THE KIRWAN LAW FIRM

THE FLORIDA WAGE EXEMPTION

Florida Statutes Section 222.11 exempts from attachment or garnishment by a creditor 100% of the "earnings" of an individual who is "head of family" unless a person has agreed otherwise in writing. An additional requirement in order for the earnings to gain this exempt status is that the earnings must be "credited or deposited in any financial institution." If these requirements are met, the earnings will be "exempt from attachment or garnishment for **6 months** after the earnings are received by the financial institution **if the funds can be traced and properly identified as earnings**." If an individual is not a "head of family," only 75% of the earnings will be exempt (assuming the other requirements are met). While this statutory rule appears to be rather straightforward on its face, the case law interpreting the statute has created traps for the unwary.

Definition of Head of Family. The first, and more straightforward, issue to address is the definition of "head of household." The Florida statute defines "head of family" as "any natural person who is providing more than one-half of the support for a child or other dependent." The term dependent is not defined in the statute, however, case law has held that any moral obligation to support another may be sufficient to satisfy the "head of family" requirement. Note that the courts have often required that non-related individuals live in the same home. Given this broad definition, spouses, minor and adult children, parents, and other family members for whom you provide more than 50% of their support would clearly qualify as dependants.

Definition of Earnings. The second, and less straightforward, issue to address is the definition of "earnings." The definition provided by the statute is "compensation paid or payable, in money of a sum certain, for personal services or labor whether denominated as wages, salary, commission, or bonus." Case law interpreting this definition has held that what is protected is "the fruits of someone's labor for the benefit of his family" but not "income from passive sources, such as investment income or return on capital." In short, the intent of the statute appears to have been to protect the classic "employee" who works for another to provide for his or her family.

The first exception to this rule that may not be readily apparent is that a sole practitioner cannot avail him or herself of the wage exemption despite the fact that they earn their money providing personal services. The court in making its analysis focused on whether a person has an "arms length agreement" with the employer. Since a sole practitioner or a person who owns a controlling interest in a corporation or other legal entity cannot make an "arms length agreement," they lose the protection of the wage exemption. The court stated that people who run their own businesses have control over the timing and amount of their compensation and whether the monies they receive are classified as distributions or earnings. While I feel that this conclusion is bad law as it discriminates against heads of family who market their services directly rather than through employers, it has been upheld in several Florida court cases. Given this state of the law, there are two primary concerns that need to be addressed, both of which are listed below.

1. <u>Ensure that Payments Meet the Definition of Earnings</u>. Your first concern is whether or not the remuneration you are receiving are pure "earnings" within the definition of the wage exemption statute. First, distributions from your medical practice or any other business are NOT earnings. Physicians will often try and minimize the amount they are paid as salary (i.e., W-2 earnings) and maximize the amount they receive as S corporation distributions (reported on IRS Form K-1) in an attempt to reduce the amount they pay in payroll taxes. A significant downside to doing this is that distributions are NOT protected "earnings" for purposes of Florida's wage protection statute. In addition, if distributions are deposited into a Wage Account (see below) with the physician's W-2 earnings, then the entire Wage Account may be rendered unprotected because the protected earnings are being commingled with unprotected non-earnings.

   In addition, since "earnings" do not include "income from passive sources, such as investment income <u>or return on capital</u>," any income you receive that is akin to business profits rather than "the fruits of **<u>your</u>** labor" should be segregated and distributed to you separately **<u>even if it is paid to you as W-2 earnings</u>**. Common examples of "business profits" in the physician context are (i) profits derived from the activities of physician assistants, physical therapists, and/or other staff members, and (ii) profits akin to "technical fees" such as fees for X-Rays, Cath labs, etc. (I'll call (i) and (ii) "Non-Earnings") Therefore, if there is a technical fee component to any procedure you perform, you should account for it separately. Note that the fact that you bill on a global basis is not justification for failing to separately account for the "Non-Earnings" portion of the compensation. You may also want to establish an accounting method whereby the "Non-Earnings" portion is used to reduce overhead. Whether or not you choose to do so, in the event any Non-Earning are distributed to you, you should receive a separate check for the "Non-Earning" which should never be deposited into your Wage Account.

