THOITS LAW

Trusts & Estates Notes

A Series of Articles on Legal Issues Regarding Estate Planning and Estate Administration

Use of Lifetime Trusts in the Estate Plans of Parents of Young Children

By Stewart Richardson
srichardson@thoits.com

Parents of young children should create estate plans that will take effect if the parents die before those children reach adulthood. Such parents often direct that, after the death of the surviving parent (or of the single parent), a separate child's trust will be created to hold each child's share of the assets. The terms of the child's trust must be specified in the parents' (or parent's) estate plan.

Almost all trusts for a child direct the use of trust assets as needed for the child's health, education, maintenance, and support until the child reaches adulthood. However, parents have dramatically varying views with respect to distributing assets to the child after he or she has become an adult.

Some parents prefer a "distribution trust," in which the child will receive his or her entire inheritance, free of trust, at one or more ages. For example, the child might receive all of the remaining trust assets at age 30, or one-half of the remaining trust assets at age 27 and the rest at age 32. Distribution trusts appeal to many parents because the child is not controlled "from the grave" - once the child reaches the specified age(s), the trust assets belong to the child to spend in any manner he or she chooses.

By contrast, a "lifetime trust" is one that may last for the child's entire lifetime. Some parents use lifetime trusts to minimize transfer taxation (when wealth is eventually passed to grandchildren) or to create a layer of protection against future spouses or creditors. This article focuses on a different use of lifetime trusts, as a tool for passing wealth from deceased parents to their children while instilling the parents' own values. Many variations are possible, but a lifetime trust designed for this purpose might have some of the features discussed below.

- Some parents do not want the child to be able to rely on trust assets for daily expenses after the child reaches adulthood (*e.g.*, age 23). These parents fear that, if trust assets are always available, the child will not work hard, learn to act responsibly, and build a career. Accordingly, they may direct that, once the child reaches a specified age, trust assets may not be distributed to pay for the child's ordinary living expenses (but they may still be used for other beneficial purposes, such as to pay for medical care or educational pursuits).

©2010 Thoits Law, A Professional Corporation

- The terms of the child's trust may encourage or forbid distributions for particular educational purposes. For example, some parents wish to financially support all such pursuits, including, for example, multiple graduate degrees. Other parents are more concerned that the child may become a "professional student," and, accordingly, limit the length of time that trust assets may be used to pay for educational expenses.

- Many parents want the child to learn to live within a budget, but also want the sustainable level of income the child's trust can generate to be a part of that budget. To promote this, they may direct that, after attaining adulthood, the child will automatically receive all or a portion of the income that the child's trust generates. The child may choose to spend these income payments, or the child may save and invest them (in order to build up his or her own asset base outside the child's trust).

- Parents may also include controls to ensure that the child cannot, directly or indirectly, lose the child's trust assets by making a bad investment or by giving them away. Such parents often feel that the child can always make unwise decisions with money that the child earns, but that the child's inheritance should operate as a "safety net" that will always remain available for specific purposes (for example, to generate regular income for the child and pay for his or her medical care).

- The child's trust may also direct cash distributions in recognition of specific events and achievements, such as graduation from college or graduate school, marriage, or the birth or adoption of a child. These distributions essentially serve as "gifts" from the deceased parents to reward the child's accomplishments and help with extraordinary expenses.

- Some parents prefer a hybrid lifetime trust/distribution trust approach. For example, they may provide for substantial distributions totaling one-half of the child's trust to the child at specific ages, but direct that the remaining assets of the child's trust be reserved as a safety net in the lifetime trust.

For parents of young children, estate planning addresses the possibility that significant wealth (including, for example, life insurance proceeds) will eventually pass to those children under the terms of the parents' estate plan. Ideally, this transfer of wealth should occur in a manner that promotes the parents' values. The lifetime trust structure is often well-suited to that goal.

©2010 Thoits Law, A Professional Corporation

This publication is of general applicability and not specific to any set of facts. Thus, it should not be relied upon for any specific case or matter without further discussion. No attorney-client relationship is formed as a result of your reading or replying to this publication, which is not intended to provide legal advice on any specific matter, but rather to provide insight into current developments and issues.

Internal Revenue Service Circular 230 Disclosure. Please note that any discussion of or advice regarding United States tax matters contained herein (including any attachments hereto) does not meet the requirements necessary to be a "covered opinion" as defined in Internal Revenue Service Circular 230, and therefore, is not intended or written to be relied upon or used and cannot be relied upon or used for the purpose of avoiding federal tax penalties that may be imposed or for the purpose of promoting, marketing, or recommending any tax-related matters or advice to another party.

THOITS LAW
www.thoits.com

400 Main Street, Suite 250
Los Altos, California 94022
Telephone: (650) 327-4200
Facsimile: (650) 325-5572

8030 Soquel Avenue, Suite 100
Santa Cruz, California 95062
Telephone: (831) 425-4660
Facsimile: (831) 425-4543

Thoits Law Blog

©2010 Thoits Law, A Professional Corporation