



Four Ways to Protect Your Children's Trusts From Divorce

Trusts play an important role in protecting assets and provide a flexible way to pass wealth to future generations. Nearly all high net worth families utilize trusts, in some form or another, when devising their estate plans. However, common trust provisions may not offer much protection for trust assets if the beneficiary and his or her spouse get divorced.

Increasingly, courts across the country are considering assets held inside trusts when determining how to equitably divide a divorcing couple's assets, or even when calculating spousal or child support. Spendthrift provisions that are designed to protect assets from the reach of creditors may not be enough to guard against such judgments.

Whether a trust will come under judicial scrutiny during a divorce can vary widely from state to state, county to county — even from judge to judge. While there are no guarantees, there are steps you can take when creating a trust to help ensure your legacy is protected and will be there for your children and grandchildren, as you intended.

Don't Make Distributions Seem Like an Absolute Certainty

Certainty in life is usually a good thing. However, when it comes to trust provisions governing distributions to beneficiaries, certainty can have unintended consequences.

There is a greater likelihood that a court will consider trust assets when making decisions related to a divorce settlement if it appears that the beneficiary is certain to receive distributions from it. The specific phrasing of the instructions in your trust documents may seem like a minor thing, but it can have a major impact on how a court might rule. Instructing the trustee to make distributions using phrases such as “shall distribute,” or indicating that distributions “will be made,” can be viewed as a guarantee that the beneficiary will receive the assets.

To reduce this risk, the trust agreement should be written so that distributions seem like a “mere expectancy,” rather than a certainty. This can be accomplished by substituting the words “shall” or “will” with the word “may.” That way, the distributions seem conditional, rather than certain.

Another strategy is to name multiple beneficiaries, including beneficiaries in subsequent generations. Doing so can demonstrate that trust assets are intended to benefit more than just the specific beneficiary involved in divorce proceedings.

It may be advantageous to skip the “ascertainable standard,” in which beneficiaries are allowed to request and receive funds intended for certain purposes, such as expenses related to health, education, maintenance and support. Instead, use a “discretionary standard,” which gives the trustee the authority to determine whether distributions are justified. This is another way to signal that the beneficiary isn't able to treat their trust like a bank account.

Consider Alternatives to Direct Distributions

If assets are kept inside the trust and managed by an independent trustee, it is easier to make a case for why those assets should not be considered in divorce-related settlement determinations. It also ensures that the beneficiary truly benefits from the protections afforded by the trust — once the money is distributed, it's no longer protected.

Instead of directly distributing funds from the trust to the beneficiary during their lifetime, allow the trustee to make payments on the beneficiary's behalf, for his or her benefit. For example, if the beneficiary wants a new car, the trustee can pay the car dealer directly rather than writing a check to the beneficiary. The end result will be the same: the beneficiary will own the car outright, but they won't have received any money that could be used to justify involving the trust in a divorce settlement.

Trustees could also loan money from the trust to the beneficiary for larger purchases, such as a house. In the event of a divorce, the house would be seen as a debt to the trust, rather than an asset subject to division.

Trusts are often written to provide for scheduled distributions based on certain events, such as a marriage or a graduation, or when the beneficiary reaches a certain age. However, it's best to avoid this — you can't anticipate what might be going on in a beneficiary's life at some point in the future, and there's a risk that a big distribution could be made at an inopportune time, like immediately preceding a divorce.

If distributions must be made, be sure that the timing and amount of the distributions are varied. A court could potentially view regular, consistent distributions as evidence that the beneficiary had more than a mere expectancy that they would receive the funds in the trust.

Empower Trustees and Trust Protectors

The less control the beneficiary has over trust assets, the less likely the trust will be endangered during a divorce.

Consider reducing your beneficiaries' exposure by giving the trustee more control over the trust. You may also want to consider adding a trust protector — a close friend or advisor who guides the trustee in certain actions — who can make changes to the trust in order to best serve your original intentions for the assets.

Giving the trustee and/or trust protector the authority to remove beneficiaries who are involved in divorce proceedings is one way to protect trust assets. Of course, it is important to be confident that the trustee or trust protector will use this power wisely, and that they will add the removed individual as a beneficiary again after the divorce-related risk has passed.

The trust agreement should also give the trustee and/or trust protector the ability to “decant” the trust into a new trust. This allows them to move assets into a trust that's more suitable for the beneficiary's needs and circumstances, or into a trust that's located in a jurisdiction with more favorable trust laws.

Work With an Independent, Institutional Trustee

When creating a trust, it is important to make thoughtful, deliberate decisions about who should serve as the trustee. While any trusted friend or family member could be named in that role, being a trustee carries a significant amount of responsibility.

Using a professional trustee gives you a level of objectivity and professional expertise that friends or family members simply cannot provide. That objectivity can be particularly important when the trustee will have discretion to make — or withhold — distributions for beneficiaries.

Naming an independent, institutional trustee can also provide peace of mind because the trustee will be paying close attention to rulings and decisions that could have an impact on your trust. If the trust agreement provides the trustee with the flexibility to take proactive measures to protect trust assets, they will be able to do so promptly in response to new laws or evolving standards.



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