a far better chance of protecting their wages from the claims of a creditor.

While the above three reasons do not cover all the problems associated with running your medical practice via a P.A. or P.L., they hopefully give you some idea of the difficulties you will be facing if you have a P.A. and are ever sued. If physicians were legally required to use P.A.s like some other professionals are, that would be one thing; true and unfortunate. But they are NOT. Physicians are legally permitted to use regular, non-professional, corporations and LLCs. So why do so many physicians have P.A.s and P.L.s?

If P.A.s Are So Bad, Why Do So Many Physicians Have Them?
If you look at the history of doctors using corporations to run their medical practices, you see issues being raised as far back as the 1890s. One of these issues was “fee splitting.” Fee splitting became an issue when surgeons began paying family practice doctors for patient referrals. This apparently common practice lead to the issuance of ethical prohibitions by the American Medical Association, and the passing of laws expressly making fee splitting illegal in twenty-two states by 1953. Today, at least thirty-six states have enacted anti-fee splitting / anti-kickback laws.

Another issue that was raised was whether a fictitious, non-human, legal entity, could legally practice medicine. They reasoned that since only a live human being can go to medical school, pass medical boards, and meet other requirements that states require to practice medicine, only a live human being can own a medical practice (i.e., not a corporation). Another concern was that if a corporation was owned by people other than just a physician, the physician may put the needs of their patients behind the financial interests of the corporation’s shareholders.

For all these reasons, prior to 1957, the vast majority of physicians practiced medicine as individuals and did not use corporations. But why all the concern about doctors and other professionals? Builders use corporations to protect themselves from liability. So do restaurants, drug companies, car manufactures and dealers, and thousands of other businesses. The court in the case of Lochrane Engineering, Inc. v. Willingham Realgrowth Inv. Fund, Ltd., explained why:

> “The duty of a professional who renders services, such as a doctor, lawyer, or engineer, is different from the duty of one who renders manual services or delivers a product. The contractual duty of one who delivers a product or manual services,

> is to conform to the quality or quantity specified in the express contract, if any, or in the absence of such specification, or when the duty and level of performance is implied by law, to deliver a product reasonably suited for the purposes for which the product was intended . . . or to deliver services performed in a good and workmanlike manner. However, the duty imposed by law upon professionals rendering professional services is to perform such services in accordance with the standard of care used by similar professionals in the community under similar circumstances."

I must say that I personally find the court's logic unconvincing and actually, downright stupid. It may make sense when applied to a comic book company or the maker of dish rags, but there are thousands of companies producing and selling products like drugs, food products, automobiles, children's toys, buildings, bridges, etc., all of which are required to meet state licensing and safety requirements and all of whose products could harm or kill their users if not produced and delivered in accordance with strict quality standards; standards at least as rigorous as "the standard of care used by similar companies in the community under similar circumstances." But my opinion on this matter doesn't change things. The bottom line is that no professional (e.g., doctors, lawyers, etc.), is allowed to use a corporation to protect his personal assets from a malpractice law suit even though the officers, directors, and shareholders of companies who pose an equal or worse threat to a consumer can. Make's you feel good about our legal system; right?

Additional problems were faced by doctors who couldn't use corporations. First, when any two or more people run a business together, most state laws consider them to have formed a general partnership. For example, Florida Statute Section 620.8202 entitled "Formation of partnership" reads, in part, as follows:

> "Except as otherwise provided . . ., the association of two or more persons to carry on as coowners of a business for profit forms a partnership, ***whether or not the persons intend to form a partnership***."

And guess what? All partners of a general partnership are ***personally*** liable for the acts of the other partners, even if they did nothing wrong. So if Dr. Jones went into practice with Dr. Smith without using a corporation (and also WITHOUT intending to form a general partnership), a patient who successfully sued Dr. Jones for malpractice could take his assets AND all the personal assets of Dr. Smith even if Dr. Smith was vacationing in Europe when the "bad thing" happened.

Not being able to use corporations also placed physicians in the position of having to pay more taxes since the income tax benefits offered by corporations were unavailable to them. This more than anything else finally lead to the House of Delegates of the American Medical Association approving the practice of medicine through partnerships, associations, or other lawful groups in 1957. After this approval was granted, physicians started using P.A.'s. The P.A. first gave them the tax benefits provided by corporations. While P.A. does nothing to shield a physician from his or her personal malpractice liability, it's use did prevent a malpractice creditor of one physician from going after the personal assets of his or her partners. Of course, the corporation's assets were still subject to seizure by such a creditor due to the legal doctrine of "Respondeat superior." This phrase is latin for "let the master answer" and stands for the general proposition that an employer is responsible for the actions of employees performed within the course of their employment. So the employer corporation (whether it be a P.A. or Inc.) can always be sued.

