

Lawsuit-Proofing Trusts

You need an irrevocable *intervivos* trust to shelter your assets from your creditors. Any trust that includes the right protective provisions can lawsuit-proof the trust assets from your beneficiaries' creditors.

A trust is either *intervivos* or testamentary. A living trust is created and funded during your lifetime. It is an *intervivos* trust. Trusts that you fund upon your death are testamentary. You would usually create it in your last will or living trust. During your lifetime, your assets remain in your name and would be unprotected against your creditors, unless they have otherwise been sheltered.

Trusts are also revocable or irrevocable. You can change or revoke a revocable trust. You cannot revoke or modify an irrevocable trust. Every testamentary trust is irrevocable once you die because you obviously cannot spring back to life to unwind it.

It is important to distinguish a revocable from an irrevocable trust because a revocable trust won't protect you. For protection you need an irrevocable trust. You also need an irrevocable trust that you presently fund – an *intervivos* trust.

One serious disadvantage from using an irrevocable *intervivos* trust for protection is that once you establish and fund the trust, you cannot cancel or modify it and reclaim property you transferred to it. You thus lose both ownership and control over the trust assets. That's why an irrevocable *intervivos* trust is seldom used for protection – though such trusts can be useful for estate planning.

A revocable trust will not protect your assets because your creditors can step into your shoes and revoke your trust. For example, assets titled to your revocable living trust are vulnerable to your present and future lawsuits. Nevertheless, a living trust will help you avoid probate. For lawsuit-proof wealth, you need an irrevocable trust or another protective entity. Since you cannot revoke or change an irrevocable trust, your creditors have no greater power to unwind your trust and reclaim its assets. But for an irrevocable trust to protect you, it must be presently *funded*. Until you transfer assets to your trust, they are your assets, and can be claimed by your creditors.

There are other limitations with trusts to shield assets. One limitation is that you cannot settle your trust for your sole benefit. For lawsuit protection, you should have no beneficial interest in the trust. You can, however, retain income rights based on some ascertainable standard (health needs, etc.). Some states disallow self-settled trusts for asset protection. The grantor can neither control the trust nor have any beneficial rights.

Another limitation is that assets fraudulently transferred to the trust can be recovered by present creditors. An irrevocable trust can protect only against future creditors. You should only transfer assets to an irrevocable trust when you are confident that you have no present creditors. But how can you ever be absolutely certain of this? It's more accurate to say that you shouldn't transfer assets to an irrevocable trust if you have the likelihood of a present creditor. A present creditor can recover assets from the trust because the transfer was without consideration. In other words, you received nothing in exchange from the trust.

You can see the limitations with trusts. For protection, you must use an irrevocable trust, relinquish control, and beneficial interest, and still your trust assets may be seized as a

fraudulent transfer. Trusts are also set aside when a court concludes that a trust is a sham or that the grantor retained *de facto* control over the trust.

The irrevocable trust for asset protection imposes a heavy price that most people want to avoid. They want less draconian ways to become lawsuit-proof.

An irrevocable trust can make sense when:

- 1) You would soon gift the assets to your beneficiaries anyway, and
- 2) You do not foresee needing the assets for your future financial security.

Your price, then, is not particularly heavy, if you do not foreseeably need the assets, and the trust will now accomplish what you would eventually do – distribute your assets to your beneficiaries (usually your children) at some future time. Only then, should you consider an irrevocable *intervivos* trust for wealth preservation.