

## Drafting Trusts with Prophylactic Planning Provisions—How Far Should You Go?

By Douglas G. Chalgian

Most of us are comfortable with the idea of including a catch-call provision in our trust agreements that prevents trust property from unexpectedly being distributed to minors. Clearly, that makes sense in many cases. The purpose of this article is to suggest that there may be other situations in which a settlor may want to empower the trustee to delay or withhold distributions in addition to minority. Following, these few introductory paragraphs are suggestions as to the types of things that a planner may want to address through these “prophylactic planning provisions.”

Did you know, for instance, that Michigan is among the leaders in the nation in collecting against the resources of persons who end up in our jails or prisons, and that the State regularly proceeds against the property inherited by incarcerated persons? Do you think some of your estate planning clients might want to protect the assets they leave to their beneficiaries from being used to pay for the costs of incarceration?

In these materials, you will note the liberal use of discretionary trusts as the means of protection. Michigan law has long held that a beneficial interest in a discretionary trust is not reachable by creditors, even the state government. *Miller v Department of Mental Health*, 432 Mich 426, 442 NW2d 617 (1989). This level of creditor protections afforded discretionary trusts is proposed to be carried over in the Michigan Trust Code in its current form as approved by the Probate and Estate Planning Council of the State Bar.

The obvious down side of this type of planning is the excessive power it gives a trustee to alter the interests of beneficiaries; fertile ground no doubt for an unnecessarily controlling trustee with a penchant for jerking around other family members. One optional provision that may alleviate some of that concern is to make the Trustee’s authority to exercise these provisions sub-

ject to the consent of a trust protector or trust committee.

These provisions are offered as a starting point for planners to consider in drafting and to decide whether they feel comfortable expanding beyond the basic provisions now frequently used to protect against distributions to minors. The author is interested in feedback and invites comments from planners about these suggested provisions.

### Article \_\_\_\_\_

My Trustee (optional: with written consent of the trust protector) shall have the discretion to alter the nature of the distributions provided for in this agreement in the following manner:

**\_\_\_.1 Needs-Based Government Benefits.** The Trustee may establish a discretionary “special needs” trust and fund said trust with all or any portion of the share which would otherwise be distributed to a beneficiary, if said beneficiary is receiving government assistance which assistance is based on financial eligibility requirements, or if the Trustee reasonably anticipates said beneficiary may need such government assistance in the foreseeable future. In establishing a discretionary “special needs” trust, the Trustee may select a trustee and successor trustees, establish accounting requirements, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary “special needs” trust established pursuant to this provision be drafted and managed so as to provide the maximum benefit to the beneficiary who would have otherwise received

an outright distribution, and to be for the sole benefit of said beneficiary during his/her lifetime. The remainder beneficiaries of any discretionary "special needs" trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary (unless directing assets through the estate of said beneficiary would subject the Trust property to recovery for the payment of services provided to the beneficiary as a result of his/her receipt of government benefits, in which case the remainder beneficiary of said discretionary "special needs" trust shall be \_\_\_\_\_).

**\_\_2 Criminal Prosecution.** The Trustee may establish a discretionary trust and fund said trust with all or any portion of the share which would otherwise be distributed to a beneficiary, if said beneficiary is in prison or jail, or is facing prosecution for alleged criminal conduct, or who Trustee reasonably believes may be facing criminal prosecution for an alleged crime in the foreseeable future. In establishing a discretionary trust, the Trustee may select a trustee and successor trustees, establish accounting requirements, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed so as to (1) prevent the resources in the Trust from being exposed to recovery by the state(s) or county(ies) in which the beneficiary is or may be incarcerated or for any other costs which such entities may be able to assess against said beneficiary for the costs of his/her interaction with the corrections system, (2) prevent the resources in the Trust from being subject to any victim's repayment obligations imposed by a court, through a quasi-judicial process, or otherwise, and (3) prevent the resources in the Trust from being reached by persons injured by the conduct of the beneficiary which conduct gave rise to the criminal charges. The remainder beneficiaries of any discretionary

trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary (unless directing assets through the estate of said beneficiary would subject the Trust property to recovery for any of the obligations outlined earlier in this paragraph, in which case the remainder beneficiary of said discretionary trust shall be \_\_\_\_\_).

**\_\_3 Civil Judgments.** The Trustee may establish a discretionary trust and fund said trust with all or any portion of the share which would otherwise be distributed to a beneficiary, if said beneficiary is a defendant in a civil action, or who is subject to collection of an unsatisfied civil judgment, or who Trustee reasonably believes may become a defendant in a civil action in the foreseeable future. In establishing a discretionary trust, the Trustee may select a trustee and successor trustees, establish accounting requirements, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed so as to (1) prevent the resources in the Trust from being exposed to the plaintiff(s) in a civil action in which the beneficiary is a defendant, and (2) prevent the resources in the Trust from being used to satisfy a civil judgment against the beneficiary. The remainder beneficiaries of any discretionary trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary (unless directing assets through the estate of said beneficiary would subject the Trust property to recovery for any of the obligations outlined earlier in this paragraph, in which case the remainder beneficiary of said discretionary trust shall be \_\_\_\_\_).

