Legal Brief

The Best Offense is a Good Defense — Protect Yourself from Potential Creditors

Given the increasingly litigious nature of our society, the concept of asset protection, which once had a very negative connotation, is becoming more and more mainstream. The recent volatility in the economy only increases this focus and makes protection from potential liability even more important.

Asset protection strategies, like anything else, come in various degrees of complexity. Depending on the circumstances and the potential liability involved, some individuals already enjoy a considerable degree of protection simply because of the way their assets are titled. Other individuals could face financial devastation if they were to incur significant liability. Therefore, the first step in the asset protection process is to obtain a general understanding of your potential exposure and review how your assets are currently titled. You will then be able to analyze some of the most common asset protection "strategies."

UMBRELLA INSURANCE POLICY

Purchasing an umbrella insurance policy is a very simple, cost effective and well recognized method of providing a "security blanket" for you and your family. These policies usually insure against tort liability that exceeds the policy limits of your auto, property and general liability insurance policies. Typical policies range from $1 million to $5 million.

JOINT OWNERSHIP

In Pennsylvania, as well as many other states, married individuals may take title to property as tenants by the entirety. Property held as tenants by the entirety is generally not subject to claims of creditors unless both spouses are liable on the particular debt. This prevents creditors of one spouse from accessing a home held by a couple as tenants by the entirety. On the other hand, this strategy often increases your exposure in the event of divorce and may have negative impacts on components of your estate plan.

QUALIFIED PLANS

Assets held in qualified retirement plans such as 401(k) plans, defined benefit plans, and individual retirement accounts are usually not subject to claims of creditors. These types of arrangements also allow income tax deferral until the time of distribution.

LIMITED LIABILITY ENTITIES

When individuals are particularly vulnerable to liability, it is sometimes prudent to form a separate entity such as a corporation, limited liability company, or limited partnership in order to isolate the liability prone activity and limit your individual exposure. While this strategy is more complex and has additional costs, these arrangements can sometimes provide a number of estate planning and tax benefits.

TRUSTS

Trusts can be drafted in a manner that will provide a considerable degree of protection for assets that are transferred into the trust. In order to be effective, the trust must be irrevocable. Access to the trust's assets by creditors of a particular beneficiary depends on whether the beneficiary has control over distributions from the trust. Therefore, the more discretion that an independent Trustee has regarding the access to the assets, the more protection will be afforded. Under limited circumstances, it is even possible for the creator of the trust to be one of the beneficiaries. Once assets are distributed to a beneficiary, any degree of asset protection will be lost.

Time may be of the essence with respect to any of the foregoing strategies. If liability is already looming, it is usually too late. Therefore, it is important to review your individual facts and circumstances and determine whether any of the above strategies makes sense for you and your family.

For more information on asset protection strategies or other estate planning matters, contact Mike Thomas at MacDonald, Illig, Jones & Britton LLP at 814/870-7711 or mthomas@mijb.com.

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