legal briefs

Your Assets in the Balance

Estate-Tax Planning Versus Asset Protection for Medical Professionals

By Jane Frankel Sims, Esq.

As a medical professional in a litigious society, one of your primary goals is protecting your personal assets from malpractice claims. A doctor's greatest fear can be losing his or her home and other hard-earned assets in a malpractice lawsuit. As an estate-planning attorney in an increasingly high-tax environment, one of my primary goals is to facilitate the tax-efficient transfer of wealth from one generation to the next.

The state of Maryland imposes a tax of approximately 16% on estates exceeding $1 million in value. In an era of budget deficits, Maryland legislators are loath to increase this exemption. Assets that often fall into the estate tax bucket include, to the surprise of many taxpayers, life insurance proceeds, home equity and retirement accounts, as well as the typical bank and brokerage accounts.

Currently, the federal government only imposes estate tax on estates exceeding $3.5 million. Above that threshold, the federal estate tax rate is a steep 45%. Although scheduled to expire in 2010, the federal estate tax comes back with a vengeance in 2011 with an exemption amount of only $1 million. Again, given the current fiscal crisis, repeal of the federal estate tax is highly unlikely. The best we can hope for, many commentators believe, is that the 2009 exemption amount and tax rate will be made permanent.

The conflict arises in how you, as medical professionals, seek to protect your assets from liability, and how we, as estate planners, seek to shield your assets from estate taxation. Doctors are often aware of the importance of properly titling their assets. Assets titled jointly with right of survivorship between spouses, referred to in Maryland as "tenants by the entirety," can only be reached by creditors of both spouses. Medical professionals are wise to title their homes and financial accounts in this manner. However, in an effort to maximize the amount that a married couple can pass free of estate tax at death, estate planners often recommend splitting the ownership of assets equally between spouses, so that the husband owns 50% of the assets in his sole name, and the wife owns 50% in her sole name.

Why jeopardize the ironclad creditor protection of tenants-by-the-entirety ownership? The reasons stem from the way the estate tax exemption works. Using Maryland as an example (the federal estate tax works the same way but with higher exemption amounts), each spouse can pass $1 million free of estate tax at death. If, for instance, you have $2 million of assets titled jointly with your spouse, or you have simple wills that leave everything to your spouse, the exemption of the first spouse to die is wasted. Although you can leave as much as you want to your spouse free of estate tax, on your spouse's later death, he or she will be taxed on any amount above his/her $1-million estate tax exemption, without regard to your $1-million exemption. This can result in a Maryland estate-tax liability of up to $160,000. If, by contrast, you each own $1 million of assets individually, and your wills provide that the amount that can pass free of estate tax flows not directly to the surviving spouse, but to a "credit shelter" trust for his/her benefit, then estate tax can be completely avoided. Passing the husband's assets to a trust for the wife's benefit utilizes the husband's estate tax exemption. On the wife's later death, she only has to shield her individually owned assets (the assets owned in her own name and not in trust for her benefit) with her $1-million estate-tax exemption. The efficiency of this solution is clear, but it overlooks the importance of asset protection to clients such as medical professionals, whose occupations put them at risk of lawsuits during their lifetimes, a proposition that can be much more frightening than the risk of owing estate tax at death.

Fear not — there is a solution that allows you to balance your asset protection and estate-planning goals. Spouses can keep their assets titled jointly during their lifetime and provide in their wills an opportunity for the surviving spouse to "disclaim" any assets that pass directly to him or her by title or by will. Effectively, the husband says to his deceased wife, "Thank you for leaving me these assets, but for tax purposes I am going to refuse them." Then, by the terms of the wife's will, the disclaimed assets pass to a trust for the husband's benefit.

Because you must take the above-described actions within nine months of a spouse's death, there is a risk that the disclaimer will not deliver the promised results. Failure to consult an estate-planning attorney immediately upon the death of a spouse could jeopardize the estate tax plan and cost hundreds of thousands of dollars in tax. But, with sound legal advice and advance preparation, you can reconcile the often divergent goals of asset protection and estate-tax planning.

Jane Frankel Sims, Esq. represents clients in matters involving estate planning, trust and estate administration and taxation. She is a member of the Maryland, DC and New York bars. Ms. Sims can be reached at (410) 828-7775 or jsims@janesimslaw.com. ■

SUNSHINE MEDIA © 2009 Sunshine Media, Inc. Usage Agreement Good Through: 03/19/10