Practical Probate

Taking the Mystery Out of Trusts Part 5: Protecting Family Legacies

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The Mystery

How may a family's assets be protected from third parties, such as creditors, a divorcing son- or daughter-in-law, a beneficiary with a substance abuse problem, or a loved one who is unable to responsibly manage their finances?

Protecting Family Legacies

One of the more attractive features of trusts is the ability to keep a family's assets out of the hands of third parties. A trust can prevent creditors of trust beneficiaries from reaching trust assets. This important feature makes it much more likely that a family's assets won't end up in the hands of creditors, a divorcing spouse, or drug dealers.

A family trust created by a married couple can be arranged so that the surviving spouse would get full use of whatever assets are in the trust at the death of the first spouse. However, the surviving spouse would be unable to transfer assets in the family trust to a new husband, wife, boyfriend, girlfriend, or other third party.

Example: Leonard and Lucy Lake, a married couple, have three adult children. They create the Lake Family Trust. Several years later, Lucy passes away. At that time, all the assets in the Lake Family Trust are available for Leonard's support. Trust assets can be used to pay Leonard's expenses. The entire value of trust assets may be used for this purpose. However, Leonard cannot direct trust assets to third parties, such as a girlfriend, new wife, stepchildren, or others. When Leonard dies, any assets left in the trust will be distributed to Leonard and Lucy's three children.

Example: Tom and Tina True, a married couple, have three adult children. Tom and Tina prepare "mirror" wills. Under the terms of each mirror will, the surviving spouse inherits everything upon the death of the first spouse to pass away. The will directs that when the surviving spouse passes away, Tom and Tina's three children each get an equal share of the surviving spouse's estate. Tom and Tina do this in the belief that the surviving spouse should receive all of the couple's assets, and their children should receive what is left after the surviving spouse dies. Several years later, Tom dies. Tina inherits all of the couple's assets, worth $1.5 million. Two years after Tom's death, Tina gets remarried to Terry. Terry owns few assets. Because of Tina's remarriage, she executes a new will, revoking her old will. In her new will, Tina leaves $1.2 million to Terry, and the rest of her estate to her three children in equal shares. Sometime later, Tina dies survived by Terry and her three children. Tina's estate at that time is worth $1.4 million. Terry receives $1.2 million, and Tina's three children each get an equal share of the remainder of Tina's probate estate with a value of $200,000.

Spendthrift Trusts

A trust can also be effective in protecting beneficiaries who, because of youth, inexperience, or inability to properly manage their own finances might foolishly spend a windfall inheritance. Trust assets will be available to such a beneficiary, but with important safeguards. Use of trust assets for such a beneficiary could be limited in some way, for example, to pay for health (medical care, health insurance premiums); education (tuition or other educational expenses); maintenance (housing, transportation, food, clothing); and support, or for other specific purposes. The trustee could pay the provider of these goods or services on behalf of the beneficiary; there may be no distributions directly to the beneficiary in order to prevent him or her from squandering their inheritance.

Discretionary Trusts

In a discretionary trust, the trustee has unlimited authority to withhold distributions to beneficiaries. This is particularly useful when a beneficiary's trust distribution may be subject to garnishment by a judgment creditor, the beneficiary has a substance abuse problem, the beneficiary is in an unstable marriage, or the beneficiary has a gambling problem, to name only a few circumstances where trust distributions may be in jeopardy of seizure by a third party.

Example: Greta Gamble is a beneficiary of the Nostrum Family Trust, set up by her grandparents. Two weeks ago, Greta celebrated her 35th birthday with a trip to her favorite casino. Unfortunately, Greta lost $7,000 at the Roulette table. Greta's visits to the casino are frequent and, like most casino patrons, she usually loses money. The trust states that when Greta turns 35 years old, the trustee may distribute $50,000 to her. Greta requests the $50,000 distribution from the trustee, since she now has reached age 35. Greta plans to parlay her $50,000 inheritance to a much larger sum at the Blackjack table. Upon learning of this, the trustee refuses to distribute $50,000 from the trust to Greta. Because the trust is a discretionary trust, the trustee has complete and total authority to withhold distributions from any beneficiary under these circumstances. Greta is greatly disappointed, but reflects that she needs help with her gambling addiction. She seeks treatment, and, after many years of hard work, has completely given up gambling. At that point, the trustee, if convinced that Greta has overcome her gambling problem, may distribute $50,000 to her.

Supplemental Needs Trusts

A trust can also be used to help a disabled beneficiary by allowing them limited use of trust assets without jeopardizing eligibility for public or private benefits, such as Medicaid. Commonly known as a "Special Needs Trust", such a trust would allow certain expenses to be paid on behalf of a disabled beneficiary. The beneficiary would not actually receive distributions directly from the trust.

Example: Barnaby Jones created and funded the Barnaby Jones Living Trust. Barnaby wants his four children to be beneficiaries of his trust. One of the beneficiaries of Barnaby's trust is his daughter, Leeann. Leeann suffered a traumatic brain injury and receives public assistance. In his trust, Barnaby created provisions so that any inheritance going to Leeann will be protected from claims for benefits she received. More importantly, Barnaby's trust provides that distributions to Leeann are restricted in such a way that they will not jeopardize Leeann's eligibility for public benefits.

Example: Steve Mannix has a son, Alan, with intellectual disability. Alan has received, and continues to receive public benefits because of his diagnosis. Steve has no will. When Steve dies, Alan's inheritance from his father may render Alan ineligible for public benefits until he spends down his entire inheritance. This creates an income and support disruption for Alan. A potentially prolonged process to restore Alan's eligibility for public benefits after his inheritance is depleted will be necessary. Just as unfortunate, none of Alan's inheritance may be set aside to help pay for Alan's needs in addition to what public benefits provide.

About the Author

A Connecticut Probate Judge since 2003, and a trusts and estates attorney since 1995, Dom Calabrese is admitted to the practice of law in Connecticut, Florida, and New York. Judge Calabrese has given hundreds of presentations on probate and estate planning to the general public, bar associations, the University of Connecticut Income Tax School, the Connecticut Society of Certified Public Accountants, and the Connecticut Probate Assembly. Calabrese Law PLLC has offices in Palm Beach Gardens, Florida, and Watertown and Stamford, Connecticut devoted to estate planning, asset protection, and business counsel.