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How to protect an inheritance even when divorce occurs

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With the divorce rate crossing 50 percent and experts predicting a higher future rate, the odds your children will divorce are significant. Add this issue to the sue-happy American population and permitting your children to simply receive an outright inheritance may not be in their best interest.

How can you pass on your inheritance and safeguard it against loss if your child gets divorced? It's not an easy answer, but there is a solution anyone who might be faced with the possibility of divorce within their family should consider.

Beneficiary-controlled trusts are being recommended by many sophisticated estate planners as a way to help provide divorce protection to a family's estate. A beneficiary-controlled trust provides your child with nearly all the rights, benefits and control over the trust property that a person would have with outright ownership, in addition to divorce protection that is not available with outright ownership.

A typical trust is designed to last for a short time after the grantor is deceased, with the trust paying out its assets when your child reaches a certain age or at different age levels.

In the event of a divorce, those assets are at risk of being included in the marital assets, especially if they have already been distributed to your child.

The beneficiary-controlled trust differs by maintaining the assets in trust for your child's lifetime and appointing your child as trustee along with an independent trustee, such as a bank or other adviser. The independent trustee has the sole discretion to pay income and the trust principal for your child's education, health, maintenance and support. However, your child maintains control by possessing the ability to remove and replace the independent trustee with another independent trustee.

If you desire, your child can enjoy further control by being able to rewrite the trust as long as the new recipients are not your child, his/her creditors, your child's estate or the creditors of that estate. This provides control in the event of future challenges, such as a drug problem with a grandchild. Upon your child's death, the assets can stay in trust for his/her children, and the trust can be drafted to avoid generation-skipping tax and the estate taxes as well.

A carefully drafted beneficiary-controlled trust will maximize the following benefits:

- Asset protection -- Because the independent trustee has the sole discretion to distribute trust assets, the trust helps protect against your child's creditor claims in the event of divorce or bankruptcy.

Estate planners also insert a "spend-thrift clause" in the trust to provide that a beneficiary cannot voluntarily or involuntarily (as in bankruptcy) assign his/her interest in the trust. Because of the independent discretion and the spend-thrift clause, your child has no enforceable rights against the trust so that a creditor cannot "stand in your child's shoes" to collect assets from the trust.

- Power -- Your child retains the right to change independent trustees and alter the distribution scheme of the trust so that unanticipated future events can be accounted for and your child can find the right fit for the working partner trustee.

- Investment freedom -- There is much flexibility in the nature of the trust assets. Along with stocks, bonds, hedge funds and mutual funds, the trustee can acquire assets for your child's enjoyment, such as vacation homes and artwork as well as businesses that employ your child.
- Longevity -- The trust is there for your child's lifetime to provide added financial security. However, if the child has many other assets and there is no need for distributions, the trust can accumulate assets for other beneficiaries chosen by you or your child. The trust can be drafted to last for generations, giving each generation the benefits and protections afforded your child.
- Tax savings -- Asset protection is also afforded by minimizing the impact of estate taxes and generation-skipping transfer taxes.

Drafted properly, the trust can use the credit from estate taxes and the exemption from generation-skipping transfer taxes to pass down tax-free compounded assets for generations.

The beneficiary-controlled trust continues to gain in popularity among estate planners by providing more powerful creditor protection and tax savings. It is important to see a qualified estate planning attorney to review the many options with this trust and the select few creditors that may be able to reach its assets.

However, the trust will provide substantial security and peace of mind should a divorce or other creditor mishap occur within the family.

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