The Beneficiary-Controlled Trust:
Keeping an Inheritance in the Family and Protecting Family Assets

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It has long been ingrained in American property law that we have the right to determine who will receive our property after we pass away. In the United States the majority of laws on disposition of property at death are governed by the states. Some laws are more liberal, permitting flexibility in determining who can receive property. Some require at least a portion of the property to be passed to specific individuals (i.e. spouses, children, etc.). States have even developed default laws that dictate who will receive your property should you fail to leave behind valid instructions. The right we have to determine the details of how our property will pass is an important right. In addition to being able to determine who will receive your property at death, you also have the ability to determine many other details, such as when the property will be distributed and limitations on the use of the property.

As laws developed around the right to dictate how property will be distributed at death, an entirely new area of planning, referred to as estate planning, emerged. Various tools and techniques have been developed and refined over the years to provide individuals and families a means to effectively carry out their wishes. Sophisticated legal instruments accomplish a broad array of goals including: avoidance of income and estates taxes, provisions for contingent distributions (i.e. the recipient must do certain things or accomplish certain achievements before receiving the property), and a means to provide a high level of asset protection.

This last goal, asset protection, has become increasingly important for several reasons: society has become more litigious; divorce rates have surpassed 50%; and the federal estate tax applicable exclusion is set to return to $1,000,000 in 2011 ($2,000,000 for married couples). In fact, asset protection planning may be a priority for many more families than estate taxes. Leaving property outright to children, grandchildren, and other heirs may be the simplest form of distribution, but it exposes the property to attacks from a vast array of potential creditors. There may be tort claims against the beneficiary, ex-spouses who claim a right to the beneficiary's property and income, unsecured lenders who go after the inherited property and a host of other unintended recipients of the property that you intended to 'keep in the family.' As estate planning professionals have tried to stay one step ahead of this issue, we have seen the development of different techniques to create roadblocks for the potential unintended recipients. However, the problem with many of the devices is that by limiting access of the unintended, they also limit the access of the intended recipients. In other words, the more assets are protected from potential creditors, the less access the intended beneficiaries have to the use and enjoyment of the property.

A beneficiary-controlled trust has been developed to provide future beneficiaries with access to both their inheritance and protection from future creditors. A properly designed beneficiary-controlled trust accomplishes all of the following:

- Reduces or eliminates federal transfer taxes (gift tax, estate tax, generation skipping tax)
- Keeps family assets in the family
- Protects assets from various creditors (law suits, tax liens, divorce, etc.)
- Permits retention of control over the management of assets
- Permits you to dictate the eventual beneficiaries of the assets
- Allows for the retention of flexibility if circumstances or goals change

The beneficiary-controlled trust includes many of the same provisions as other trusts. It may be established during the life of the settlor (person creating the trust) or upon the death of the settlor (a testamentary trust.) The settlor transfers property to the trust, either during life via gifts to the trust or at death, and names the beneficiary of the trust. The beneficiary is typically the settlor's child or other family member, and is the person who will eventually receive distributions of principal and income from the trust.

Here is where we diverge a bit from the typical trust structure. The beneficiary is also named the trustee of the trust, and is given the authority and responsibility to manage and invest the principal of the trust. A third party (individual or corporate trustee) that is friendly to the beneficiary may be named and given authority over trust distributions. The terms of the trust are very flexible and will include common provisions seen in many trusts. However, in order to accomplish the dual objectives of beneficiary access and prevention of access by future creditors, there are a number of specific provisions that need to be included. It is important to seek the advice of legal counsel who is familiar with this type of planning.

One distinct advantage of a beneficiary-controlled trust is that the principal of the trust may be used to acquire assets for the personal use and enjoyment of the beneficiary. For example, the trust could acquire a vacation home and permit the beneficiary to use the home without subjecting the property to attack by the beneficiary's creditors. Another unique opportunity is that beneficiaries may use the trust principal to fund the start-up of a business. With a beneficiary-controlled trust as the business owner and supplier of the funds, the beneficiary could run the business, receive benefits and a salary from the business, and receive distributions of business profits without exposing the business to attack from the beneficiary's creditors. In cases where the founders wish to pass a family business onto a child, a separate trust-owned life insurance policy on the life of the parent and a beneficiary-trust purchase of the business from the estate upon the parent's death can be a very effective was to keep the business in the family.

There are numerous means by which an individual can keep their assets away from the reach of potential creditors. Qualified retirement plans offer protection from creditors pursuant to the Employee Retirement Income Security Act (ERISA), but they are heavily taxed upon death (both income and federal estate taxes), limit contributions, limit investment options and may be assigned to ex-spouses upon divorce. Offshore trusts vary in their effectiveness, may limit access to funds, may not protect assets from all creditors (including the U.S. government) and are often expensive to establish. In contrast, the beneficiary-controlled trust has become popular in recent years due to its broad asset protection features, ability of the beneficiary to access funds, and the ease and limited expenses involved in establishing and administering the trust.