**\_\_4 Marital Difficulties.** The Trustee may establish a discretionary trust and fund said trust

with all or any portion of the share which would otherwise be distributed to a beneficiary, if said beneficiary is becoming divorced or legally separated from his/her spouse or partner; expected to become divorced from his/her spouse or partner in the foreseeable future; subject to domestic court orders requiring the payment of child support, alimony, or any similar obligation which obligations are unsatisfied or not being regularly met by said beneficiary; or Trustee reasonably expects a beneficiary to become subject to domestic court orders requiring the payment of child support, alimony, or any similar obligation which obligations Trustee reasonably believes the beneficiary will be unlikely to be willing or able to satisfy. In establishing a discretionary trust, the Trustee may select a trustee and successor trustees, establish accounting requirements, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed so as to (1) prevent the resources in the Trust from being used to satisfy the beneficiary's obligations under a judgment of divorce, separate maintenance or similar judgment, and (2) prevent the resources in the Trust from being used to satisfy child support, alimony or other comparable obligations to a child, spouse or partner, that the beneficiary is not otherwise willing or able to satisfy from resources that s/he has other than those which would be made available from trust distributions. The remainder beneficiaries of any discretionary trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary (unless directing assets through the estate of said beneficiary would subject the Trust property to recovery for any of the obligations outlined earlier in this paragraph, in which case the remainder beneficiary of said discretionary trust shall be \_\_\_\_\_).

#### **.5 Drug/Alcohol Abuse and Dependence.**

The Trustee may establish a discretionary trust and fund said trust with all or any portion of the share which would otherwise be distributed to a beneficiary, if Trustee reasonably believes that said beneficiary is abusing drugs or alcohol and that the resources of the Trust, if distributed, would facilitate continued abuse. For the purposes of this paragraph, the term "drugs" would include legal and illegal substances, whether prescribed by a physician or not, that the beneficiary has become dependent upon and/or uses with regularity to his/her detriment. In establishing a discretionary trust, the Trustee may select a trustee and successor trustees, establish accounting requirements, and shall include all provisions determined to be reasonable and necessary by the Trustee after consultation with a qualified attorney. It is my intent that any discretionary trust established pursuant to this provision be drafted and managed so as to (1) prevent the resources in the Trust from being used to purchase drugs or alcohol in situations where the purchase of same would work a detriment to the beneficiary, as perceived by the Trustee, and (2) prevent the resources in the Trust from enabling a beneficiary to continue a self-destructive lifestyle as a result of his/her drug and/or alcohol use and/or dependency. Trustee may demand, and the Trustee of the discretionary trust established in accordance with this paragraph may demand, that a beneficiary participate in testing to determine whether or not drug and alcohol use is occurring, demand a beneficiary participate in drug or alcohol counseling or rehabilitation programs, and charge the beneficiary's share for all costs incurred in such testing and treatment or require the beneficiary to pay for such testing and treatment from non-Trust resources. The demands of the Trustee to have the beneficiary tested and treated may continue for so long as the Trustee determines, at its discretion, and the results that would allow the Trustee to be satisfied that the risks to the Trust property intended to be avoided by this paragraph shall be set by the Trustee

at the Trustee's discretion. The authority of the Trustee to mandate testing or rehabilitation may be continued as provisions in the discretionary trust to be established pursuant to the terms of this paragraph. The remainder beneficiaries of any discretionary trust established pursuant to this provision shall be the descendants of the lifetime beneficiary, by right of representation, or if none, the estate of said beneficiary.

**\_\_\_6 Comparable Protections not Otherwise Stated.** Provisions \_\_\_1 – \_\_\_5 are intended to provide the Trustee with direction with respect to specific situations in which the Trustee may choose to act to prevent distributions of Trust property from being made in situations where the results of such distributions would be contrary to the intended purposes for which this Trust was created. These examples may not anticipate all such situations, and I authorize the Trustee to exercise the authority granted in this Article, including the withholding of distributions and the creation and funding of discretionary trusts, in other situations in which, in its judgment and at its discretion, the Trustee reasonably believes such protection would be appropriate and desirable, including to protect the Trust distributions from the creditors of a beneficiary or from conduct of the beneficiary which is likely to result in a waste of the Trust distributions or if the Trust distributions would contribute to the demise of, or act to the detriment of, the beneficiary.

### Conclusion

The purpose of this article is to suggest an approach to planning that may be appropriate for some clients in some situations. When discussing these issues with clients, a planner would need to advise the client about the risks and benefits of providing a trustee with such broad authority, as well as tax ramifications and other issues that might be involved in a client's particular case.



Douglas G. Chalgian, of Chalgian & Tripp Law Offices PLLC, East Lansing, practices in the areas of elder law, estate planning, special needs planning, and probate litigation. Mr. Chalgian specializes in Medicaid planning, guardianships and conservatorships, and will and trust contests. A member of the National Association of Elder Law Attorneys, he is a Certified Elder Law Attorney by the National Elder Law Foundation. Mr. Chalgian is a member of the Probate and Estate Planning Section Council of the State Bar of Michigan and is a former chair of the Bar's Elder Law and Advocacy Section. He is a regular speaker on elder law issues for ICLE and other organizations, and a previous contributor to the *Michigan Probate and Estate Planning Journal*, as well as the *Michigan Bar Journal*, the *Elder Law Advocate*, and *Michigan Lawyers Weekly*. Mr. Chalgian also is a coeditor and chapter author for *Advising the Older or Disabled Client* (ICLE 3d ed 2004 & Supp). He is involved in various community activities, including as a member of the board of directors of the Alzheimer's Association, Great Lakes Chapter; the Huntington's Disease Association, Michigan Chapter; the Michigan Society of Gerontology; and the Thomas M. Cooley Law School's Sixty Plus, Inc., Elderlaw Clinic.