Despite the fact that states like Florida never legally required physicians to practice through P.A.s and technically permitted them to use regular corporations for that purpose, most lawyers (wanting to be conservative) recommended P.A.s to their doctor clients since they (i) provided the corporate tax benefits, (ii) solved the "general partnership" problem, and (iii) avoided the appearance of fee splitting with non-physicians due to the fact that non-physicians could not hold stock in a medical P.A. Unlike physicians, Florida lawyers are required by their ethics rules to use P.A.s, which also may have led to a mistaken belief that P.A.s should be used. And so the practice (and habit) of using P.A.s began. And even though Florida law now permits the ownership of medical practices by non-physicians as long as certain requirements are met, most attorneys and accountants helping doctors form their medical practice automatically form P.A.s and P.L.s for them. And what's even worse, is that most of them can't even tell you why. It's just what's always been done.

<u>If P.A.s and P.L.s Are So Horrible, What Legal Structure Should I Use?</u>

Before we look at how to solve the P.A. problem, we need to look at what the best legal entity is to house a physician's medical practice. In my book, *The Asset Protection Guide For Florida Physicians*, I go through all the available legal entities and explain each of their potential benefits and detriments. If you want a complete explanation, I recommend that you read the book (its available to read on my website for free), but for now, I'll first list the four attributes we want it to have and then give you an example of a great practice structure to consider using.

1. First, the ownership in the legal entity needs to be transferable. For the reasons listed above, the practice entity must be able to be owned by a trust or otherwise held in some "asset protected place" (e.g., a family limited partnership, LLC, low risk spouse's name, etc.);

2. Second, it needs to provide "charging order protection" which keeps a creditor from being able to take any ownership a physician might have or being able to vote their "shares."

3. Third, it must be able to provide the physicians with income tax benefits.

4. Finally, it must be able to have both voting and non-voting "shares."

To see why these four qualitites (I'll refer to them as the "Big Four Qualities") are so important, let's look at the following example:

> Assume three Florida physicians, Dr. Andrews, Dr. Bigelow, and Dr. Chapman, decide to start a medical practice where they will practice together as partners. The attorney they chose to form their practice was well versed in Florida's asset protection laws and also understood how important it will be to the doctors for their legal entity to possess the Big Four Qualities. He decides to form Quality Medical Associates, LLC (I'll call this company "QMA" for short).
>
> This non-professional limited liability company is formed in a state whose LLC statutes specifically provide that a creditor who sues an LLC owner is strictly limited to a "charging order" and that all other creditor remedies (e.g., taking their ownership interest, voting their interest, etc.) are prohibited. He then files documents with the IRS to ensure that QMA is taxed as an S corporation. This ensures that distributions made by QMA will not be subject to self employment tax.
>
> The attorney also drafted the necessary legal documents to create two classes of ownership interests. The first class, Class A, gave its owner the right to vote with respect to the business and general governance of QMA. Despite the fact that the Class A shares represent 100% of the voting control over QMA, they only represent one-tenth of one percent (0.1%) of the total "ownership" of the LLC. The second class of ownership interest, Class B, had no voting rights but represented ninety-nine and nine tenths percent (99.9%) of the company's total ownership. Dr. Andrews, Dr. Bigelow, and Dr. Chapman are each issued 1 Class A Unit[7] and 999 Class B Units. Since each physician owns an equal number of Class A and Class B Units, they each have equal voting rights and equal ownership in QMA.
>
> Being an asset protection attorney, he knew not to draft a "typical" business Operating Agreement[8] but rather made sure it contained additional provisions to bolster its asset protection benefits. The Operating Agreement also (i) mandated that Class A Units could only be owned by a doctor, (ii) allowed Class B Units to be owned by certain trusts, LLCs, and family members, and (iii) granted the LLC's managers (the 3 doctors) the right to take back Units under certain circumstances such as if Units fall into unfriendly hands.

---

[7] A "unit" of membership interest in a LLC is like a "share of stock" in a corporation.