   Remember that under the statute earnings are "exempt from attachment or garnishment for 6 months after the earnings are received by the financial institution **<u>if the funds can be traced and properly identified as earnings</u>**." The primary reason to segregate these distributions is that if the assets flowing to the Wage Account (i.e., the account with the financial institution referenced by the statute) are a combination of "earnings" and "non-earnings," it may be difficult to impossible to accurately "trace" the deposited funds to "earnings." If that were the case, there exists the possibility that none of the assets in the Wage Account would be exempt from creditors.

2. Ensure that Sufficient Evidence Exists to Support Employee Status. The second concern is that if you are deemed to not be an employee of the P.A. you are currently with for purposes of the Wage Exemption Statute, you will not be able to protect your earnings. While it may seem a ridiculous concern, there is case law that resulted in this outcome. In short, the court will take a totality of the circumstances approach to determine whether your relationship with the P.A. is similar to that of an employee or whether the P.A. is merely a conglomeration of separate sole practitioners. Courts consider several factors when determining whether someone is an employee for purposes of the Wage Exemption Statute. Below I have used the court's actual language in the bankruptcy case of In re Montoya, 77 BR 926, to describe these factors and what the courts typically look for.

a. **Existence of an Employment Contract**. The court starts by explaining the importance of having an employment agreement:

> "The first factor is the existence of an employment contract itself. A contract is the best possible evidence of whether the contracting parties intended to form an employee-employer relationship or merely engage the services of an independent contractor. *Ware v. Money-Plan Intern, Inc.*, 467 So.2d 1072 (2d DCA, Fla.1985). In this case the Debtor entered into an Employment Agreement with the P.A. which is quite comprehensive. The P.A. provides the Debtor with facilities, equipment and supplies and pays for his professional liability insurance, occupational license fees and many other expenses which would typically only be paid by an employer in an employee-employer relationship. The Employment Agreement gives the P.A. authority to establish policies and procedures to be followed in treating patients and to determine which patients the Debtor may treat. Additionally, the agreement establishes a fixed salary for the Debtor. The agreement itself is strong evidence that the parties intended to create an employee-employer relationship."

As the above language indicates, it is not only important to have an employment contract in place, but the employment contract should address certain key issues.

b. **Who Furnishes Tools and Supplies**. The Montoya court went on to describe the importance of having the P.A. supply the tools and supplies necessary for the employee to carry out his or her job.

> "Typically, an independent contractor furnishes his/her own tools and supplies whereas an employer generally furnishes any necessary tools and supplies for employees. in this case, the P.A. is responsible for providing medical facilities, offices, equipment, utilities, supplies and drugs which are necessary for the Debtor to use in the course of his employment. Additionally, the P.A. is responsible for providing all necessary support personnel. The Debtor is not required to purchase any supplies nor employ any other personnel. Thus, the P.A.'s obligation to furnish necessary tools and supplies is further evidence that an employee-employer relationship was created."

c. **Right to Control the Progress of the Employee's Work**. The court then points out what it considers the most important factor in determining whether a physician will be considered an employee:

> "The next factor, and perhaps the most important factor, in determining whether a person is an employee or an independent contractor is the right to control the progress of work. Typically, an employer has a right to control the progress of an employee's work . . . As evidenced by the Employment Agreement in this case, the P.A. has the exclusive authority to establish the professional policies and procedures for treating patients. Through these policies and procedures the P.A. has the right to control the means by which the Debtor may treat his patients. If the Debtor is subject to control as to the means used in treating his patients, he is an employee. . . . Additionally, the Employment Agreement gives the P.A. the right to determine what patients the Debtor may treat. The Trustee has argued that the P.A. has not actually controlled or interfered with the Debtor's treatment of the P.A. patients. However, as stated by the Florida Supreme Court in *National Surety Corporation v. Windham*, 74 So.2d 549 (Fla.1954) "[i]t is the *right* of control, not actual control or actual interference with the work, which is significant in distinguishing between an independent contractor and a servant." The court held that the "right to control depends upon the terms of the contract of employment." *Id*. at 550. In this case, the Employment Agreement granted the P.A. the right to control the work of the Debtor regardless of whether the P.A. ever chooses to exercise that right. Thus, the P.A.'s right to control is an

> additional indicator of the existence of an employee-employer relationship.

d. **Method of Payment**. Next the court addressed how the physician was compensated.

