

Title: The Descendant's Inheritance Trust
Author: Randy Drewett
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Most Wills are prepared by attorneys who concentrate on the proper distribution of assets to a surviving spouse in compliance with Texas law with little or no thought as to how the couple's estate will someday pass to the children's generation. Since the client is not trained in the law of Wills and Trusts, very few people understand the possible planning techniques available to protect the ultimate distribution to their children and grandchildren in a manner which offers asset protection from loss in costly divorces and lawsuits by creditors.

Virtually every Will addresses final distribution to children, or other beneficiaries, upon the death of the surviving spouse. This is usually handled by dividing the net estate to the beneficiaries if they have reached a certain age, such as 21 or 25. Some Wills, although not many, establish a pattern of passing the remaining estate at various ages, such as 1/3 at age 21, 1/2 of the balance at age 25, with the final distribution at age 30. Even with this type of planning, the beneficiaries will receive large amounts of money, or other property, in outright gifts of inheritance.

Trusts are rarely used in the case of adult beneficiaries and usually come in the form of contingent trusts for the benefit of minor, or underage, children and grandchildren. Since the majority of a couple's children will have reached adulthood long before the second parent's death, the trusts rarely come into being. The result is an outright distribution. These outright inheritances are not protected in any manner from loss by the child in a future divorce or lawsuit.

Trusts have been used by wealthy families to pass wealth down from one generation to another in order to restrict how much money is available for distribution and for protection of great estates from waste by spendthrift heirs along the way. These trusts are usually created as "stand alone" irrevocable trusts which are funded during the lifetime of the patriarch. The same technique is rarely used in every day Wills or Living Trusts as an asset-protected testamentary disposition at the death of the surviving spouse.

Why should you be concerned about protecting your children's ultimate inheritance? There are many estate planning myths which people take as gospel, when they are actually far from the truth. For instance, most of my clients believe that an inheritance passing to children is the "separate property" of that beneficiary and will remain so in the future. As "separate property" of that child, the inheritance passing from the parent cannot be subject to division in that child's potential divorce. As usual, such myths are just partial truths, which can result in devastating loss when it is too late to plan for protection.

The truth is that an inheritance IS separate property. But the reality is that under Texas law, all income from separate property is community property, not separate property. Suppose a child inherits \$250,000 from their parent. The child then takes the money to a

broker who invests the money in stocks, bonds, mutual funds, CD's and money market funds. Over a period of years, the stocks pay dividends, the bonds pay interest, the mutual funds pay capital gains or interest, the cash investments pay interest. The portfolio is managed by a broker who sells and purchases different investments, all of which grow over time. All of the income of that portfolio is community property. Many of the original investments will have been sold and replaced by new ones. The entire inheritance now consists of "co-mingled" assets - some separate property, some community property.

Under Texas law, ALL assets accumulated during a marriage are PRESUMED to be community property. This does not mean that all assets accumulate during a marriage actually are community property. It means that all such assets will be considered community property unless the person claiming them as his or her separate property can prove that the specific asset is an exception to the community property presumption.

Sometimes, this is not too difficult to do. If a child inherits a piece of real estate, and that real estate sits, unchanged for years during the marriage, the manner of acquisition, the parent's Will, is proof of inheritance and separate property ownership. However, in most instances, the inheritance consists primarily of liquid assets, as described above. Since the child does not know to keep the income separate from the principal, the co-mingled result is presumed to be 100% community. The tracing of all transactions over a period of years, the only way to actually prove the separate from the community, is usually cost-prohibitive. The bottom line is that the inheritance will be considered as a community asset divisible by the divorce court. The child will lose half of the entire amount to the spouse from whom he is being divorced. Most of my clients say that they will "roll over in their grave" if their son-in-law or daughter-in-law takes half of their child's inheritance in a divorce. This is an unfortunate, but all too real story.

