

The Weekly Scenario: What is a Spendthrift Provision?

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One of the best forms of asset protection we can provide is through a trust that contains a spendthrift provision. The general idea behind a spendthrift trust is to prevent certain beneficiaries from receiving their inheritances all at once. The risk is that the 'spendthrift' beneficiary will end up blowing through the money in a short period of time.

The process of establishing a spendthrift trust is nearly identical to creating any other trust, except the trust instrument must contain a spendthrift provision.

So what exactly does a spendthrift provision do?

A spendthrift provision is a provision within a trust that limits the beneficiary's access to trust. This restriction protects the trust property in two ways:

First, it prevents a beneficiary from selling his or her interest in the trust property as a beneficiary to a creditor, and second, it prevents the beneficiary's creditors from compelling the trustee to satisfy a debt by making a distribution except where this would void public policy like in the case of alimony, child support and some civil judgments.

So, for instance, creditor X demands that Beneficiary 1 use the money to pay his debt of \$20,000. Even if the beneficiary cannot pay off his debt, creditor X cannot compel the trust to pay a debt directly to creditor X if the trust is discretionary and contains such a spendthrift provision. However, once the trustee has made a distribution to a beneficiary, the creditor may then take the distributed assets from the individual beneficiary.

In a discretionary spendthrift trust arrangement, the beneficiary's inheritance is, therefore, distributed in portions over an extended period of time. The beneficiary has no right to the money and can't spend it before actually receiving any of these distributions, and creditors and others can only reach the money that the beneficiary has actually received—not the portion of the inheritance that remains in the trust.

The trustee would have discretion to decide when and why payments are made, or the creator of the trust can set these terms in the trust documents when the trust is created.

There are some debts that courts do not allow spendthrift provisions to protect due to public policy concerns. For instance, a spendthrift provision will not apply to claims for alimony, child support, and back taxes. The courts favor these debtors because it is public policy to keep families from relying on support from the state when there are other resources that could provide support.

If such great protection from creditors exists, why not simply create a spendthrift trust and name yourself a beneficiary?

The reason is that most states won't allow this for public policy reasons. However, there are some exceptions where certain states allow something called 'self-settled' asset protection trusts where the person setting up the spendthrift trust can also be a beneficiary.

As always, if you have any questions or would like to learn more, please contact Steve Shane at sshane@offitkurman.com or 301.575.0313.