

Keeping it in the family - Bloodline Preservation TrustSM

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An irrevocable trust set up by someone other than one of the beneficiaries provides the ultimate in creditor protection. With a divorce rate of over 50%, as well as an increasing number of personal lawsuits, creditor protection is often the most important objective of our planning clients.

The creator of a Bloodline Preservation TrustSM can dictate who may receive the beneficial enjoyment of the property and the extent and circumstances under which this enjoyment continues. As a result, unless trust property is distributed outright to a beneficiary, it will generally be protected from the beneficiary's creditors so generally the Bloodline Preservation TrustSM principal is not distributed, only the income.

For mature, competent family members who would receive the property outright were it not for the benefits that can be derived through the receipt of property in a trust, the trust should be designed to give the beneficiary of a trust the functional equivalent of outright ownership, including undisturbed control over the property. Many candidates for this type of planning would be unwilling to create such a structure unless the trust benefits are coupled with the Bloodline Preservation TrustSM of the beneficiary to obtain control over the trust property that is virtually tantamount to outright ownership.

In order to achieve the maximum transfer tax savings, the Bloodline Preservation TrustSM should be wholly exempt from the generation-skipping transfer tax. This will avoid the imposition of transfer taxes for successive generations. The Bloodline Preservation TrustSM should be drafted as a dynasty trust when possible which is an irrevocable trust that is protected from estate taxes for as long as applicable state law allows. With proper drafting, a Bloodline Preservation TrustSM can also be designed to protect the trust assets from the creditors and divorcing spouses of the trust beneficiaries. Many of our farmer/rancher clients and large real estate investing clients demand these protections.

The Bloodline Preservation TrustSM concept is that if it makes sense to protect the trust assets from creditors and estate taxes at the first generational level, then the identical notion should apply at the next generation and each generation after for the longest time period allowable by state law. Since the primary beneficiary at each generation can be given control in some cases over the trust, there should be no reason to ever draft an irrevocable trust without making it a Bloodline Preservation TrustSM.

Support Trusts vs. Discretionary Trusts

A Bloodline Preservation TrustSM can be drafted as either a "support trust" or a "pure discretionary trust" for creditor protection purposes. The pure discretionary Bloodline Preservation TrustSM is more complex, but exponentially more protective than a support version of the Bloodline Preservation TrustSM.

A support trust is created by the grantor to support one or more beneficiaries for the beneficiary's lifetime. A support trust directs the trustee to distribute the trust's income and/or principal as is necessary for the support of a beneficiary. The beneficiary of a support trust can, in some cases, induce the trustee to make a distribution of trust income or principal merely by demonstrating that the money is necessary for the beneficiary's maintenance, education or healthcare, or whatever other standard the grantor wishes to create in the trust. The standard for distributions often contains words such as "health, education, and maintenance" since that language keeps the trust assets outside of the trustee/beneficiary's estate even though that person is both a beneficiary and in rare cases the trustee.

A discretionary Bloodline Preservation TrustSM allows the trustee complete and uncontrolled discretion to make allocations of income or principal if and when the trustee deems appropriate. Because the trustee is given such broad powers, the beneficiary can only compel the trustee to distribute funds if it can be shown that the trustee is abusing its discretion by failing to act in the beneficiary's best interest, acting dishonestly, or acting with an improper purpose in regard to the motive in denying the beneficiary the funds sought.

A discretionary Bloodline Preservation TrustSM generally uses permissive language such as the word "may" instead of the word "shall." The permissive word "may" is still generally further qualified by granting the trustee autonomous discretion using words such as "sole and absolute discretion," "absolute and uncontrolled discretion," or "sole, absolute discretion and unreviewable."

Spendthrift Provisions

A spendthrift provision is a provision in a trust agreement that states that the beneficiary cannot sell, pledge or encumber his beneficial interest, and that a creditor cannot attach a beneficiary's interest. At common law, the purpose of a spendthrift trust was to protect a beneficiary from his own spending habits. The idea was to provide for someone who could not provide for himself, and to keep such beneficiary from becoming dependent on public assistance. Therefore, if a spendthrift clause was added to a trust, the common law developed a legal principle that a creditor could not recover from the beneficiary's interest.

A beneficiary of discretionary Bloodline Preservation TrustSM does not need to rely on a spendthrift provision because neither the current distribution interest nor any subsequent interest is a property interest under state law. Therefore, neither the beneficiary nor the creditors of the beneficiary have any right to force a distribution from the Bloodline Preservation TrustSM. However, seasoned trust scriveners always include spendthrift provisions even when using a discretionary Bloodline Preservation TrustSM

Conclusion

It is generally deficient to draft a Bloodline Preservation TrustSM or any other trust with mandatory staggered distributions for the beneficiaries upon reaching certain ages. Rather, the trust should be drafted to continue in trust for the beneficiary's protection from predators and their future decisions. For maximum creditor and divorce protection, the trust should be designed as a discretionary trust rather than a support trust as the assets will always be protected for generations.