When you think of creditors what comes to mind? The bank, or MasterCard or Visa? While these institutions qualify as creditors, they are generally minor in comparison to the real creditors out there. Suppose your child inherits the \$250,000 that we discussed above. The money is deposited with a qualified broker who wisely invests the money in a well diversified portfolio. One night, during a storm, your child is driving home. The car hits a pool of water and goes out of control. Your child hits a small car which is carrying a family, including 2 children. One child is killed and the other is permanently disabled, facing a life of surgeries and medical care. What if your child had been having drinks with friends, or perhaps a nice dinner with wine? Either way, his or her negligence caused an accident resulting in a multi-million dollar law suit. Since standard insurance policy limits are between \$25,000 and \$300,000 of liability coverage, the lawyer representing the family will look to the driver to pay the difference. This is the REAL definition of a creditor - called a "judgment creditor" since they obtained a judgment against the negligent party at fault. Can your child's inheritance be taken to pay this judgment? It certainly can!

I understand that the examples of divorce and serious automobile accidents are not pleasant, they are a fact in our society. Lawsuits can arise from bad business deals, actions of you partners or in many other circumstances. Given this fact of life, do you

want your child's inheritance - the money you worked your entire life to save - to go to strangers? Probably not. So how can you protect this inheritance from such a loss without expensive asset protection planning?

I tell my clients that asset protection for yourself is complicated and usually expensive...but asset protection for your children, grandchildren or other beneficiaries is actually easy to do and is very affordable.

When an inheritance comes to a child outright, such as in the form of a cash bequest, there is no asset protection of that gift. If the same distribution is placed in a "Descendant's

While this may sound too easy to be true, it is actually one of the simplest forms of asset protection. This is how the "Drewett Will" works:

- Your Will is written in compliance with all Texas laws with a standard distribution plan between the spouses - whether it is a simple plan or a federal tax plan using "ByPass and Marital Trusts.
- Instead of making outright distributions of the net estate (after payment of debts, expenses and taxes) to your children (i.e. "If my children have attained the age of 21 years at the time of my death, I leave the remainder of my estate to my children, equally, on a per stirpes basis"), a separate trust is established for each of your beneficiaries
- Each beneficiary has his or her own trust. The trust is irrevocable. That means that your beneficiary cannot change the terms of the trust. However, there is no need for your child to resist this type of plan or fear that the inheritance will be unreasonably restricted. Every trust has a "Trustee" who is the manager of the trust. Additionally, every trust has a beneficiary who gets the use and benefit of the assets in the trust. In the case of the Inheritance Trust, your child can be his or her own trustee. So, in reality, the child is managing his or her own inheritance, but under the title of a trust rather than in an individual name.
- The child, as trustee, can take the money out of the trust as needed for health, education, maintenance and support. Almost anything can be defined in one of those categories, so there is little limitation or restriction in the use of the money. No one must be consulted when managing or withdrawing money from the trust. This is in the child's discretion.
- The trust will be assigned a federal tax identification number. The trust must file an annual income tax return, but this is a small price to pay for 100% asset protection. If the income is paid to the child (as beneficiary) at least annually, the trust will not pay any tax...the beneficiary will include the income in his or her personal income tax return. After all, they would be paying the same tax on the income if the inheritance was owned by them outright, rather than in trust.
- The Inheritance Trust does not end during your child's lifetime. It goes on into the life of your grandchildren, where it continues to grow, and be available for their benefit, all in an asset protected trust. The trust will end at a designated age of each grandchild.

- . As long as the money or other property is in the Inheritance Trust, it cannot be divided in a divorce or taken by a judgment creditor. This is because your child does not own the money - the trust owns the money! However, once the asset is taken out of the Inheritance Trust, it loses its asset protection. Once removed, the asset cannot be placed back into the trust. Your child cannot put his or her own money into the trust; it is exclusively for your inheritance.
- You can name the trustee of the Inheritance Trust. It can be your child or someone else. It can be a corporate trustee, such as a bank or brokerage trust department with trust powers in Texas. Later, the acting trustee can name their own successor, which can also be an individual or trust company.
- The Inheritance Trust is very flexible. If you want to limit your child's access to the money for some personal reason, you may do so.

While the implementation of Inheritance Trusts increases the size and apparent complexity of your Will, it is now hopefully apparent that the benefits of asset protection far exceed the modest increase in cost and length of your Will.

*The **TEXAS ESTATE LAW SERIES** is a collection of articles written by attorney Randy Drewett to assist Texas residents in understanding the importance and basics of all areas of estate planning, probate, elder law and estate litigation. **The Randy Drewett Law Firm***