



## What are the Risks to Your Child's Inheritance, and How Can you Prevent Losses due to these Risks?

### *Read about the "4Ds."*

The principal risks to successful inheritance are ***Divorce, Debt, Disability, and Dissipation***. These are the "4Ds" as I like to refer to them.

The meaning of *divorce* and *debt* seem clear enough, but let's see how they can threaten the inheritance and how a device like the Inheritance Trust™ can prevent a loss of acquired wealth:

#### **Divorce**

An unprotected inheritance is automatically stigmatized as a "marital asset." This means that it's up for grabs in a separation agreement or divorce judgment. A divorcing spouse can say, "Gee, that's a nice inheritance you received yesterday (10 years ago, or whenever). I'd like half of that, now that I'm divorcing you."

Aside from one instance in many years of planning estates (where the parents recognize that their child was not a good provider for his family, unfortunately), I have never had a parent say "I'd rather have my son- or daughter-in-law received this inheritance than I would my own child or grandchildren." It just doesn't happen too often that parents leave the inheritance to their son or daughter in law instead of to their own child or grandchildren. That's not to say that children's inheritances should not be shared with spouses. After all, we hope for happy and successful marriages where the inheritance can benefit the entire family unit.

While we hope for the best, there is no sense in leaving the inheritance vulnerable to attack by a divorcing spouse who probably did nothing to earn sharing the inheritance. Therefore, it makes sense to leave the inheritance in a protected environment, such as the Inheritance Trust™ where the assets are left primarily for the benefit of the child and other descendants, with the possibility that they should be used for the entire family, and perhaps shared and enjoyed with a spouse, at the child's or the trustee's discretion.

#### **Debt**

An outright inheritance is also vulnerable to being swept up by a creditor of my child. My child may or may not have credit problems that I am aware of, but a lawsuit can strike anyone and threaten his or her assets at any time. The creditor may already exist at the time of my death when the child inherits, or the creditor may arise years later, long after the child has received the inheritance and co-mingled it with other assets that the creditor can take to satisfy the judgment or claim.

Lawsuits arise from events as common as car accidents where the claim exceeds the auto insurance, or where an insurer denies the claim. Suits arise against our children for their liabilities at work or in their profession, through their business or social involvement, through their ownership of real property, and so on. An outright inheritance provides a pool of funds for creditors to attach or collect against.

An inheritance protected in trust, on the other hand, cannot be forced to be paid out to the creditor. The child can either make other arrangements to pay without having to dip into the trust at all, such as paying over time or paying only cents

on the dollar, or can, if he or she wishes, use a portion of the trust funds to create a final settlement and dismiss the claim where otherwise the creditor would have received nothing. In this way, a child is not be avoiding his or her obligations, which we don't want to encourage, but is also not unnecessarily rendered vulnerable to an unscrupulous creditor, an unlucky experience, or an unwarranted judgment.

### Disability

Disabilities can be devastating to the beneficiary's assets and to the well-being of his or her family. I recall one child of a wealthy parent who was required to spend all his inheritance – while his stay-at-home wife and three young children sat by and watched the money disappear, before qualifying for government benefits. Our Inheritance Trust™ can prevent this unfortunate result.

Not only can the child's disability require “spending down” of assets, including an inheritance, but the disability of the child's spouse or children can require spend-down as well. It's far better to leave the assets in a protective trust environment where they can be used judiciously for health and support needs rather than having to be exhausted.

The goal asset protection in the event of disability is not to make a child *dependent* on government assistance. To the contrary, a child can lessen his or her needs for government assistance over a lifetime by a supplemental provision for his or her care.

When one knows in advance that a child or grandchild has a disability, then a special trust, known as a Supplemental Needs Trust can be designed with asset protection in mind. But when the disability is unknown because it is latent or comes upon the child as a result of an accident or illness, then receipt of the inheritance in a protected trust can be an immeasurable benefit. The Inheritance Trust™ can “flip a switch” for additional asset protection allowing the funds to be used as a supplement to other benefits that may be available.

### “Dissipation”

The *dissipation* risk is the tendency of inherited assets to disappear. Picture sand sifting through your child's fingers or visualize dry ice wafting away. An inheritance in the hands of *some* children is like that sand or ice!

