



By Robert Goff

### **The beneficiary-controlled spendthrift trust**

If you want your children to have control over their inheritance — and yet protect their inheritance from claims by your in-laws and your children’s creditors — consider including spendthrift trusts for your children in your estate plan. If you want protection for your children, but don’t want to give control over their inheritance to a third party trustee, consider naming your children as trustees of their own trusts.

#### **Dangers of leaving property to a child outright**

If a parent leaves an estate to a child outright and not in trust, the child is free to spend the inheritance at once. Once an inheritance is received, it is subject to liens filed by the child’s creditors just as any other property. Furthermore, leaving an inheritance to a child outright may result in the child’s spouse claiming an interest in the inheritance. An inheritance is generally considered non-marital property and not subject to a spouse’s claims in a divorce action. However, once a child commingles or mixes the inheritance with a spouse’s funds or property, the inheritance may lose its non-marital status, may be considered marital property and may be subject to the spouse’s claims in a divorce action.

#### **What is a trust?**

A trust is a legal relationship where one person (the trustee) holds legal title to property and is under an obligation to use that property for the benefit of another person (the beneficiary). The trustee decides how to invest the property and when to pay money out to the beneficiary. In making decisions about the trust the trustee is obligated to follow the directions of the person who created the trust (the settlor). The trustee is prohibited from using the trust property for the trustee’s personal benefit. Instead, the trustee must use the trust property for the benefit of the beneficiary. The trustee is limited to paying himself or herself reasonable compensation for his or her time and reimbursement for reasonable expenses.

## **Spendthrift trusts**

The spendthrift trust was developed to provide an inheritance to children, or other heirs, in a manner that would prevent three things:

- The child or heir from spending the inheritance at once.
- Losing it to his or her creditors.
- Giving it to his or her spouse.

Spendthrift trusts are generally designed to give a beneficiary:

- Money from the trust only as needed for legitimate living expenses.
- Only the income from the trust property each year.
- A sum certain each year.
- A percentage of the value of the trust each year, or at certain ages.

Perhaps the most common spendthrift trust is created for minor children in the event of a parent's death. The settlor generally provides that the trustee may pay the income and principal of the trust for the minor child's health, support, education and maintenance. The trustee is given discretion on when to pay out money for the child and how much money to pay out for the child. Furthermore, the trustee is given discretion whether to pay money directly to the child or indirectly to providers of goods and services. The "health, support, education and maintenance" standard is generally interpreted to authorize the trustee to maintain the minor child in the standard of living to which he or she was accustomed during the parent's lifetime. The trustee's discretion is subject to review by a court but the court will generally defer to the trustee's determination as long as it is reasonable. Most settlors name a fiscally responsible friend, family member or financial institution as trustee for minor children.

A spendthrift trust can be included in a person's last will and testament, or in a person's revocable/living trust. In either case, it does not take effect until the settlor's death.

Creditor and spousal protection results from two characteristics of spendthrift trusts.

1. In many spendthrift trusts the trustee has discretion when to pay money for the child and how much money to pay for the child. As long as the trustee is acting reasonably, the child will be unable to convince a court to compel the trustee to distribute money to the child.  
Because the child is unable to compel a distribution, the child's creditors will also be unable to compel a distribution.
2. Spendthrift trusts contain a clause preventing the child from assigning, transferring, selling or pledging the child's interest in the trust. State laws generally prevent a child's creditors from obtaining an interest in a spendthrift trust as long as the trust contains such a clause.

Because the trust property must be kept separate and apart from a beneficiary's or trustee's personal assets, spendthrift trusts are much less likely to result in commingling or mixing with a spouse's funds that may result in the spouse claiming an interest in the inheritance.

State law provides that there are certain types of creditors that may be able to attach a child's interest in a spendthrift trust. For example, such creditors are child support claimants to the extent of child support owed, as well as the U.S. and state governments for taxes due on account of the trust property.

### **Beneficiary-controlled spendthrift trusts**

Fortunately, trusts are very flexible and they can be customized to fit just about any particular situation. The spendthrift trust can be adapted to provide creditor and spousal protection to a financially responsible child while also allowing the child to exercise control over the trust with respect to investment and distribution decisions. Generally speaking, there is only one change required to the typical spendthrift trust for minor children in order to make it suitable for financially responsible adult children. This is where the settlor names his or her child as the trustee, rather than naming a friend or financial institution as trustee.

The settlor generally provides that the trustee (the child) may pay the income and principal of the trust to the child for his or her health, support, education and maintenance as determined by the trustee (the child) in his or her discretion. The settlor further provides that the standard is interpreted to maintain the child in the standard of living to which he or she was accustomed during the settlor's lifetime.

Another favorable characteristic of spendthrift trusts is that the settlor can designate who receives the property upon the child's death. This gives settlors peace of mind that upon a child's death, the child's children — not his or her spouse — will receive the benefit of the trust property. Most settlors provide that upon a child's death, the property remaining in his or her trust passes into identical equal trusts for the child's children. Thus, the trust property stays within the settlor's bloodline or lineage.

Settlors should be aware that nothing in the law is 100 percent guaranteed. Naming a beneficiary as a trustee of his own spendthrift trust will result in creditors making arguments that the spendthrift provisions should be disregarded. However, the roadblocks created by the settlor leaving an inheritance in a spendthrift trust are certainly more effective than leaving a large sum to a child outright. The costs and uncertainty faced by a creditor facing a beneficiary-controlled spendthrift trust may cause the creditor to abandon its collection attempts or seek a settlement favorable to the child.

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