PROTECTIVE TRUSTS - HOW TO PROTECT YOUR CHILDREN FROM OPPORTUNISTS AND GOLD DIGGERS

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Introduction

Setting up a trust during your lifetime (an inter vivos trust) allows you to preserve assets until your children, or even grandchildren, are old enough to enjoy and manage those assets responsibly. A trust is created when a person (the **"Settlor"**) transfers assets (the **"trust property"**) to a person or company (the **"Trustee"**) on the basis that the Trustee shall hold the trust property for the benefit of a third party or parties (the **"Beneficiary"** or **"Beneficiaries"**) on the terms set out in a deed of settlement or a declaration of trust (the **"Trust Deed"**). A unique legal characteristic of a properly set up trust is the separation of legal and beneficial ownership of the trust property – the trustee is the legal owner with management and control of the trust property, but owns the trust property exclusively for the benefit of the Beneficiary. The Beneficiary could be one named person or, if more than one, several named persons or there may be a class of Beneficiaries clearly defined in the Trust Deed, such as the lawful descendants of the Settlor, rather than any specifically named individuals. In its simplest form, the trust is set up as a 'fixed trust' in which the beneficiaries are named individuals, each entitled to a specific share of income and/or capital of the trust property. However, a fixed trust is not the most appropriate form of trust for the protection of the Beneficiaries and for the preservation and appropriate administration of the trust property.

Protection of assets from predators

In general, a protective trust may be designed to ensure that the trust property or the capital constituting the trust property is held securely by the Trustee for the benefit of the Beneficiaries and the Trust Deed constituting a protective trust would normally create a discretionary trust of the trust property. The Trust Deed would include clear provisions on the regularity and conditions under which income derived from the trust property and, eventually, the trust property itself, is to be held, administered, invested and distributed to the Beneficiaries for a specified period, which could be the rest of the lives of the Beneficiaries or any shorter period (the **"Trust Period"**).

Instead of assets from the Settlor being given directly to or inherited by the Beneficiaries (say under the Will of the Settlor), after which the Beneficiaries may be vulnerable to opportunistic persons who may encourage the Beneficiaries to dissipate such assets via bad investments or to a gold-digging spouse upon divorce, a protective trust may be set up for the protection and benefit of the Beneficiaries. A protective trust would be a 'discretionary trust' (instead of a fixed trust) where the Trustee will have an absolute discretion to determine which Beneficiaries from a list of named Beneficiaries or from a defined class of Beneficiaries (to be stated in the Trust Deed) will receive income, in what proportions. In a discretionary trust, the Trustee may also have the power to exclude persons from being Beneficiaries either at the absolute discretion of the Trustee without reference to circumstances or at the discretion of the Trustee with reference to certain circumstances set out in the Trust Deed.

As the amount, if any, to be distributed to each beneficiary under a discretionary trust is to be decided at the absolute discretion of the Trustee, creditors of the Beneficiaries, opportunists and gold-diggers would not be able to claim any portion of the trust property because, under the terms of the Trust Deed constituting the discretionary trust, no Beneficiary is entitled as of right to any particular share of the trust property. If a Beneficiary should do anything which puts the trust property at risk during the Trust Period, for example, if a Beneficiary becomes insolvent or divorces his/her spouse, such event would normally give rise to a potential claim against the trust property and the Trustee can exclude that particular Beneficiary from distributions of the income and capital and will usually have an express power under the Trust Deed to declare that such person (who would otherwise be a Beneficiary) shall be an ‘excluded beneficiary’ in order to preserve the trust property.

Protective trusts are designed to protect the trust property in accordance with the terms of the Trust Deed. This type of trust ensures that each Beneficiary will have a steady income even if he or she is unlucky or improvident as long as the Trust Property is not imperilled by the acts of a Beneficiary or from a Beneficiary’s circumstances, including being prey to opportunists and gold diggers.