> "Turning next to the method of payment, the Debtor's compensation typifies that of an employee rather than that of an independent contractor. An employee is typically paid by time, whether it be by salary or by hourly rate, whereas an independent contractor is typically paid by the job. In the instant case, the Debtor is paid a straight salary by the P.A. His salary remains constant regardless of how much money the P.A. is paid for his services or whether the P.A. incurs profits or losses. Thus, the Debtor's wages are indicative of that of an employee."

e. **Work Part of Regular Business of Employer**. The final factor addressed by the court is whether the work is part of the regular business of the employer.

> "In the instant case, the P.A. is a professional association comprised of physicians engaged in the practice of medicine. The P.A.'s sole enterprise is that of providing medical services. Therefore, the Debtor satisfies this test as an employee."

Significance of the Wage Exemption. The benefits to having your wages exempt from attachment or garnishment are significant, especially given your level of compensation. First, in the event you were ever sued for malpractice, your earnings that were deposited into the Wage Account after the suit was anticipated or filed against you could be freely transferred to your trust, Debra's individual name, or another exempt asset (e.g., an account titled as tenants by the entireties, a life insurance contract or annuity, etc.) without that transfer being subject to the fraudulent conveyance laws. Second, if a judgement was obtained by a would be creditor, you would be in a significantly better negotiating position since the judgement creditor would be unable to garnish your earnings. If your wages are not exempt (or if there is a serious concern that they may not be exempt) each transfer made after a potential law suit is identified may be subject to the fraudulent conveyance laws. For this reason, I would recommend not making transfers to your trust of questionably non-exempt earnings but instead using a domestic asset protection device (e.g., an account titled as tenants by the entireties, a life insurance contract or annuity, improving or buying a bigger homestead, etc.), since doing so could be considered bad faith by a court which may have serious repercussions.

<u>How to Establish a Wage Account</u>.

Opening a Wage Account is a simple procedure. First, start by opening an account with your local bank. The account can be a checking or a savings account. In the event a physician is married, I typically recommend opening the account jointly between the spouses as “Tenants by the Entireties” to add additional protection. In the case of a single physician, the account would be simply opened in his or her name or the name of their revocable trust. You can also give most accounts "labels" like "Summer Vacation Account." Naming the account something like "Dr. John Doe Wage Account" provides additional evidence that your intent was for wage alone to be deposited into the account. If the "label" is omitted, however, it does NOT prevent the account from being a "Wage Account." I also recommend that the account be non-interest bearing to make tracing the account to “earnings” more simplistic.

Once the account is opened, from a procedural standpoint, I prefer that you use the Wage Account as a "conduit" account. For example, assume Dr. Granker gets paid twice a month. His W-2 earnings (i.e., no corporate distributions or dividends) are deposited into his Wage Account on the 1st and the 15th of day of the month by direct deposit. It's the 1st, and Dr. Granker sees the deposit has been made. His paycheck is $10,000 and he knows that he and his family needs $7,000 from that paycheck to live on. He first transfers $7,000 to his and his wife's joint checking account from which all the bills are paid. The remaining $3,000 is then transferred to a brokerage account owned by Dr. Granker's asset protection trust. This means that the monthly bank statement issued with respect to the Wage Account each month will be very simple in form (read "easy to read and understand even by a moron"); 2 deposits and 4 withdrawals.

Why is this important? Because we have a legal system, NOT a justice system. At the end of the day, you will have to convince a judge that the account you are claiming to be a Wage Account is, in fact, just that; meeting all the statutory and case law definitions described earlier in this memo. And sometimes, the judge that ruled against you in the case you lost, the same judge that signed the judgement that is allowing the guy that beat you to take your assets, is the same judge who will have the ultimate say as to how convincing you are in proffering your "yes, I have a Wage Account argument." And sometimes, that judge will have a bias towards seeing that his judgement is enforced and that the winning party actually collects something from you. And sometimes the judge is consciously or unconsciously looking for excuses to rule against you.

