FINANCIAL TIMES
TUESDAY MARCH 25 2008

Parents must put children in the know

ESTATE PLANNING

Done properly, the process can help enshrine values and educate beneficiaries in the wise use of money, writes **Ian Driscoll**

Inclusivity: keeping your children in the picture is key to ensuring equitable estate planning Getty

"Death and taxes and childbirth! There's never any convenient time for any of them!" wrote Margaret Mitchell in *Gone With the Wind.*

In the world of estate planning, fluctuating tax laws, untimely death and the birth of a child can all upend established plans. And while tax efficiency often dictates much of the process, advisers say addressing the emotive aspects can be just as important.

"Tax planning is a very important part of estate planning; sometimes the only part," says Susan Schoenfeld, principal and associate fiduciary counsel at New York-based Bessemer Trust. "But it shouldn't be, in the perfect world, the sole motivator."

Done wisely, estate planning can help parents enshrine values and educate children about fiscal responsibility. It can also forestall sibling conflicts that may follow a parent's death.

Constructed unwisely, however, or without a child's knowledge, an estate plan may leave offspring questioning parental motives. Avoiding common pitfalls can be as helpful as choosing the right structures. Often, the two are intertwined.

Before thinking of heirs, says Donna Morgan, head of the wealth management practice at Chicago law firm Mayer Brown, clients should establish their financial comfort threshold: "How much money can you take off the table and never worry about not seeing again?''

Ms Schoenfeld also begins by determining the client's financial concerns. Afterward, "the guiding language or decision tree we take clients down is to encourage communication and education of the next generation," she says.

Responsible stewardship of wealth includes not leaving your children in the dark. Usually this isn't an issue for families with multi-generational wealth or trusts. But entrepreneurs can be old-school in their approach to money and unwilling to discuss wealth issues with their family.

"The kids see the way their parents live; they see the way their parents travel," says Ms Schoenfeld. "If the children are given mixed messages and money's never discussed, they ultimately don't know how it should impact their career choices or their personal priorities."

'No incentive trust will help a child who is troubled. You need to provide for the child's well-being'

Educating children about money should begin early. Many families begin through philanthropy, either via a family foundation, or by giving their children small sums to donate to charities with instructions to follow how the money is spent.

Another option is the family limited partnership, an investment partnership in which family members have different ownership percentages (outright or in trust). "If you took 10 per cent of a family's worth, you can empower young adults to become active participants in investment decisions," says Lisa Whitcomb, a trusts and estates expert and managing director of wealth advisory services at Philadelphia-based The Glenmede Trust.

Substantive discussions about the passage of familial wealth, however, might wait until the children are mature enough.

"There's a sweet spot in the family dynamics, which is a very important time to talk to your children, and it's between 22 and 35; that's

when you have a fairly good idea of who they are becoming," says Ms Whitcomb. These ages roughly coincide with the time when experts advocate beginning to pass money to succeeding generations.

A popular tool is the "three-strike rule", whereby money is disbursed in five-year tranches (usually one third at a time) beginning at age 25 or 30. The process, says Ms Whitcomb, not only broadly traces the three stages in which most adults think about money during their lives, but it can also give children a leg-up at important milestones, be it buying a first home or beginning a family.

By such distribution at intervals, the parents and/or the trustee can see how responsibly the child handles wealth. "If a child makes a mistake, then they're making a mistake with a fraction of the inheritance rather than the whole thing," says Ms Morgan. But there are circumstances when automatic access to the tranches may not be beneficial.

"What if the child is going through a divorce or bankruptcy?" asks Ms Morgan. "Now we just give the child the right to withdraw at that time."

Many lawyers advise such trusts be terminated before the children reach 60. "I once read a trust where the children didn't get a dime until they were 70 years old," says Ms Schoenfeld. "It sends a message that you don't trust your children."

The temptation to control one's children from the grave also afflicts incentive trusts (sometimes known as ethical trusts), an estate planning tool that has attracted much attention in recent years.

