

# Personal Planner

From Crescendo



## TRUSTS FOR CREATIVE SPENDERS

Trusts can be quite useful for protecting children. However, for some children, the trust serves an additional function: It protects the principal from being rapidly spent by a child. These trusts have a specific name—they are called "spendthrift" trusts.

Marla was visiting with her attorney Elizabeth shortly after her husband Harry passed away. She shared her concern for her youngest child, Joe.

**Marla:** "Harry and I were very fortunate to have four great children. I love each one of them very much. However, when it comes time to making decisions about inheritance, I have a big problem. Our older children Sam and Linda are quite good with financial matters. The third child Lynn is average, but our youngest son Joe is very carefree. If Joe has money, it is gone in a flash. What can I do?"

**Elizabeth:** "This is a fairly common situation. Many parents would like to treat their children equally, but some children are very good managers and one or two are not. In your case, we hope that Joe eventually learns to become more responsible. But for the present plan, it makes good sense to provide Joe with spendthrift trust provisions."

## THE SPENDTHRIFT TRUST CONCEPT

A spendthrift trust allows a parent to protect a certain amount of inheritance. If you have a circumstance like Marla, it may be appropriate to transfer inheritance outright to some of your children and the same amount of property into a spendthrift trust for the "creative spender" child.

A spendthrift trust will need to be managed by a trustee who can make good decisions. For a larger trust, this could be a bank or trust company. In many circumstances a private trustee is selected, such as one of the family financial advisors or even one of the other children.

The trustee will have the usual power to invest and manage the trust assets. The first important provision for the trustee is his or her power over income. The spendthrift trust normally includes seven different provisions that apply to the income:

1. Income may be paid to the child.

2. Income may be paid to persons or organizations providing benefits to the child. For a spendthrift child, it frequently is necessary to make the payment directly to the provider or the child would simply spend the money.
3. The child may not demand the payment of the income. A spendthrift child may desire to purchase some item and would simply demand income if that right existed.
4. The child may not pledge or borrow against the trust income or principal. Once again, if the child could pledge or borrow against the trust, they could quickly deplete the trust through those loans.
5. The trustee usually has complete discretion over distributions. A parent may indicate the general purposes of the trust, but a trustee is better able to protect the principal and the beneficiary if he or she has complete discretion.
6. Trust principal may be used by the trustee for the education, healthcare needs or support of the child.
7. Some trusts create incentive plans. In these trusts, the trustee is authorized to distribute income that will match the income of the child.

## **SPENDTHRIFT TRUSTS AND DISTRIBUTIONS OF PRINCIPAL**

With a spendthrift trust, distribution of principal is also subject to specific requirements. While the parents are given a reasonable level of flexibility in setting forth the distribution rules, there are several general guidelines that are usually followed.

1. The trustee will have discretion to distribute principal over the duration of the trust. The trustee normally has quite broad powers to make distribution of principal. In order to protect the child, this is quite important. However, the child may have a very good investment or business opportunity for which he or she needs principal. If the trustee is convinced that the child can use principal responsibly, then the distribution may be made.
2. The trust principal is normally held in trust for life or until a fairly senior age, such as 50 or older. If the child eventually acquires the capability of managing assets properly, the trustee can use the discretionary power to move the assets to the child. However, because the parent is concerned that the child may never acquire a high level of management expertise, the trust often lasts for life.
3. The child has no right to demand principal. The principal is controlled by the trustee for the protection of the child.
4. The child may not pledge the trust principal or borrow against the principal. Because the trustee is not obligated to make payment on any loans by the child, the banks or other lenders will not make loans using the trust income or principal as collateral.

## **A SOLUTION FOR "CREATIVE BILL "**

Sam and Sandy have an estate of \$1 million. Their children—Alice, Jim and Bill—are all in their mid-thirties. Alice is age 38 and Jim is age 37. They are both solid and responsible. However, Bill is 33 and is quite a creative person. Sandy says that "If Bill had a million dollars, he would use it creatively in three weeks."

Because of their desire to treat everyone equally and to protect Bill from his creative spending habits, Sam and Sandy created a fairly typical plan for their circumstances. If one spouse passes away, the \$1 million estate will be transferred to the survivor. When the survivor passes away, their favorite charity will receive a bequest of 10% of the estate. The other 90% will be divided. Alice and Jim will receive their shares outright. However, the third share will be transferred into a spendthrift trust with family advisor Steven as trustee. There will also be a successor trustee—First Bank from their local community.

As trustee of the spendthrift trust, Steven will receive approximately \$300,000. He will invest this amount in a diversified portfolio of stocks and bonds. Steven will have discretion to distribute income and/or principal to Bill. When Bill reaches age 55, he will then receive the full inheritance. Sam and Sandy believe that by that time he will be responsible in managing the property.