I also like using the Wage Account as a conduit account because earnings deposited into a Wage Account are “exempt from attachment or garnishment **<u>for 6 months</u>** after the earnings are received by the financial institution . . ..” I have seen many physicians stock pile money in their Wage Account. Their thinking goes something like this. “Well, I earn roughly $600,000 a year. And since 6 months is one half of a year, that means that I can keep $300,000 in my Wage Account at any time and it will always be protected.” I have even seen physicians pull money equal to half a year’s salary from a unrelated bank or brokerage account (i.e., amounts that can not be “traced and properly identified as earnings”), deposit those funds in a “Wage Account” (which it really isn’t), and think those funds are protected. In both these examples the physicians have completely misunderstood how the 6 month rule (and several other rules governing Wage accounts) and end up with the mistaken belief that these funds are asset protected. And as Mark Twain once said "What gets us into trouble is not what we don't know. It's what we know for sure that just ain't so."

The way the six month rule actually works is that actual W-2 earnings that are deposited into a Wage Account in the form of a paycheck are exempt from the claims of creditors for a period of 6 months from the date of deposit. There is a running total based on FIFO (First In First Out). Suppose you make a deposit of your paycheck (which I will assume are proper W-2 earnings) in the amount of $20,000 on January 1. You then transfer $12,000 to your checking account to pay your monthly bills. On February 1, you get another paycheck and deposit it into your Wage Account. Once again, transfer $12,000 to your checking account to pay your monthly bills. When you pull out $12,000 in January to pay your bills, there are $8,000 left in the account. Those fund will cease to be exempt on June 30 unless they are withdrawn before that. On February 1, the balance of the Wage Account is increased to $28,000. When the $12,000 is subsequently removed from the Wage Account in February, the first $8,000 is attributable to the earnings deposited in January, and the next $4,000 is attributable to the earnings deposited in February. That would leave $16,000 in the Wage Account in February after the deposit and withdrawal (i.e., $28,000-$12,000=$16,000) all of which would cease to be exempt on July 31 unless they are withdrawn before that.

As you can see, keeping an accurate account of this rolling six month period and the exact amount that is exempt at any given time is not intuitive and would require a spreadsheet. The spreadsheet is actually pretty complex too. But you can dispense with all this complexity by simply using your Wage Account as a conduit account. Going back to our example, assume you deposit your $20,000 paycheck on January 1. You then transfer $12,000 to your checking account to pay your monthly bills. And finally you transfer the remaining $8,000 to your asset protected trust (you would probably leave a small amount in the Wage Account to keep it open but I'm using these numbers for simplicities sake). The transfer of the $8,000 to your asset protection trust is a transfer of exempt assets and will, therefore, not be a fraudulent transfer. When February rolls around, your Wage Account is a clean slate and you simply repeat the process. Keeping it simple like this will serve you far better in protecting your assets.

If you do have non-exempt income (e.g., dividends, rental income, income of your spouse, etc.), you should always spend that income first and then transfer the exempt earnings deposited into the Wage Account to your asset protection trust or other exempt structure (i.e., an annuity, etc.).

One final point; remember that under the wage protection statute earnings are "exempt from attachment or garnishment for 6 months after the earnings are received by the financial institution **<u>if the funds can be traced and properly identified as earnings</u>**." Once again, using your Wage Account as a conduit account will help you accurately "trace" the deposited funds to "earnings." Each month when the physician receives the bank statement for the Wage Account, he or she should staple the corresponding pay stubs to the statement and store the bank statement in a safe place. This would ensure that if the exempt nature of your Wage Account was ever called into question, you would have a simple bank statement that showed one or two deposits of money easily traceable to "earnings for personal services" and two or four withdrawals to other accounts.

Conclusion.

Utilizing the benefits of the Florida wage protection laws is an important part of every person's asset protection plan. If you have any questions regarding this memo or any other aspect of asset protection planning, please contact me.