It is becoming increasingly difficult to find a family that has not been touched by either a divorce or lawsuit. Therefore, protecting and insulating family assets from the possibility of divorce or lawsuit is a growing concern. In particular, clients are asking the question “How can we protect our children’s inheritance from their creditors?” They are searching for ways to protect the inheritance they leave to beneficiaries. Parents have worked long and hard to grow their family’s wealth and do not want for it to be lost to a third party. Now parents can take advantage of estate planning opportunities to help secure the distribution of assets that they will make to their children.

**BEFORE CREDITOR PROTECTION**

Traditionally, people have considered estate planning documents, such as wills and trusts, as a mechanism for naming the beneficiaries of an estate and the people who would be in charge of the estate such as Executors or Trustees. These documents often included simple distributions which named a surviving spouse as a primary beneficiary and the children as the outright beneficiaries of assets when both parents passed away. Some people took the additional step to have a minor’s trust prepared within the will that said if a child were to inherit and was under a certain age, such as twenty-five (25) years, that the assets would be held in trust for their benefit until they reached that age. The Trustee was to use the assets for the child’s health, support, maintenance and education. Upon reaching the age of twenty-five (25) years the child was given the right to make a complete withdrawal from the trust. Once the withdrawal was made, the assets were subject to the spending habits of the child and all of his or her creditors.

This is an example of how a great opportunity to protect your children’s inheritance was lost. The following are some of the potential creditors and examples of the circumstances under which your beneficiaries can lose their inheritance:

**PERSONAL INJURY CREDITORS**

If your child is in a car accident or someone is injured in their home and a lawsuit results, his or her personal assets could be subject to the results of the legal action. Most
people assume that car insurance of liability insurance will be sufficient protection. However, it is possible a child could neglect the purchase of proper insurance, could have insufficient liability limits or could fail to purchase insurance altogether.

**PROFESSIONAL LIABILITY**

Depending on the profession of the beneficiary, they could be more or less susceptible to professional liability. Employment positions such as medical professionals, legal professionals, contractors, builders, architects, business owners and others will carry with them increased professional liability issues. It is important to insulate your beneficiaries from the threat of malpractice or professional liability through the use of proper estate planning.

**DIVORCE CREDITORS**

From a statistical perspective, almost one out of every two beneficiaries who get married will subsequently get divorced. Therefore, if your children inherit assets from you and subsequently commingle those assets with their spouse, there is a good possibility that a portion or all of the assets that they inherited from you will be lost during a divorce. You must decide if you would want your assets to be available to a child’s ex-spouse.

The above are just some of the examples of how personal assets, including inherited assets, can be lost simply because they were owned in an individual’s own name. We are now working hard to increase the awareness of the options available for protecting beneficiaries from their creditors through the use of proper trust and estate planning. In particular, this article addresses the use of what we refer to as the Beneficiary Controlled Trust (BCT).

**PLANNING WITH CREDITOR PROTECTION**

Most frequently, the BCT will be set up as a trust within your Last Will and Testament. It will only come into effect at the time the creator of the Will passes away. Frequently, there will be one trust created for each beneficiary. The trust has one or more independent trustees acting and making all decisions until such time as the beneficiary reaches a particular designated age. Often between twenty-five (25) years and thirty-five (35) years of age. Until the beneficiary reaches the designated age, the independent trustee will be responsible for all decision making, including investment decisions and decisions on distribution of assets to or for the benefit of the beneficiaries. During the time that the assets are under the complete control of the independent trustee, the trust assets would be insulated from the beneficiaries’ creditors.

Upon reaching the designated age, unlike a traditional minor’s trust, as described earlier, there will not be an outright distribution to the beneficiary. Instead, the beneficiary will become the family co-trustee of his or her own trust. The family trustee’s job will be to make all decisions relating to the assets so long as they are contained within the trust ownership. For example, they will be able to purchase stocks, bonds, mutual funds, real estate and any other investments that an individual would ordinarily be able to make for him or herself. Additionally, they will have the ability to make decisions on how and by whom the assets can be used. For example, if they were to purchase a vacation home within the trust, they would be able to use and enjoy the property even though the property is owned in the name of trust. Increased creditor protection is achieved because these assets would never be placed into the individual name of the beneficiary and will be owned in the trust name and under the trust tax identification number.

After the beneficiary becomes the family trustee, the independent trustee’s job description will change dramatically. They will maintain a role that will help to maintain the additional creditor protection that the BCT affords. The independent trustee will be charged with the sole responsibility of making decisions on when and to whom distributions from the trust entity can be made. The family trustee will not have the
authority to make decisions on the withdrawal of assets from the trust. It is not our intention to keep beneficiaries from enjoying or receiving the assets. Quite to the contrary, we are enhancing the enjoyment of the assets because the individual’s creditors will have a significantly more difficult time reaching them. The trust beneficiary is even given the power to replace the existing independent trustee, so long as a qualified substitute is immediately named.

In safeguarding asset from potential divorce, the BCT can be very effective. Assets placed into the BCT will never become a part of the marital estate. By law, inherited assets will not become marital assets unless or until they are commingled and placed into the other spouse’s name. It is possible for the divorcing spouse to argue that the amount of growth on the inherited assets during marriage could be subject to a divorce division. Even this argument will be very difficult if the assets are owned by the trust and not by the spouse.

Mechanically, the BCT will function very easily and it is not complex to administer. Upon the trust creation, a tax identification number will be assigned and all income taxable activity will be attributable to the trust entity. The trustees will keep an accounting of all of the income and distributions on an annual basis and will file income tax returns with the state and federal government. The trust will operate as an entity in and of itself and will be independent of the trust beneficiary. There are very few instances that the trust will actually have to make significant distributions to or for the benefit of the beneficiary. Most things that the beneficiary could ordinarily purchase as an individual could be purchased and owned within the trust entity. The greatest benefit will always be that the assets owned by the BCT will be protected from the individual’s creditors and the risk of loss will be greatly reduced.

**CONCLUSION**

Most clients have worked long and hard to develop and grow their family assets. It is very difficult for them to consider the possibility of leaving these assets to their beneficiaries only to have them lost to third party creditors and/or divorce creditors. Through the use of estate planning documents such as wills and trusts, it is possible to insulate the inheritance that you leave to your beneficiaries from their creditors. It is also worth noting that you can consider discussing this same type of planning for your own parents so they might institute the use of the BCT when leaving assets to you in their own wills or trusts. This is truly a multi-generational mechanism that can serve to enhance and protect a family’s wealth.

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**Douglas L. Kaune and David M. Frees, III** are local Elder Law Attorneys practicing in the areas of Estate Planning, Estate Administration, Asset Protection and Nursing Home Care Planning and can be reached at 610-933-8069. Contact dkaune@utbf.com

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