[8] Operating agreements are particular to LLCs. This agreement sets forth (i) the rules governing the company, (ii) the agreement between the owners regarding the ownership of the LLC (e.g., what happens to their Units if someone dies, becomes disabled, loses their medical license, etc.), (iii) rules relating to the LLC's tax treatment, and basically constitutes the LLC's principal governing legal document,

> Dr. Andrews ends up doing some personal asset protection planning, establishes an asset protection trust, and transfers his Class B Units to it. Dr. Bigelow transferred his Class B Units to his spouse, a full time homemaker, as an asset protection strategy. Finally, Dr. Chapman does nothing and holds both his Class A and Class B Units in his own name.

I want you to note a few things about the way these three physicians structured their new medical practice. First, because the three doctors are the only ones allowed to own Class A Units, the control of their medical practice stays completely in their hands. Even though Dr. Andrews and Dr. Bigelow
transferred their Class B Units to a trust and a spouse, neither the trust nor Mrs. Bigelow have any right to interfere with their business. If Dr. And Mrs. Bigelow got divorced and Mrs. Bigelow wanted to create problems for Dr. Bigelow and the other QMA partners she couldn't. Furthermore, the QMA Operating Agreement allows the three physicians to take back her Class B Units even if she is completely uncooperative. Also note that just because QMA has two Classes of Units, Dr. Chapman is entirely free to personally own 100% of his QMA Units.

Now lets assume that Dr. Andrews made some unfortunate real estate investments and is now facing a $500,000 deficiency judgement after the bank foreclosed on his property. Dr. Andrews' prior asset protection planning ensures that the bank will be unable to reach any of his cash, real estate, and other investment assets. His homestead and retirement accounts are all protected under Florida law. But what about his income, distributions, and Class A Units in QMA? Because QMA is an LLC formed in a state whose LLC statutes specifically provide that a creditor who sues an LLC owner is strictly limited to a "charging order," the bank will not be able to take his Class A Units nor will they be entitled to vote those Units. If the creditor actually spent the time, energy, and expense to get a charging order, what would they get? They would be legally entitled to receive all distributions paid to Dr. Andrews by virtue of his being a Class A Unit holder.

Dr. Andrews has historically earned approximately $600,000 per year. To gain certain income tax advantages, Dr. Andrews received $300,000 in salary and $300,000 in distributions. Assume the creditor bank now has a charging order and QMA makes a $300,000 distribution to Dr. Andrews. Since Dr. Andrews owns 1,000 Units in QMA, each Unit gets 1/1000 of the total distribution. Since $300,000 divided by 1,000 Units equals $300 per Unit, Dr. Andrews' asset protection trust is entitled to receive $299,700 (i.e., $300 time 999 Class B Units). Dr. Andrews owns 1 Class A Unit so he is personally entitled to receive $300. This $300 can be taken by the creditor but the remaining $299,700 is protected by the trust and can be used to support his family. The remaining $300,000 paid to Dr. Andrews as salary is protected under Florida's wage protection statute.

Lets take this example one step further. Assume that QMA was Dr. Andrews solo practice and that Dr. Bigelow and Dr. Chapman were never his partners. His practice is still protected and the distributions are still safe. Remember how a person who owns a controlling interest in the company that employs them losses the ability to protect their wages? With a few minor modifications to Dr.

Andrews' asset protection planning, he has an excellent chance of now having his wages protected as well.

If QMA had been a P.A. or a Florida P.L., the bank's lawyers could have taken 100% of his ownership of QMA. If he was a sole practitioner, he would have lost his whole practice and all of its assets; accounts receivable, equipment, computers, etc. He would then have to figure out how to form a new practice that was asset protected (remember that a new P.A. owned by Dr. Andrews can be taken just as easily as the old P.A.). Assuming he could do this (and it can be done), he would have to jump through all the hoops of setting this new practice up, choosing a new business name, getting a new tax ID number, getting approved by medicare, renegotiating managed care contracts, etc. And of course, his cash flow would be interrupted. Worse yet, even if the bank didn't take Dr. Andrews' P.A. and left him alone to carry on his existing medical practice, Dr. Andrews' wages would be fully subject to garnishment, unprotected distributions would flow straight into his hands, and the bank could continue to threaten hin with taking his whole practice away at any time in the future. The use of a P.A. to hold his practice would have been devastating.

If QMA was a P.A. and Dr. Andrews only owed one-third of the stock, it could likewise be taken by the creditor. This would likely trigger a requirement by QMA to buy it from the creditor leading to a huge expense not only for Dr. Andrews, but also for Dr. Bigelow, Dr. Chapman, and QMA. If disputes arose as to the value of Dr. Andrews' 1/3 stock ownership in QMA, lawyers, accountants, and valuation experts might also need to be hired to prevent the creditor's "buy out price" from being too high. The bank would additionally be entitled to inspect QMA's financial records; something most people want kept private. Finally, even if the bank didn't take his P.A. stock, his unprotected distributions would still be paid to him individually where they could be taken, and, once again, the bank could continue to hold the threat of taking his stock away at any time.

