Estate planners use trusts to protect beneficiaries from their inability, their disability, their creditors and their predators. Included under “creditors” are the IRS and divorced spouses. Most traditional trusts distribute the assets when the beneficiary reaches a certain age or ages, with the last distribution terminating the trust.

More sophisticated estate planners generally create multi-generational dynasty trusts for their clients’ descendants that are (1) estate tax protected, (2) creditor protected and (3) divorce protected - while at the same time allowing the primary beneficiary to control the trust as a co-trustee. In essence, the primary beneficiary has nearly all the rights, benefits and control over the trust property that a person would have with outright ownership - in addition to tax, creditor and divorce protection not available with outright ownership. Such trusts are sometimes referred to as “beneficiary-controlled” trusts. Following are the design features of the typical beneficiary-controlled trust:

♦ The donor (i.e., parent or grandparent) is the grantor of the Trust.
♦ The child and his/her descendants are the beneficiaries of the Trust. However, the child is the “primary” beneficiary of the Trust during his/her lifetime and, therefore, the child’s needs take priority over the needs of his/her descendants.
♦ The Trust has two trustees – the primary beneficiary (upon attaining the age of projected maturity) and an independent trustee. The independent trustee can be the primary beneficiary’s friend, trusted advisor or a bank.
♦ The primary beneficiary has the power to remove and replace the independent trustee from time to time, thereby maintaining the beneficiary controlled feature of this trust design, so long as the replacement trustee is not a “related or subordinate party” as defined in IRC § 672(c).
♦ The trustees can distribute to the primary beneficiary (and his/her descendants) income and principal as needed for health, education, maintenance and support.

♦ The trust agreement also allows the trustees to acquire assets for the primary beneficiary’s use and enjoyment (without remuneration) such as vacation homes, art work, jewelry, etc. The trustee could also invest in a business that the beneficiaries can be employed by.
♦ The primary beneficiary can be given a broad non-general power to appoint the trust property during life and/or at death in favor of anyone other than the primary beneficiary, his/her creditors, his/her estate, or the creditors of his/her estate. Thus, the primary beneficiary can “re-write” the trust for future generations.
♦ At the primary beneficiary’s death, the assets remaining in trust pass to his/her children (i.e., the grantor’s grandchildren), in equal shares, but in further trust. At that time, the grandchild becomes the primary beneficiary of his/her separate trust, which now benefits the grandchild and the grandchild’s descendants. To the extent of the grantor’s generation skipping tax exemption (which is the same as the estate tax exemption) plus the future appreciation thereon, there would be no estate taxes due.

As a general rule, the earlier the trust is created in the life cycle of an asset or investment, the greater the benefits in tax savings. Creating a beneficiary-controlled trust early on also enables the donor to place the initial seed money for funding a favorable business or investment opportunity into a trust rather than have the donee own it. Nowhere is this opportunity shifting more productive than with new ventures or startup businesses.

The beneficiary-controlled trust is gaining popularity among estate planners. Beneficiary-controlled trusts can be created at the grantor’s death as part of the donor’s living trust, or can be used in irrevocable trusts, including irrevocable life insurance trusts. But the benefits of creditor protection and estate tax savings are only available if someone else, such as a parent or grandparent, sets up the trust. In short, a beneficiary-controlled trust should be considered whenever it is worthwhile to protect beneficiaries from creditors, divorcing spouses and estate taxes.