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IN TRUSTS WE TRUST?

A Revocable Living Trust May Not Protect Your Assets From Creditors

by Kurt F. Vote, Esq.

Many California attorneys and estate planners will wholeheartedly recommend establishing a "living trust", also known as an inter vivos trust, as a method of avoiding an expensive, extended probate proceeding. If correctly established and administered, an inter vivos trust can avoid the fees and delays which all too often accompany the passing of a loved one. However, a popular misconception about trusts is that at an inter vivos trust also protects the assets of the settlor (the person who establishes the trust) from claims of creditors. In fact, the typical inter vivos trust does not protect the assets of the settlor from claims of creditors — a fact often not known either by the settlor or the creditor!

Retaining the Power to Revoke Your Trust May Leave Its Assets Vulnerable to the Claims of Creditors

Most living trusts are designed so that the settlor retains the power to revoke the trust prior to his or her death. This is usually prudent, especially when there are questions about the use to which the beneficiaries might place their interests, or when the settlor is unsure as to whether he or she really wants his or her property to pass to the beneficiaries listed at the time the trust is first established.

However, when the settlor retains the power to **revoke** the trust, the trust assets are subject to the claims of the settlor's creditors. (California Probate Code § 18200.) This is true even if the settlor includes language in the trust documents purporting to restrict the right of creditors to reach the assets of the trust, usually referred to as "spendthrift" provisions. (California Probate Code § 15304(a).)

Careful Drafting is Necessary to Prevent Creditors from Levying Against Trust Assets

However, a spendthrift provision will provide **some** protection from creditors when the income stream to be protected is that which flows to the beneficiary of the trust. When a trust contains correctly-drafted spendthrift provisions, the beneficiary's interest in the trust can be reached only when payments to the beneficiary are actually made, and even then only up to 25% of the payment which the beneficiary would otherwise receive. (Probate Code §§ 15304(b), 15306.5(b).)

If you are considering the creation of a living trust, be sure to discuss with your attorney or estate planner the degree to which the terms of your trust will protect your assets from the claims of creditors.

This article contains general information and is provided as a courtesy to our clients and friends. It should not be relied upon in any particular fact situation without contacting your legal counsel for specific advice. Mr. Vote is a partner in McCormick Barstow's Commercial and Business Litigation Practice Group and can be reached at:
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