BOUMAN LAW FIRM
ESTATE PLANNING & INHERITANCE PROTECTION

7650 E. BROADWAY BLVD. #108
TUCSON, AZ 85710

PHONE (520) 546-3558
TOM@TOMBOUMANLAW.COM

# What You Should Know About Inheritance Protection Trusts

## 1. What is an Inheritance Protection Trust?

An Inheritance Protection Trust is an irrevocable trust established by a deceased person's estate plan typically for the benefit of a surviving child. Although the term Inheritance Protection Trust could generally describe many types of beneficiary trusts, it usually refers to a trust established for a responsible adult beneficiary who is willing and able to manage an inheritance. This type of trust is usually drafted to continue for the lifetime of the beneficiary (or until all assets have been spent), rather than end at a predetermined time or age of the beneficiary.

The beneficiary is usually named as the sole trustee of the trust and is given the right to name an independent trustee, if desired; thus, an Inheritance Protection Trust is commonly described as a "beneficiary-controlled trust."

An Inheritance Protection Trust is used as an alternative to outright distribution when the amount of inheritance is expected to be substantial (generally more than $100,000 per non-spouse beneficiary). Its protective features are promoted as benefits to the beneficiary, not the trustmaker, because the trust is usually established after the death of the trustmaker. But it is possible to establish and fund an Inheritance Protection Trust during the lifetime of the trustmaker by making lifetime gifts. This is relatively uncommon because the usual incentive for gifting is to reduce estate taxes and few people are wealthy enough to be concerned about it.

## 2. What are the benefits of an Inheritance Protection Trust?

By receiving inheritance in a trust, rather than receiving inheritance outright, the beneficiary can protect assets from various threats:

- *Creditor protection*. The trust assets are shielded from creditors of the beneficiary, even if insurance is insufficient to satisfy a judgment obtained by lawsuit.
- *Divorce protection*. The trust assets are separate property of the beneficiary and may not be claimed by an ex-spouse of the beneficiary after divorce.
- *Family protection*. The trust may be drafted to ensure that family assets pass to the next generation in the "blood line" rather than to surviving spouses.
- *Estate tax protection*. If desired, the trust may be designed to exempt its assets from the federal estate tax upon the death of the beneficiary.


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## 3. How is the Inheritance Protection Trust established?

The personal representative or successor trustee for the trustmaker, depending on whether the trust provisions are drafted into a Will or living trust, establishes an inheritance trust by giving the separate trust a name and applying for its taxpayer ID number. The provisions in the Will or living trust document govern the new trust, although it may be permissible and helpful for the trustee to restate the terms of the separate trust with a new document. This process is called trust decanting.

## 4. Who should serve as the trustee?

In most cases the beneficiary will serve as the initial trustee. However, if creditor protection is a paramount concern, the beneficiary should not serve as trustee. Rather an independent trustee (someone unrelated to the family or a professional fiduciary) should be appointed. This enhances the level of creditor protection by eliminating the conflict of interest held by a beneficiary who also serves as trustee. If an independent trustee is appointed, the beneficiary may be given the right to remove and replace the independent trustee.

A common drafting option is to name the beneficiary as initial trustee and grant the beneficiary the power to resign and appoint an independent trustee. This gives the beneficiary the discretion to choose the level of creditor protection desired.

## About the Author

Thomas J. Bouman provides legal counsel in the areas of estate planning, estate administration, and asset protection. He brings a highly systematic approach to the practice of law, which is critically important when wading through the complex, and often bizarre, legal requirements associated with estate and trust law. Mr. Bouman is the author of the Arizona Estate Administration Answer Book and a prominent member of WealthCounsel, the nation's premiere organization of estate planning attorneys.


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