BENEFICIARY CONTROLLED TRUSTS

Many individuals are reluctant to use trusts due to their mistaken belief that a trust must be designed to keep the trust property away from the beneficiaries. A properly designed trust can allow the beneficiary to control the trust property, yet provide tax planning and asset protection for the beneficiary that are not available with outright ownership. There are two problems with outright ownership. First, the property becomes available to the creditors of the beneficiary immediately upon an outright distribution. Conversely, as long as property is held in an irrevocable trust, it is protected from the creditors of the beneficiary, including spouses in the context of divorce. Second, the property and all of its growth and income needlessly increase the size of the beneficiary's estate. Upon the death of the beneficiary, this may cause an estate tax that otherwise could have been avoided using a trust that is controlled by the beneficiary as controlling trustee. Another name for this type of trust is a Beneficiary Controlled Trust.

When an individual wants property distributed to his or her beneficiary either outright or upon reaching a specified age, in most instances he or she merely desires that the beneficiary have control over the property. This objective can be accomplished by using a trust and naming the beneficiary as managing trustee rather than requiring the property be distributed. There are not many rights that the beneficiary can have owning the property outright that the beneficiary cannot also have as trustee.

Outright ownership gives a person (i) the right to manage and control the property, (ii) the right to use the property, (iii) the right to access the income from the property, (iv) the right to access the principal, and (v) the right to determine who gets the property upon the person's death. These are all rights that can be given to the beneficiary as trustee. However, if the beneficiary is given the right to distribute principal to himself, then such right must be limited by an ascertainable standard. In order to provide a broader distribution standard and more flexibility, an independent co-trustee can be appointed by the beneficiary to make distributions and other tax sensitive decisions. The beneficiary is given the power to remove the independent co-trustee, with or without cause, and name a successor independent co-trustee. This leaves the control in the hands of the beneficiary. Thus, the beneficiary does not lose any rights that he or she would have had with outright ownership of the property. Meanwhile, the beneficiary achieves potential estate tax savings and creditor and divorce protection.