

DEALING WITH YOUR TRUST ISSUES

PICKING THE RIGHT TRUSTEE

By Robert Prior



For the benefit of loved ones, preserving and protecting hard-earned assets at death is a primary goal of estate planning. To properly do this, separate trusts should be created for each beneficiary, even if they are adults, instead of distributing assets to them outright and free of trust. By leaving assets for your beneficiaries in the care of a trustee, a properly established and managed trust ensures that a spendthrift beneficiary (one who can't manage money) does not fritter away their inheritance and that a child with a substance abuse problem does not get access to funds that could lead to his or her harm. Additionally, if you select the right trustee, a trust can also protect your beneficiary's inheritance from bankruptcy, creditors and divorce.

A trustee is the person selected by the creator of the trust to be responsible for the trust assets and, with a fiduciary obligation, to follow the instructions set out in the trust document. Trustees invest trust assets, file trust tax returns and, most importantly, use their discretion to distribute trust income and principal to the trust beneficiaries, in accordance with the creator's instructions in the trust agreement.

Trustees can be any person or entity the creator of the trust selects. There are two extremes: at one, the beneficiary of the trust can serve as their own trustee while at the other, an independent third-party corporate trustee can serve. Between those two extremes are trusted family members, friends or colleagues who are not the beneficiaries, who have financial expertise and who can say no to a beneficiary.

The degree that trust assets are protected depends on the identity of the trustee and how the trust is drafted. A spendthrift clause, which is standard in most trusts, prohibits beneficiaries from selling or assigning their interests, either voluntarily or involuntarily. Thus, it prevents a creditor from reaching a beneficiary's trust interest before the beneficiary receives it. Once the beneficiary receives it, however, it is subject to creditor's claims. To counter this outcome, discretionary trusts offer the strongest creditor protector by allowing the trustee to use discretion on when and in what amount to make distributions of income and principal, as opposed to trusts that call for mandatory distributions at specified times. If distributions are within the trustee's sole discretion, the beneficiary cannot compel a distribution and, therefore, neither can a creditor. Naming a beneficiary as trustee of a discretionary trust, however, erases this creditor protection, allowing a creditor to reach the maximum amount the trustee/beneficiary can properly take, which becomes subject to a court's discretion to reserve a portion of that amount for the beneficiary's support.

Naming an independent third party as sole trustee of a discretionary trust offers the best asset protection. This arrangement makes it difficult, if not impossible, for the beneficiary's creditors to compel distributions from the trust to satisfy judgements. What you gain in asset protection, you give up in allowing the beneficiary to control his or her own assets and in costs paid as trustee's fees.

Often the beneficiary may be named as sole trustee, but

the agreement will include extensive successor trustee provisions. Under this arrangement, the beneficiary has total control while there are no creditor problems but can resign or appoint an independent trustee if creditor problems later arise. The downside of this approach, however, is that an unsophisticated beneficiary/trustee may not resign or appoint an independent co-trustee in time to avoid creditor claims.

An alternative is to “bifurcate” the trust responsibilities by creating two trustee roles: one to handle the administrative provisions of the trust (making investments, filing tax returns), and another to make all discretionary decisions regarding trust distributions. The beneficiary is named as trustee of his or her own trust and has full authority to manage the trust assets. Before being able to distribute those assets, an independent third party would serve as distribution trustee and would have to authorize each distribution. The distribution trustee could then refuse to authorize a distribution to satisfy a creditor claim.

Establishing a trust and selecting a trustee is a complex matter that first should be discussed thoroughly with your estate planning professional.



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