SPENDTHRIFT TRUSTS

DEFINITION

A spendthrift trust is a type of trust which gives an independent trustee full authority to make decisions as to how the trust funds may be spent in the interest of the beneficiary. Often times, the fiscal responsibility that was exercised in creating a family's wealth is not shared by children and grandchildren, and this wealth can be gone within a few generations. A spendthrift trust contains clauses specifically designed at preventing the beneficiaries from squandering their inheritance. For those who want to leave substantial amounts of money to their children or grandchildren, but do not trust them to manage it wisely, they can use spendthrift trusts to achieve these results. Creditors of the beneficiary generally cannot reach the funds in the trust, as the funds are not actually controlled by the beneficiary.

HOW THEY WORK

SPENDTHRIFT PROVISION

In general, a trust is not considered to be a spendthrift trust unless the trust document specifies the grantor's intent for it to be treated as such. This language is known as a spendthrift clause or spendthrift provision, which creates an irrevocable trust preventing creditors from attaching the beneficiary's interest in the trust before the funds are actually distributed to him or her. Most irrevocable trusts will contain spendthrift provisions even if the beneficiaries are not known to be spendthrifts. This is because such a provision protects the trust and the beneficiary in the event a beneficiary is sued and a creditor attempts to attach the beneficiary's interest in the trust.

TRUSTEE

A trustee is designated by the grantor in the trust document and is in charge of the trust's funds and distributes them according to the terms of the trust. The trust document may direct the trustee to distribute income annually, periodically as needed for health, maintenance and support, or all of the trust funds at a certain date or event. Payments may be made directly to the beneficiary if the trust allows or requires it. However, in the case of a true spendthrift beneficiary, disbursements will most likely be made directly to third parties such as educational institutions, health care providers, and landlords. If the trustee does give trust money directly to beneficiaries, they are free to spend it however they wish.

CREDITOR PROTECTION

A beneficiary is not able to access a spendthrift trust's funds before he or she actually receives distributions. This also means the trust assets cannot be pledged as collateral for any debt. The spendthrift language is also intended to prevent creditors from going after trust funds to pay what a beneficiary owes them. However, the creditor protection of the spendthrift trust extends solely to the property that is in the trust. Once the property has been distributed to the beneficiary, it can be accessed by creditors, except in the case where the distributed property is used to provide support for the beneficiary. If a trust calls for a distribution to the beneficiary, but the beneficiary refuses the distribution, the beneficiary's creditors can now reach those trust assets.

It is also important to note that there are some types of creditors that can attach themselves to the trust in order to recover debts owed by the beneficiary. These include cases where the beneficiary owes alimony or child support, outstanding debt to the Internal Revenue Service, or creditors who have supplied the beneficiary with "necessary" support like food and shelter.

SELF-SETTLED SPENDTHRIFT TRUST

With such great protection from creditors, one may ask whether they could set one up for themselves. However, most states do not allow this. A trust created by an individual for his or her own benefit is sometimes called a "self-settled trust" and has the potential to be viewed as being created to deceive creditors. Because of this, they do not protect the grantor. As long as the grantor is also the beneficiary, creditors will have access to these funds, even in the presence of a spendthrift clause.