
Top 5 Reasons to Leave Assets to your Beneficiaries in Trust

By Attorney Keith J. Pilger



When considering their estate plan many individuals are concerned about how the hard-earned assets they are passing on will be used by their heirs. Those concerns can include the relative young age of the heirs, the possibility of a divorce, or an inability to handle money properly. These concerns can be addressed through the use of a trust to hold the assets for the benefit of one or more beneficiaries.

There are generally five advantages to using trusts to pass assets to beneficiaries rather than giving them the assets outright:

- 1. Spendthrift Protection.** The trust is managed by a trustee or co-trustees who make decisions about investments, distributions to the beneficiary for health, education, maintenance and support, and are responsible for reporting to the beneficiary and tax filings. The beneficiary does not have unrestricted access to the trust. Distributions are made in the judgment of the trustee or co-trustees. Therefore, a young beneficiary or a beneficiary who is inclined to spend liberally does not have the ability to access the trust. Rather, the trustees or co-trustees decide when to make distributions from the trust to or for the benefit of the beneficiary.
 - 2. Protection from Creditors.** The creditors of the beneficiary may not garnish, attach or levy against the assets of the trust. Therefore, if a beneficiary files bankruptcy, has a judgment filed against them or is sued for a large sum, the creditor does not have access to the trust funds until after the trust funds are distributed to the beneficiary.
 - 3. Divorce Protection.** Generally, assets received by gift or inheritance from a third party are not to be divided in a divorce so long as the beneficiary keeps the gifted or inherited assets separate from marital assets. The trust facilitates keeping the gifted and inherited assets separate.
 - 4. Income from Gift and Inheritances.** Generally, if a gift or inherited asset is received from a third party, it is separate and not marital property. However, income earned on the gifted or inherited assets (such as interest or dividends) is usually marital. In a recent Wisconsin Supreme Court case the court held that income generated inside an irrevocable trust for a beneficiary continued to be classified as gifted and inherited property, not marital property. Accordingly, the trust facilitates protecting income on gifts and inheritances earned while inside the trust and prior to distribution to the beneficiary.
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5. Generation-skipping. If a child dies prior to the trust liquidation and termination, assets in the trust can transfer to his or her children without gift or estate taxes. In order for this generation-skipping advantage to apply, you must file a gift tax return and elect to allocate a portion of your generation-skipping transfer tax exemption to your gifts to each trust, so that the trust is GST exempt or the trust must qualify as a GST trust that receives an automatic exemption allocation. Also, in order for this advantage to apply, the child may not have a general power to appoint the property to himself or herself, to his or her estate, to his or her creditors or to the creditors of his or her estate.

These advantages do not come without some drawbacks. Mainly, there is an increased formality when using trusts to hold assets for beneficiaries. If a trust has taxable income, it would be required to file a federal and state fiduciary income tax return and trusts reach the higher tax brackets faster than individuals. An irrevocable trust must have a separate tax identification number and a separate checking account. The fact that a beneficiary does not have unrestricted direct access to the trust assets can be both an advantage (described above) and a disadvantage (from the perspective of a beneficiary who feels their request to withdraw funds is justified).

Depending on your particular family situation and the nature of the assets you plan to leave to your heirs, using a trust to facilitate these bequests may be the right option for you. If you would like more information on these types of trusts and whether they are right for you, please contact one of our estate planning attorneys.



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