Rethinking The Way We Look At The Revocable Living Trust

THE EMERGENCE OF Beneficiary-Controlled Trusts

by Douglas Wood, CPA, Esq.

Planning for the future includes planning for the day you leave this earth. Post-mortem planning is not a topic that people like to face. In fact, we often push it to the side because the tasks for today seem more important and pressing. Unfortunately, the lack of planning sometimes results in no plan, which leaves your assets to be handled by someone other than yourself. If you want to maintain control during your lifetime over the assets you plan to leave to others, yet provide flexibility and built-in asset protections for those beneficiaries, you should consider incorporating beneficiary-controlled trust provisions into your existing or future estate plan.

One of the most popular mechanisms for creating a beneficiary-controlled trust is to include these provisions as part of a revocable grantor trust. These types of trusts are usually created by spouses to hold the family assets and are often referred to as a revocable family trust. Upon the death of the last surviving spouse, the family trust is deemed irrevocable and the provisions for the beneficiary-controlled trust are administered for the beneficiaries of the family trust.

Like many other types of trusts, there are cost savings, incapacity management, tax savings and beneficiary protections available for those who choose this option. All of these benefits make this trust a great way to protect and pass on your assets with the added assurance that your beneficiaries will have in place proper mechanisms to protect those assets from creditors or ex-spouses.

How Beneficiary-Controlled Trusts Work

In setting up a beneficiary-controlled trust, the grantors are generally the spouses of a joint revocable family trust. Title of assets is held individually in the name of the grantor or grantors and then transferred by way of retitling the assets into the name of the trust. Upon the death of the last surviving grantor, the family trust is considered irrevocable and the provisions for the beneficiary-controlled trust are administered upon the beneficiaries of the family trust, also called the primary beneficiaries. The beneficiary-controlled trust can be designed so that the primary beneficiary, along with a "friendly" independent co-trustee, will manage the trust. The primary beneficiary has the flexibility to remove or replace the independent co-trustee.

The primary beneficiary, acting as a co-trustee, may invest and acquire assets under the trust using the trust principal. However, all of these assets still belong to the trust and should be kept titled in the name of the trust. The beneficiary's assets owned individually in the beneficiary's name must be kept separate from the trust and should not be comingled with the trust assets.

A beneficiary-controlled trust can be used to protect a wide variety of assets. Assets in the trust may be used for just about anything. From everyday expenses to vacations, the assets are still protected by the trust to the extent they are still titled in the name of the trust and have not been transferred or transmuted into the beneficiary's individual name.

When the primary beneficiary of the trust passes away, the assets held in the trust may continue to be held by the trust or at the discretion of the terms of the beneficiary-controlled trust, be passed on according to another testamentary instrument, such as a will or subsequent trust prepared according to the primary beneficiary's wishes.

In other words, a beneficiary-controlled trust allows the grantor to provide for the beneficiaries but also builds in asset protection to ensure the preservation of the grantor's wealth down to the appointed beneficiaries. This can be very important if you have significant assets that you want to ensure stay in your family or beneficiaries who could be at risk to creditors.

Protection from Liability and Creditors

Aside from the ability to keep assets in the family, a beneficiary-controlled trust can help protect the trust assets from creditors and potential ex-spouses of the beneficiary. If the primary beneficiary becomes a party to a lawsuit, the assets in the trust should be protected. The primary beneficiary will resign as a co-trustee, and as such, the creditor can't compel the independent trustee to make distributions from the trust. For similar reasons, assets in the trust should also be protected from the IRS, ex-spouses and creditors.

Also, since the beneficiary doesn't own the trust's assets, the assets are protected from bankruptcy filings. To further protect the trust, secured loans from the trust to the beneficiary may be considered instead of taking distributions directly from the trust. This would ensure that the trust has priority in the event of bankruptcy by the beneficiary. In this case, the trust would be considered an additional creditor rather than an asset.

It's important to take steps to determine the details of how your assets will be handled now so that it isn't handled by the default laws of your state. Depending on the state, this can mean significant taxes and creditor access. You also want to ensure that you make determinations about how property will be used. Society has become increasingly litigious and divorce happens regularly. A beneficiary-controlled trust should ensure that your assets don't end up being owned by someone you never knew or intended to have control.

Beneficiary-Controlled Trusts Provide Control

Compared to other estate planning arrangements, a beneficiary-controlled trust is relatively simple to use, easy to implement, and is more cost effective. It's a valuable vehicle for exercising control over the inheritance you want to leave to those you love.

When you create a beneficiary-controlled trust, you can design it with a wide or narrow discretion for implementing the control and flexibility afforded to your beneficiaries. Regardless, a beneficiary-controlled trust will help prevent your family assets from falling into the hands of creditors, ex-spouses, and other unintended sources – yours or your children's. Again, your beneficiaries individually own nothing unless a distribution is made from the trust.

Given the opportunity to provide the beneficiary with assets they can enjoy in a manner as close to outright ownership as possible, it's no surprise that more and more people are beginning to incorporate the beneficiary-controlled trust provisions into their existing or newly created estate plans. With the tax benefits, creditor protections and access to family assets, a beneficiary-controlled trust will give you peace of mind and is a great option for those looking to pass their assets forward. ■

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