

Spendthrift Trusts: An Effective Strategy for Avoiding Spooky Pitfalls

As we prepare for the Halloween season, there are many reasons to be on edge. These fears may involve ghosts and goblins for some, while others may view estate planning as frightening. Although I have yet to find an effective way to conquer ghosts or goblins, there are tools for alleviating the fears related to estate planning.

One effective tool for protecting, preserving, and transferring assets is a spendthrift trust. Spendthrift trusts can offer protections from an overspending beneficiary and the beneficiary's creditors. These types of trusts operate similar to other trusts in that the trust property is placed in a trust for the benefit of another person. This person is known as a beneficiary. However, these trusts also include a spendthrift clause or provision providing for limitations on the beneficiary's access to the assets.

In a spendthrift trust, the trust's creator (commonly known as a grantor or settlor) establishes the precise rules for distributing trust payments. This strategy ensures that the settlor's wishes are captured in the trust document. These rules can be as strict or loose as the settlor intends. For example, a spendthrift provision can control the amount and timing of the beneficiary's payments.

The settlor also appoints a trustee responsible for making the distributions and managing the trust. A family friend or an institution may be appropriate as a trustee of a spendthrift trust. While the terms of the spendthrift provision control the actions of the person appointed trustee, a reliable entity serving as trustee is crucial to the trust's operation as the trustee acts as an intermediary between the trust property and the beneficiary. The trustee administers trust property on behalf of the beneficiary. In other words, the beneficiary does not have direct access to the trust property.

There are several benefits to a spendthrift trust. As its namesake suggests, many settlors establish a spendthrift trust to preserve trust property when there are concerns of an overspending beneficiary. This trust arrangement allows some structure to disbursements that may otherwise be distributed as a lump sum to a young or financially irresponsible beneficiary. Therefore, the spendthrift provision can potentially provide financial support to the beneficiary over his or her lifetime.

Another advantage of the spendthrift trust is creditor protection. A spendthrift trust can be drafted in a manner that prohibits a beneficiary's creditors from reaching into the trust. For example, in Tennessee, the trustee is allowed to withhold mandatory distributions from third parties such as a creditor. However, Tennessee law does not provide complete protection against creditors as spendthrift provisions are unenforceable against claims of the state to the extent that state statutes allow for it.^[1]

As an example of the creditor protections provided, a credit card company will be unable to attach claims on the trust property against a beneficiary of a spendthrift trust. This protection does not ensure that the credit card company will be unable to execute its claim against the beneficiary once the payments are received, but it does ensure that the creditor cannot attempt to come after the trust for funds the beneficiary has not yet received.

Similarly, Tennessee law allows the protection of assets in spendthrift trusts from beneficiaries employed in high-risk professions (i.e., physicians). This means that a creditor or party to a malpractice lawsuit cannot attach its judgment against a beneficiary to the spendthrift trust. The State of Tennessee also extends protections to trust assets in a

divorce, so an ex-spouse cannot access the funds of a trust when the spendthrift trust is properly drafted. The rationale for the protection is that the beneficiary does not technically own the trust property.

Spendthrift trusts allow for much-needed flexibility in estate planning. It is one of many tools available to clients as they plan for the future. It is also an option that can be adjusted to each client's particular planning needs.

If you have any questions or want to learn more about spendthrift trusts or any of the various estate and special needs planning strategies available to you, please contact me, Isiah Robinson, or another member of our Estate Planning Team.

[1] Tenn. Code Ann. § 35-15-503.