

Protecting a Spouse's or Heir's Inheritance from Divorce, Creditors and Death Taxes – The Lifetime Trust

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By the time a person becomes a “senior citizen,” he or she likely has saved a substantial “nest egg” for retirement. For some this nest egg may be \$500,000 or less, but for others it may be \$5 million or much more. However, regardless of the amount, the nearly universal desire is to leave one's spouse or heirs the balance of the nest egg.

Interestingly, the law has long recognized this instinctive desire to provide for one's family after death when, centuries ago, an unknown lawyer coined the term “natural objects of one's bounty” – a term still used by today's lawyers.

PREDATOR AND CREDITOR RISKS TO AN INHERITANCE

The opportunity to provide financially for one's family after death is often the last act of care that is offered. However, unbeknownst to many, the nest egg – after passing into a spouse's or other heir's hands – can be lost if the heir later experiences a divorce, is sued or taken advantage of by an unscrupulous “friend.”

Further, the nest egg – as a part of the heir's estate at the heir's later death – will be subject to any federal and state death taxes applicable to the heir's own estate. And although the federal estate tax exemption is \$5 million through next year, many modest estates will be affected beginning in 2013, which is when the exemption is scheduled to decrease to \$1 million and have a 55% top tax rate.

Importantly, such “predator” and “creditor” risks to an inheritance are created when the spouse or heir receives the inheritance outright, or “free and clear,” instead of in a protected format.

By law an outright inheritance is deemed the heir's own property, and thus it is generally subject to all of the heir's financial risks. Further, the inheritance can be spent or given away without restriction.

In certain respects, an heir having complete freedom over an inheritance would seem a good thing – but this freedom comes at a high price. Specifically, not only will the inheritance be subject to the estate tax system at the heir's death, but also for the rest of the heir's life the inheritance will be at risk of loss to divorce and creditors.



And surprisingly, the heir at risk to predators and creditors is not always the “traditional” widow or the stereotypical “spoiled child.” Many times it is the successful heir in a high risk profession, such as a doctor or lawyer, business owner or entrepreneur, or the heir in a strained marriage.

A CREATIVE SOLUTION – THE LIFETIME TRUST

The main technique available to provide “inheritance protection” for the nest egg is the Lifetime Trust.

Under the trust law of most states, including Florida, an inheritance held in a properly drafted Lifetime Trust receives broad legal protection from the heir's predators and creditors. This is because the inheritance technically is not owned by the heir but by the Lifetime Trust.

Also, it is possible to protect assets of the Lifetime Trust, at least in part, from federal and state death taxes at the heir's later death – so that at the heir's death the Lifetime Trust passes tax-free to the desired beneficiaries.

For example, assume Mr. Smith, a widower, has an estate of \$2 million and one child, John. Also, John is a CPA who is 45 years old, in his second marriage, and has 3 children from his first marriage. Mr. Smith is concerned for John because John's marriage is “shaky” and his CPA practice puts him at risk for a lawsuit. Also, although John has invested well and his CPA practice has prospered, John has his own estate tax concerns.

In this case, Mr. Smith could amend his Will or Revocable Trust to direct that a Lifetime Trust be formed at his death for John, to hold John's \$2 million inheritance.

The Lifetime Trust would designate John and his descendants as the beneficiaries for the rest of John's life, and that the inheritance funds may be used for housing expenses, food and clothing, health care and education, as well as many other appropriate expenses.

Importantly, John may even be designated as the sole Trustee of his Lifetime Trust. This status would give John sole control of the investments of the Trust as well as the authority to pay Trust funds to himself and his children.

Upon John's death, the Lifetime Trust would pass to John's children or otherwise as Mr. Smith directed via the Lifetime Trust, and free of any federal death taxes under current tax law.

Also, if Mr. Smith were married, his estate plan could first create a similar Lifetime Trust structure for his wife's inheritance, with John's Lifetime Trust being delayed until both Mr. and Mrs. Smith are deceased.

SUMMARY

In summary, the Lifetime Trust is an excellent tool to reduce creditor, divorce and death tax concerns while positioning an inheritance to be available to provide for one's spouse and heirs for the rest of their lives.

The comments expressed herein are intended for general informational purposes only and should not be relied upon as legal advice. Please consult legal counsel to obtain specific advice for your situation.



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