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## Guest Article

# Asset Protection Planning - It's Everywhere, Part II

By Jeffrey A. Baskies

In the Nov. 24, 2003 issue, I discussed a Wall Street Journal article which asserted that doctors, accountants, lawyers, business executives and many other people are all "putting their money where creditors can't get to it," and that pointed to a recent survey indicating a dramatic increase in asset protection planning. See Rachel Emma Silverman, "Litigation Boom Spurs Efforts to Shield Assets," Wall Street Journal (Oct. 14, 2003).

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My prior article explored some of the basics in the area of asset protection planning for our clients: the doctrine of fraudulent transfers, states' statutory exemptions, offshore plans and domestic trusts. Those are the types of asset protection planning issues we address when meeting with clients looking to protect assets in their own names - for example, many of our doctor and business executive clients.

However, asset protection planning may be relevant even for clients without significant assets to shield, because this planning may be helpful for virtually anyone expecting an inheritance.

This time, we will consider why and how clients should consider arranging for their inheritances (and/or any substantial lifetime gifts) to be paid in trust instead of outright.

Inheritance trust planning is an important part of our estate and asset protection planning landscape.

For example, when we have clients with minor children (or minor grandchildren they want to benefit), we always talk about this sort of asset protection planning - the standard "trusts for children" we draft in their wills or revocable trusts. Such trusts are created to protect minors from themselves (so the money doesn't all vest at age 18) as well as from their creditors (via spendthrift clauses). This type of planning is so prevalent, we may not even think of it as asset protection planning. But it is.

### 'Standard' Trusts For Children

It seems that drafting trusts for children for many clients has evolved over the last 20 years or so. Perhaps it is just that there are more wealthy clients. Or perhaps children are in greater need of protection. But sophisticated trusts for children are becoming (if they are not already) the norm.

At its most basic, drafting standard trusts for children is primarily about protecting minors until they reach the age of majority or beyond. If assets pass outright to a minor, they wind up subject to state court controlled guardianships, which can be costly and needlessly meddlesome. Further, guardianships generally allow funds to pass outright to the child on the child's 18th birthday.

Standard trusts for children not only avoid guardianships, but they typically are drafted to last well beyond a child's 18th birthday. How many 18-year-old children are really prepared to manage significant wealth? Standard trusts for children often last until the children reach their mid-20s, or 30s or even beyond. Now (as described more below) trusts for life (multi-generational trusts) are becoming more common.

Trusts for children typically provide for discretionary distributions of income and principal to support the child and perhaps pay for college or post-graduate education. The principal may be used to help form a professional practice, a business or to purchase a home. Sometimes the income will be required to be distributed, as well as some or all of the principal. Some trusts will have distributions based on an ascertainable standard (relating to the health, education, maintenance and support of the child), while others may be for any reason in the trustee's discretion. In those cases, usually the "best interests" of the child are the guiding principal.

The reasons to use ascertainable standards usually deal with who will be trustee and what relation the trustee will have with the beneficiary. For example, if the child can become a trustee, then if he can make distributions to himself for his best interests, without regard to an ascertainable standard, then the trust assets will be taxed in his estate. An ascertainable standard can avoid that result.

In some circumstances, trusts for children may be drafted to have multiple trustees with different authorities. For example, the child himself may have investment oversight, while an "independent" trustee may have a power to distribute trust assets to the child under a "best interests" standard.

Standard trusts for children are often drafted to protect children not just from immaturity, but also from drugs, alcohol and substance abuse. Special clauses may be added to trusts to withhold distributions if the trustees believe the beneficiaries are addicted to those substances.

Further, there have been provisions drafted regarding gambling and other forms of dangerous or addictive behaviors that the trustees are directed to consider prior to distributing assets.

In addition to protecting children against their own problems, trusts for children are used to protect children from the claims of others. Spendthrift clauses offer a two-way benefit. In addition to protecting a child against selling his trust interest, the spendthrift clause, of course, protects the trust's assets from his creditors.

Thus, assets held in a spendthrift trust for a child are exempt from attachment by the child's creditors or a divorcing spouse. So while assets inherited in an individual name are available to creditors, trust assets are not.

Given all the twists and pitfalls in asset protection planning for one's own assets - discussed in my earlier article - taking advantage of the opportunity to create asset protected inheritances has become very popular.

### **Asset Protection Planning With Inherited Trusts**

Now, trusts for children are being drafted to offer much more than "standard" protections. Moreover, trusts for children now often last for life (sometimes the child's life and his children's lives too, and more).

Indeed, children of sophisticated clients are often not only willing but also happy to receive their inheritances in trusts. Knowing that their inheritance is safe and not at risk, might help them take some risks in business, might protect them in case of a divorce, and might allow them to rest easier knowing their money won't be taken by a plaintiff in a lawsuit.

Moreover, there are ways to draft these trusts where the children have all the beneficial rights of ownership - rights to income and principal, investment responsibility, etc. In that case, the inheritance via trust is more valuable than an outright inheritance.

The key elements to these inherited asset protection trust are usually control in the hands of the beneficiaries, generation-skipping tax protection, limited distributions, and strong protections against creditors.

### **Protecting Multiple Generations**

These types of asset protection trusts for children are so becoming so popular, that extending them to grandchildren and even lower generations has also become a very common planning technique. This form of multi-generational asset protection plan usually allows the patriarch/matriarch to protect their estates for their children, grandchildren and beyond while offering them all of the beneficial rights of ownership.

The popularity of multi-generational planning has led several states to extend or eliminate their rules against perpetuities to accommodate long-lasting multi-generational asset protection plans.

Multi-generational asset protection plans often take the forms of large pooled trusts. The beneficiaries may have access to a share of the trust or the whole. The distributions are often limited as much as possible. Why take assets from the protected trust form to an unprotected individual ownership form?

So these trusts (sometimes called "dynasty" trusts) may act like pooled family banks. They may own vacation homes in which the family is allowed rent-free use. Or they may make loans to the beneficiaries. Or they may fund the creation of new businesses which are owned by the protected trust, but which create an income stream to the family members.

There are many excellent articles available describing the benefits of "dynastic" trust planning.

### **Conclusion**

Frequently estate planners see clients who want to protect their own assets from their creditors. But they do not consider an easy and obvious option - ask clients about their plan for their inheritance. If the clients discuss the benefits of trust planning with their parents and/or grandparents, then a multi-generational approach may be beneficial.

Similarly, when planners are meeting with the senior generation, they should be discussing trusts for children even if the children are not minors (particularly if the children are already successful). Because this is an easy way to have a very strong asset protection plan without the worries, hassles or fraudulent transfer concerns often associated with domestic or foreign planning. These are easy, on-shore trusts that offer very potent protection.

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