A variant of the incentive trust matches dollar-for-dollar distributions according to a child's income. Another type might disperse funds when children meet benchmarks – graduating from college, performing philanthropic work or remaining drug-free. But some advisers warn incentive trusts must be used judiciously, if at all.

"Incentivising children to achieve certain goals is an imposition of the parents' values on the child," says Ms Morgan. "I remind people that their children – unlike others who have to pay the mortgage – have the ability to do good work or pursue careers that aren't necessarily lucrative."

Joanne Johnson, head of US fiduciary and wealth advisory for JPMorgan Private Bank, says incentive trusts have to be viewed in the wider context of estate planning.

"Whenever people create trusts, they want to protect wealth across generations and ensure that this availability of wealth doesn't destroy the values that they are trying to instill in their children. It's the parents' money, after all."

The utility and success of incentive trusts depend on how they are drafted and family circumstances, she says, adding a possible approach to the matching dollar-for-dollar incentive trust is to cap distributions, so the child who chooses a career in teaching doesn't lose out to the investment banker sibling.

A parent with an entrepreneurial bent may wish to instill this in his children, and Ms Johnson sees no problem with trusts that might lend money to a daughter with a viable business plan. Similarly, many of her clients have formed long-term generation skipping trusts exclusively as education funding pools for future generations. Here, she says, the clients may not only be incentivising the beneficiaries but also helping parents because of the long-term costs of education.

Ms Johnson has also seen trusts that give complete discretion to the trustee with the sole (and loose) dictum that the children need only be "productive members of society", whether that is stay-at-home mother, entrepreneur or research chemist.

Not only do many estate specialists encourage steering clear of rigid trust structures, but most also advocate trusts only be used as carrots, not sticks, and especially so when the beneficiary may be an errant child.

"Despite the parents' best efforts, individuals are going to be individuals. No incentive trust will help a child who is confused and troubled. You need to provide for the child's well-being. Wealthy children can end up in rehab or as spendthrifts completely unable to handle the money, and it's no reflection on the parents," says Ms Whitcomb.

Indeed, if a child needs medical attention for the remainder of his life, or for another reason warrants a greater share of an estate than his siblings, then it's best explained while the parents are alive. Unequal treatment of siblings in an estate plan can be dangerously divisive.

Bessemer Trust's Ms Schoenfeld says some clients are concerned about wanting to be equal in what they leave to children but others take into account different circumstances. Where there is blatant inequality, she advises a family meeting to explain the reasoning to the beneficiaries.

"In their lifetimes, the parents can be the referee; when they're gone, the referee is gone. If there's an opportunity to explain your reasons, a child never has to go through life saying: 'Gee, Dad loved you better'."

Why families should consider a corporate fiduciary

Forty years ago, a wealthy family might have appointed an uncle or family friend as trustee of their estate. Today, the complexity of the role means that choosing a fiduciary (or trustee) is a very different matter. Nowhere is this more evident that when it comes to investing a trust's assets.

"If you [the trustee] don't diversify, if you don't have a balanced portfolio, if you don't balance the interest between the remainderman and the income beneficiary, if you don't look at modern portfolio theory and then apply a fiduciary overlay to that, and if your investments don't perform, then you will bear responsibility," says Joanne Johnson, head of US fiduciary and wealth advisory for JPMorgan Private Bank.

Beyond comprehending esoteric financial instruments, Ms Johnson suggests other reasons families should opt for corporate trustees over individuals. "With a corporate fiduciary you get integrated delivery, fiduciary accounting, tax compliance advice, and a professional with the background to make considered decisions with respect to distributions," she says.

Still, Ms Johnson believes that family members can be effective cotrustees. "We encourage family members to be a cotrustee because they can interject family dynamics and information about the people that we don't have." Where that family member's role is limited, their liability is limited too, she says.

However, having a corporate fiduciary act as an honest broker during disputes can also leaven the impact on the family. Fiduciaries may have enough distance from the family to make recommendations that friends or relatives may lack.

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