



The Perils of Outright Distributions and Gifts

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“Whatever can go wrong, will go wrong.”

Murphy’s Law applies itself with surprising vigor in the estate planning field. If your clients are leaving outright, no-strings-attached inheritances or gifts to their beneficiaries via wills, trusts and beneficiary designations, they are practically inviting disaster. But, there’s hope. A properly designed estate plan protects a client’s beneficiary and can help grow your business.

How Proper Planning Benefits Your Practice

An inheritance that goes outright and into the pocket of a spouse, child, or grandchild will very likely leave your office. On the other hand, an inheritance left inside a trust (such as a “Lifetime Convenience Trust,” more on that below) has a better chance of staying because:

- If assets managed by you are left outright, they can easily be transferred away by the beneficiary after the client dies.
- You have time to build relationships with the beneficiary while your client is still alive and well.
- Your client may be inclined to recommend that the trust assets be managed by you when you are proactive in the planning process and demonstrate that you have expertise in overseeing the investments for loved ones in Lifetime Convenience Trusts.

Understanding the benefits of leaving an inheritance in a Lifetime Convenience Trust for a responsible, adult beneficiary can help build your client’s confidence and trust in your relationship. Ultimately, this positions you as the trusted advisor for the client’s heirs.

What Can Go Wrong with Outright Distributions or Gifts?

There are many perils with outright distributions or gifts. Here’s a short list of what can (and, in many cases, will) go wrong:

- Judgment creditors can seize or garnish a beneficiary’s inheritance to satisfy their claims (even if it’s a “frivolous” lawsuit).



- Bankruptcy courts can seize a bankrupt beneficiary's inheritance to pay creditors and costs. This applies to inherited retirement accounts too.
- Guardianship or conservatorship courts can impose annual reporting requirements to the Commissioner of Accounts if a beneficiary is now or later becomes incapacitated.
- If the beneficiary is married, has commingled assets with a spouse, and doesn't effectively plan his or her estate (remember, most folks have not planned), then the inheritance will probably pass at death to the beneficiary's spouse.
- Since inheritances are often comingled with assets held jointly with a spouse, a divorce court might award some or all of a beneficiary's inheritance to a soon-to-be ex-spouse.

Many clients are unaware of these and other risks of outright distributions or gifts. But, when you understand the risks and then help to identify and proactively solve their problems, your clients will appreciate your insight and solution for their planning challenges. You build a long-term relationship as their trusted advisor.

What is a Lifetime Convenience Trust?

A Lifetime Convenience Trust is the solution to the problems created by outright distributions or gifts. It is a mechanism that allows clients to pass assets to responsible, adult beneficiaries in a trust rather than as an outright gift. This has advantages for you, by providing a solution for a problem facing your clients, and for your clients, by protecting their beneficiaries from everything that can go wrong from "outside" interference.

Two points about Lifetime Convenience Trusts. First, these trusts are really just one feature in a client's estate plan. After a client's death, the trust holds assets for the next generation, while providing direction and control during the entire lifetime of at least one successor generation. In this way, they are similar to dynasty trusts in that remaining trust assets are passed down to the next generation in "cascading" trusts.

Second, Lifetime Convenience Trusts are designed for responsible, adult beneficiaries. In a Lifetime Convenience Trust, the beneficiary will serve as the sole trustee. Consequently, this type of trust does not protect the beneficiary from his or her own poor decisions, because there is no co-trustee to "talk sense" to the beneficiary and stop an ill-advised transfer from the trust.

Third, in the event the beneficiary needs protections from a creditor or divorcing spouse, the beneficiary should be advised either to resign as the sole trustee, or appoint an independent co-trustee to serve with him or her. Accordingly, it is important to name an independent back-up trustee who will then manage the trust.

Here are the four primary benefits of a Lifetime Convenience Trust:



Benefit #1 – Protection from Liabilities

An inheritance that goes directly into the beneficiary's pocket is readily available to pay the beneficiary's liabilities from a car accident, creditors in a bankruptcy, or a judgment following a lawsuit. A properly structured Lifetime Convenience Trust will protect the inheritance from the beneficiary's liabilities and provide a means for long-term safekeeping.

Benefit #2 – Protection from Divorce

An inheritance that goes directly into a beneficiary's pocket is readily available for division during a divorce. A properly structured Lifetime Convenience Trust will keep the inheritance out of the hands of the beneficiary's possibly soon-to-be ex-spouse.

Benefit #3 – Protection during Incapacity

An inheritance that goes directly into the beneficiary's pocket will become inaccessible if the beneficiary becomes incapacitated; court intervention may be needed to appoint someone to manage the asset on behalf of the beneficiary. An inheritance held inside a Lifetime Convenience Trust will provide a back-up trustee, who will manage it for the benefit of the incapacitated beneficiary without any court involvement.

Benefit #4 – Protection for the Bloodline

An inheritance that goes directly into the beneficiary's pocket will often be commingled with a spouse, if married. If commingled, the inheritance will likely go to a spouse and not to the client's grandchildren. An inheritance held inside a Lifetime Convenience Trust will be protected and invested for the benefit of the client's son or daughter (the lifetime beneficiary) and then go wherever your client wants it to go (such as to grandchildren) after the lifetime beneficiary dies.

Advisor Tips

- A Lifetime Convenience Trust can allow an inheritance time to grow. For example, consider the income that might be generated annually by a portfolio of dividend-growth stocks held for decades.
- Consider including a thoughtfully drafted Investment Policy Statement (IPS) to help guide (but not handcuff) successor trustees in the investment vision of the grantor.

WARNING: Lifetime Convenience Trusts Aren't for Everyone

Even though Lifetime Convenience Trusts offer many benefits, they're not for everyone. If your client desires to protect the inheritance from an irresponsible adult child or spouse, an



independent Trustee is needed. Although trust management is minimal, the beneficiary trustee will need to file an annual tax return (IRS 1041 Fiduciary Tax Return) if the income of the trusts exceeds a certain threshold (presently \$600 annually.) Thus, the smaller the value of the trust, the more expensive it will become to maintain over time. Things that should be considered include the beneficiary's age, the value of the assets that will be used to fund the trust, and the expenses projected for managing the trust during the beneficiary's entire lifetime.

Let's Work Together

Identifying when a discretionary lifetime trust will benefit a client's spouse, child, or grandchild is relatively easy. Knowing when the benefits outweigh the long-term cost is not. Call us if you have questions. We're always available to help and look forward to working with you and your clients.