WILL AND TRUST BEQUESTS, BANKRUPTCY AND JUDGMENT CREDITORS

By: James W. Mallonee

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The need to protect your current assets as well as future assets (e.g. inheritance) is becoming more critical than ever. This article discusses those situations where a family patriarch who is financially stable has children who are under financial distress, insolvent or in bankruptcy and lose their parents' bequests because the parent's testamentary document did not contain a protective contingent trust and spendthrift clause.

The typical facts are these:

1. The parent has a Will or Trust document that leaves the bulk of their estate to their children;
2. The majority of the parents estate consists of cash (savings, CD's, stocks, bonds or other like instruments);
3. One of the children are in financial distress (bankrupt or insolvent);
4. A reading of the parent's Trust or Will contains no language that states that the property to be passed to a child may be held in trust if such child is insolvent or in bankruptcy.

The critical piece in the above set of facts is the language of the Will or Trust (#4 above) that does not protect the child or children who may be financially insolvent or in the middle of bankruptcy proceedings. If no contingent language exists in a parent's testamentary document to withhold a devisee's share in the event the devisee is insolvent, the bankruptcy court or judgment creditors can seize such share. In essence, the child's share of their parent's estate will be seized by either the bankruptcy court or a judgment creditor.

In most cases the contingent trust that is found in a Will or Trust targets those individuals who are under a specific age or persons who are disabled. A contingent trust generally takes the share of a parent's estate that is to be delivered outright to a devisee and puts it aside. The funds that are put aside are then delivered to the devisee in limited increments for the purposes of assisting such devisee in their needs involving their health, education, maintenance and support.

The key to protecting a devisee's share of an estate from being seized is to not let it come into the possession of the devisee (child). As long as the assets destined for a devisee is held by a Trustee or personal representative (who cannot be the child experiencing the financial distress), the bankruptcy court or judgment creditor cannot touch it provided that the estate's administrator has the right to take possession of a child's share in the event that child is insolvent, financially distressed or in bankruptcy proceedings.

When a Trustee or Personal Representative of an estate is granted the right to take possession of a child's bequest for said child's benefit, a spendthrift clause contained in the parent's testamentary document takes over and prevents the courts and judgment creditors from having

the right to attach to the assets. A spendthrift clause is a simple paragraph that states in pertinent part that the assets of the decedent are not available to creditors of any beneficiary of the decedent's estate as long as such asset remains in the possession of the personal representative or Trustee of a trust.

You may be wondering how long would a devisee (decedent's child) have-to-have their share maintained by a Trustee. The answer depends on the status of a person's insolvency and bankruptcy proceedings. For example, once a bankruptcy court issues a discharge of a person's obligations, the full amount of the trust for such child could be released with virtually no consequences. In the event of a judgment creditor, if the judgment is discharged by the bankruptcy court, the Trustee could once again release the full amount of the child's funds to him or her with virtually no consequences. On the other hand if certain judgments or obligations are not discharged by a bankruptcy court, then in that event, the Trustee may have to hold a devisee's share until such time as the statute of limitations passes on such judgment or obligation. Thus, it is important to know what judgments and obligations are being discharged by the bankruptcy court (if any).

The final message that needs some explanation is the time to seek out a bankruptcy attorney is before you stop making your loan or credit card payments. This author strongly suggests that the time to seek the advice of a bankruptcy attorney is in anticipation of becoming insolvent, not after it. How can you determine if you are insolvent? Insolvency occurs when your assets are less than your current liabilities. It is easy to become insolvent if the assets you own (homestead) are not in balance with the amounts you owe on such assets (e.g. mortgage). If you continue to make the payments on your obligations and then file for bankruptcy, it is likely your attorney can save your credit score and many of your assets if you seek timely assistance. This seems hard to fathom, but bankruptcy in and of itself does not cause a credit score to drop significantly, it's the failure to make four or five months payments preceding the filing for bankruptcy that causes a person's credit score to rapidly decline.

As you can see from this article, it is a good idea to review the language of your testamentary document to see if it contains a contingent trust, and if it does, will it protect your devisees from losing their share of your estate to a third party in the event the devisee is insolvent, financially distressed or in bankruptcy. If you are unsure about your testamentary documents, seek out an attorney of your choice and have your Will or Trust language reviewed. Moreover, if you anticipate being financially insolvent seek out a bankruptcy attorney to protect your assets. Don't wait until you are four of five months behind in paying your obligations to seek the assistance of the bankruptcy attorney.