How Parents Can Use Trusts to Protect Wealth for Kids in Divorce

INSIGHT

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If you work with families on estate planning, you've likely been asked some version of: "How do I make sure the assets I leave to my kids don't end up in the hands of a future ex-spouse?"

Americans increasingly have turned to trusts to protect family assets left to their children who may become wrapped up in a divorce. These individuals aim to keep family assets in the family rather than lose them in a divorce settlement.

But properly structuring these trusts can be complex, and they require diligence to provide long-term asset protection. It's important to use trusts correctly.

Discretionary Trusts

The first and most important move is to use a discretionary trust, not an outright gift or simple bequest.

When assets pass directly to a child, they can easily become marital property—especially if commingled. But if assets are held in a trust with true discretionary powers, the child (as beneficiary) doesn't own them. They can't demand distributions. And in most jurisdictions, a divorcing spouse can't claim what the beneficiary doesn't control.

Make sure the trustee has sole discretion over distributions. This single feature does more than anything else to protect trust assets from a future ex-spouse.

Spendthrift Clauses

Every trust meant to protect against divorce or creditors should include a spendthrift provision. This clause prevents the beneficiary from assigning or pledging their interest in the trust.

It also bars most creditors—including divorcing spouses—from reaching into the trust to satisfy claims.

Trustee Independence

Courts will look past the legal wrapper if the beneficiary effectively controls the trust. That's why a third-party trustee is critical. Whether it's a professional fiduciary or a trusted family member, separation between the trustee and the beneficiary reinforces the trust's asset protection features.

You can allow the child to serve as co-trustee with limited powers or step in as trustee at a certain age, but unrestricted control is a red flag. For example, the child might have the ability to assist with general administration tasks, or specific tasks, but not given authority over their share, once initial administration is complete.

Alternatively, trusteeship changes hands to the child at a certain age, when the client feels comfortable with them having the control, and marital or creditor issues are potentially no longer a concern. Note, balancing control, with the cost of an ongoing trust administration, should also be considered.

Efficiency Versus Control

Discretionary trusts present a classic tension between tax strategy and legal protection.

If income is retained in the trust, it's taxed at compressed trust rates. If it's distributed, it's taxed at the beneficiary's personal rate—which is usually lower. But more distributions mean more exposure if those funds get commingled with marital assets.

The solution? Use HEMS standards (health, education, maintenance, support) as a baseline, and layer in discretionary powers to manage both tax flow and asset protection. Also consider spray trusts, which allow the trustee to allocate income among multiple beneficiaries for tax efficiency without triggering outright ownership.

Long-Term Protection

Consider a generation-skipping trust to not just protect from divorce, but also from estate tax. Instead of distributing the trust corpus to your client's child outright, the assets stay in trust—benefiting children, grandchildren, and beyond. This achieves multiple goals:

- **Divorce protection:** Assets remain in trust, not in the marital estate.
- **Tax efficiency:** With proper use of the GST exemption, assets avoid estate tax at the child's death.
- **Legacy control:** The family wealth stays in the bloodline and is protected from outside claims.

The higher basic exclusion amount gives taxpayers more room to make lifetime gifts. For individuals who die or make gifts in 2025, the exclusion increased by $380,000 over the 2024 level. This expansion offers added flexibility both for new gifting in 2025 and for allocating GST exemption to previously established trusts that aren't yet fully GST-exempt.

But even the best-structured trust can fall apart if the beneficiary doesn't understand how to use it —or how not to use it.

If your client's child takes a distribution from the trust and uses it to pay off a joint mortgage, they've just made a protected asset vulnerable. Part of your role as an adviser should include clear communication and education. Help your clients talk to their kids. Encourage letters of wishes that explain intent.

Children should understand that using trust funds to purchase jointly title assets, repay shared debts, or make gifts to their spouse can lead to inclusion of their inheritance in a divorce. A letter of wishes is not legally binding but can provide context for the children to understand the why behind the what, giving the trust structure more meaning, and alleviating hard feelings.

Key Takeaways

Trusts aren't just for the ultrarich. They're a smart, flexible way to make sure your assets benefit your children—and only your children. With the right structure, you can shield family wealth from divorce, lawsuits, poor financial decisions, and even taxes.

The right trust structure does more than protect assets. It protects legacy, intention, and the peace of mind your clients are paying you for. Patricia Clements is an estate planning attorney and of counsel at VF Law.

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