

Insights

Spendthrift Trusts

Transfer Wealth with Asset Protection



When transferring wealth to future generations, individuals may worry their assets could be whittled away by a beneficiary's potential creditors or other adverse circumstances. Including spendthrift provisions may prevent creditors from attaching the interest of a beneficiary to the trust and/or limit a beneficiary's ability to transfer or pledge the assets in the trust. Using these provisions has become a more common practice when drafting modern day trusts, such as family trusts and marital trusts. In tandem with spendthrift provisions, trustees typically are granted broad discretion regarding trust distributions.

Establishing and Funding Trust

To establish a spendthrift trust, an irrevocable trust must first be drafted by an attorney and a trustee must be appointed. The trust is funded by transferring assets to the trustee. Most types of property, including income-producing assets such as cash, stocks, and bonds, can be held in the trust. As the trust is irrevocable, once established, it may not be revoked and most provisions in the document may not be changed.

Role of Trustee

Trust assets are managed by the trustee according to directions specified in the trust and statutory guidance. However, the trustee typically has broad discretion regarding distributions. Although the beneficiary may act as a trustee, generally if he or she has too much control over the trust, the trust will not be effective. An independent or corporate trustee generally affords greater protection.

Additional advantages to choosing an experienced corporate trustee include access to full-time trust professionals who provide objective execution of trust directions. Corporate trustees also are able to support individual relationships with a depth of corporate resources and often are able to provide both fiduciary and investment services in house. Unlike an individual trustee, there are rarely issues of continuity as personal incapacity or death is not an issue with a corporate trustee.

Asset Protection

Spendthrift provisions restrict the beneficiary's access to trust assets as well as their ability to pledge, transfer, or sell trust assets. With this structure, creditors have no rights to the trust's assets while they remain in the trust. Creditors may have the right to access income or principal if distributed to the beneficiary.

Considerations

Because of their potential to evade creditors, most states do not allow grantors to establish spendthrift trusts for their own benefit. However, a number of states including Delaware, Alaska, and Nevada have allowed various forms of self-settled asset protection trusts.

In a number of states, the historical impact of spendthrift provisions is being altered. Children, spouses, and ex-spouses with judgments for support or maintenance, may be able to attach assets of these trusts. Additionally, judgment creditors who have provided services for the protection of a beneficiary's interest in the trust may be able to access trust distributions. Furthermore, government agencies such as the Internal Revenue Service may place a lien on distributions from spendthrift trusts.