Please note that there are alternative legal structures to the one described above and various ways to modify these structures to meet the individual needs of the physicians involved. That being said, however, I hope the above example sufficiently demonstrated (i) the reasons why the P.A. is the single worst legal entity to house your medical practice, and (ii) that better options exist. If you are thinking about hiring a lawyer or other expert to help you set up a new medical practice, please do not simply rely on their general reputation, the fact that they work with a lot of doctors, the fact that they are a "health care attorney," or anything other than their ability to precisely explain the benefits and detriments of the legal structure they are recommending. If they skip over the topic of asset protection, assume that a malpractice lawsuit is the only liability you will ever face, can't give you a way to protect your wages if you are a sole practitioner (or wrongly tell you that a sole practitioner's wages are protected even if they have a controlling interest), or worst of all, recommend a P.A. or P.L., use another attorney. Your livelihood is too important to leave to chance.

<u>So If I Already Have a P.A. or P.L., What Can I Do Fix Things?</u>

Until a few years ago, there wasn't an easy answer if you owned a P.A. In order to change over to a protected LLC without negative tax consequences, you usually needed to go through the corporate merger process or just start a new company. Both of these options required you to get a new Federal

Tax ID Number which created a billing and administrative nightmare. However, on January 1, 2006, Florida enacted new laws that allow the owners of P.A.s (and other types of business entities), to simply "convert" or directly change into an LLC or other type of business entity. When these laws were first enacted, there was uncertainty regarding certain tax aspects of the conversion, including questions about whether the converted entity would have to obtain a new Federal Tax ID Number. Thankfully, these issues have since been resolved, making the new conversion laws a wonderful option for physicians wanting to get out of their problematic P.A. without having to go through all the headaches of starting a new practice.

That being said, if you think a conversion of this type does make sense for you, please make sure the attorney you hire has successfully converted a medical P.A.s before and understands all the issues. I have seen attorneys attempt conversions by following the Florida statutes, but miss other important issues. If your current P.A. is taxed as a corporation (either an "S corporation" or a "C corporation"), certain forms need to be filled with the IRS to ensure that it continues to be taxed in the same manner. If this is not done properly, you could have an expensive tax problem on your hands and you may not be able to keep your Federal Tax ID Number. S corporations require additional tax documents to be filed. Since the conversion also needs to be properly carried out under the laws of two states (Florida and the state with sound charging order laws), additional complexity is involved that may trip up an attorney who is not experienced in converting legal entities. Certain documentation also needs to be obtained from the IRS to make the process of updating insurance and medicare billing information quick and easy. Finally, if a trust or non-physician family member is going to own Units in your medical practice, you need to file a document with ACHA (The Florida Agency For Health Care Administration) to ensure compliance with Florida's Health Care Clinic Act. But don't let all of these issues concern you. I have successfully converted numerous P.A.s and P.L.s without a single problem. And once converted, the physicians owning the converted entity had control over their practice, a way to protect their medical practice, distributions, and wages, and most of all, peace of mind.

<u>Conclusion</u>.
By now you should understand:

1. Why P.A.s and P.L.s are the worst legal entities to house your medical practice;
2. A little about the history of P.A.s and why many attorneys and accountants continue to recommend them out of habit and a lack of understanding despite all their failings;
3. What risks you face if you have a P.A. or P.L. and you or one of your partners is ever sued;
4. What attributes a good legal structure should have if it is going to be used for your medical practice; and
5. Knowledge that you can fix the problems posed by using a P.A., without any interruption to your practice or your cash flow.

If you are forming a new medical practice, please do not let your attorney or accountant create a P.A. for you. Make sure that they understand all your needs (including asset protection needs), before they start making recommendations. Knowing what you know now, make sure their recommendations come with a detailed explanation that actually makes sense. Make sure it's coordinated with any asset protection planning you have in place and if you haven't done any such planning, please consider doing so. Finally, if you already have a P.A., please take the steps to properly convert it to something that better serves you. Your livelihood is at risk if you don't.

If you have any additional questions on this topic or if you would like The Kirwan Law Firm to help you with any of your personal or business planning, please feel free to contact us.