How does dissipation occur? When assets are inherited out right the money, securities or real estate are titled in the child's name where they are freely spent or mortgage. To lose this inheritance, the child does not need to be a total spendthrift who can't hold onto a single penny, but only somebody who lives more for today and takes tomorrow for granted. Maybe very much for granted. Such a child is more likely to spend inherited assets than to save them, is unlikely to invest for kids' college educations, is indifferent to paying down the mortgage or building up a retirement account. The assets are also likely to be put in joint accounts with the child's spouse who perhaps is the big spender. Either way, the child or the spouse often has no motivation to think about tomorrow's needs over today's when it comes to using the inheritance.

Heirs tend to live higher on the hog as a result of an inheritance. In and of itself, there's nothing wrong with your child living better, safer, with a more secure future, or with a more frequent or better vacations as a result of inheritance. These may be terrific results of proper use of the inheritance. Bear in mind however, that once intermingled, the inheritance is spent without regard to their source, their intended usefulness for “rainy days,” for the education of grandchildren, and so forth.

Making life more comfortable is a very nice result for your child, except when such lifestyle comes to the exclusion of planning for life's unexpected circumstances, such as being laid off late in one's career when it is difficult to get another job, or when it's necessary to go back to school for another degree in order to change careers, or where unexpected medical expenses or disability arise, or when a spouse dies without life insurance, greatly impacting the beneficiary's ability to support herself and her family.

In contrast, assets inherited in trust tend to be used with more deliberation about the purpose of the money, with more concern to make the money last, to think about how the funds could be used for education and other higher values than simply living for today.

### Leaving assets "In trust" yields many opportunities

Some parents like to convey assets to the children in trust with very few, if any, limitations other than that they be used for the child or the family's "health, education, maintenance and support." Other families like to see that the children are doing their best first to live independently and with self-sufficiency. The trusts of these parents are more likely to say that the trustee should take into account other resources available to the child before making the payment, or that it may be equally important to see that assets are saved for the next generation's education or getting the start in life as they are to be used for the child's enjoyment.

Still other parents may want to design a trust that provides a lifetime income for children and then leaves the remainder to charity. Such a trust may provide a steady income, without the temptation or crutch of allowing the child to dip into the principal. And, it must be said, the trust can incorporate more than one of these objectives, while still allowing child considerable freedom, even the freedom to be his or her own trustee over the inheritance, without having to involve other family members or institutional trustees in many cases.

When assets are inherited *outright* instead of in trust, they are usually unrecognizable as a resource for the beneficiary and her family after a few months, let alone after a few years. The inheritance will have been spent, comingled with other assets, lost in a divorce, lost to a bad investment, and so forth. When assets are inherited in trust on the other hand, they tend to be held for their intended purposes and invested more wisely than they otherwise would be.

Assets inherited in trust may allow for a degree of higher living by the beneficiary, and if so, terrific! Perhaps all of the assets the Inheritance Trust™ will get spent and enjoyed, and this may be a good thing. In the meantime, assets in an Inheritance Trust™ are less likely to be spent all at once, or spent frivolously and without planning, or comingled without or regard for the intended purposes of the funds.

Parents who say "Ah, but my children are good, they'll figure it out, I don't tell them what to do, they're old enough to make their own decisions," mean well but are missing the point of this opportunity. There's nothing that will prevent the children from running their lives as they see fit and even using the inheritance at their own discretion if it is left in trust, a trust that they have a say in or of which they may serve as the trustee. But a child is hardly making his or her own decisions when they fall victim to divorce, debt collection, unforeseen disability or their own frailty when it comes to handling money.

Left to their own devices and outright ownership, the child has fewer choices, has ultimately less control and is less likely to succeed, compared to the child who is a trustee and given the responsibility of looking out for the future.

I find that there are fewer and fewer of these parents taking the laissez-faire attitude and more adopting the Inheritance Trust™ approach. If I had to choose a percentage, I would say about 98% of my clients are adopting the in-trust-for-life estate plan design for their children. Some of them wish they had such an inheritance – but that's the subject of another article.\*

Avoiding the 4Ds is not all that hard with just the slightest adjustment in the parent's perspective on how to leave the inheritance. Leaving the inheritance in trust can make all the difference in the long term welfare of the next generations.

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\*Another technique, The Heritage Trust™, created by Attorney Borchers, provides an opportunity for those who expect to inherit to receive the inheritance in trust, protected for life, with only the slightest modification in their parents' estate plan.