Estate Strategies

Does Your Beneficiary Need Some Incentive?

Many people have angst in leaving a lump sum inheritance to a beneficiary. Using trust planning you can control the amount of your distributions to your beneficiary over time, but maybe you feel overbearing by implementing a strict set of rules for trust distributions. On the other hand, you don't want to create a "trust fund baby" or have the wealth you've left taken for granted. One way for you to balance these competing goals is to establish an incentive trust.

Incentive Trust

Incentive trusts contain provisions stipulating that distributions can be made or withheld based upon some action by the beneficiary. There are all kinds of incentivized trusts, both good and bad. A common incentive trust provision states that the beneficiary gets a "$X" trust distribution upon completion of a college degree. While college graduation is an important milestone, consider some of the following provisions, which may generate some ideas for your situation:

Percentage of Earned Income: Beneficiaries can request a principal distribution as a percentage of their earned income. If the beneficiary earned $50,000 in their job, they could request a distribution up to"X%," no questions asked.

Philanthropy: The trust can supplement living expenses so that your beneficiary can take on philanthropic endeavors. Perhaps the trust covers all expenses while the beneficiary spends a year in the Peace Corps or does a mission trip. Another alternative is that the trust pays the beneficiary a stipend for every hour of charitable time donated or matches donations made by the beneficiary?

Business or Real Estate Investment: Trusts can be drafted to help pay for the down payment on a first home, or to provide seed money to start a business. Consider requiring the beneficiary to submit a financial or business plan to the trustee. This puts some skin in the game for the beneficiary and helps the trustee review whether the distribution is appropriate.

Social Responsibility: Perhaps you have a beneficiary who wants to take on a more "socially responsible" career (teacher, social worker, etc.), but the beneficiary recognizes that those careers sometimes don't have pay scales commensurate with the work and value provided to society. Your trust can help by providing the financial freedom for them to pursue a socially responsible career. You can supplement the beneficiary's income up to a certain dollar amount indexed for inflation or tie the supplemental distribution to the average annual salary of some other profession (accountant/lawyer/executive/etc.).

Stay-at-Home Parent: If your beneficiary is a stay-at-home parent (speaking of pay scales not commensurate to work level), you can tie incentives to the working parent or provide supplemental distributions so a parent can afford to stay home.

Academic Performance: To help you encourage educational achievement, perhaps payments for college and/or graduate school are made only if the beneficiary achieves a certain grade point average or class ranking.

Disincentives: There can also be disincentives in your trust. For example, evidence of drug or alcohol problems can trigger limiting or ceasing trust distributions until the issue is resolved.

Motivation is the art of getting people to do what you want them to do because they want to do it.
~Dwight D. Eisenhower

Creating Incentive Trust Provisions

The wonderful thing about trust planning is you can create nearly any provision imaginable as long as the goal of the provision isn't illegal or unenforceable. In other words, you can incentivize a trust in as many ways as you can think of, as long as your attorney drafts your goals clearly so that the trustee can implement your wishes.

The Importance of Flexibility

As with other trust planning, consider maintaining flexibility in your trust should unforeseen circumstances arise. For example, if a beneficiary develops a learning disability, then having an incentive to graduate college may be unreasonable or unattainable. You may want to continue to allow the trustee to make distributions at their discretion for certain needs while retaining the various incentives you'd like to promote. You don't want the incentive trust to backfire and cause the beneficiary to become resentful or disinterested.

Planning for Beneficiaries

Making outright distributions to your beneficiaries at death can be appropriate. So too can creating restrictive trusts to control assets, taxes, and potential creditor claims. Work with your financial advisor to identify your goals. Engage your estate planning attorney to help solidify which planning makes sense for you, and, when appropriate, consider incentive trusts to provide motivation for your beneficiariesto reach certain milestones. ■