

Spendthrift trusts aren't just for spendthrifts

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Now that the federal gift and estate tax exemption has reached an inflation-adjusted \$11.7 million for 2021, fewer estates are subject to the federal tax. And even though President Biden during the presidential campaign proposed reducing the exemption to \$3.5 million, it's uncertain whether that proposal will pass Congress. If nothing happens, the exemption is scheduled to revert to an inflation-adjusted \$5 million on January 1, 2026. Nonetheless, estate planning will continue to be essential for most families. That's because tax planning is only a small component of estate planning — and usually not even the most important one.

The primary goal of estate planning is to protect your family, and saving taxes is just one of many strategies you can use to provide for your family's financial security. Another equally important strategy is asset protection. And a spendthrift trust can be an invaluable tool for preserving wealth for your heirs.

“Spendthrift” is a misnomer

Despite its name, the purpose of a spendthrift trust isn't just to protect profligate heirs from themselves. Although that's one use for this trust type, even the most financially responsible heirs can be exposed to frivolous lawsuits, dishonest business partners or unscrupulous creditors.

A properly designed spendthrift trust can protect your family's assets against such attacks. It can also protect your loved ones in the event of relationship changes. If one of your children divorces, your child's spouse generally can't claim a share of the spendthrift trust property in the divorce settlement.

In addition, if your child predeceases his or her spouse, the spouse generally is entitled by law to a significant portion of your child's estate. In some cases, that may be a desirable outcome. But in others, such as second marriages when there are children from a prior marriage, a spendthrift trust can prevent your child's inheritance from ending up in the hands of his or her spouse rather than in those of your grandchildren.

Safeguarding your wealth

A variety of trusts can be spendthrift trusts. It's just a matter of including a spendthrift clause, which restricts a beneficiary's ability to assign or transfer his or her interest in the trust and restricts the rights of creditors to reach the trust assets.

It's important to recognize that the protection offered by a spendthrift trust isn't absolute. Depending on applicable law, it may be possible for government agencies to reach the trust assets — to satisfy a tax obligation, for example.

Generally, the more discretion you give the trustee over distributions from the trust, the greater the protection against creditors' claims. If the trust requires the trustee to make distributions for a beneficiary's support, for example, a court may rule that a creditor can reach the trust assets to satisfy support-related debts. For increased protection, it's preferable to give the trustee full discretion over whether and when to make distributions.

If you have further questions regarding spendthrift trusts, please contact us. We'd be happy to help you determine if one is right for your estate plan.

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