MCF Private Trust

DYSFUNCTION JUNCTION: THE REAL ISSUE IN ESTATE PLANNING

For years too much emphasis was placed on taxation in estate planning. Not that tax savings is not important, but it became the issue, rather than keeping the focus on the REAL issue which is family dynamics. Even clients will get this wrong. When we ask a client, "what is your primary goal," they will sometimes respond "to pay as little tax as possible", to which we respond, "no problem, I can eliminate your tax burden completely. We will just leave everything to charity." After a brief silence followed by the client laughing, we see the truth: who we want to leave it to and how is the primary issue, and THEN doing what we want to do in a tax efficient manner becomes second.

What we appreciate about the estate tax exemption increase is that most people, over 98 percent, will have no estate tax issues and it has had two effects. One, unfortunately, is that many people who have always focused on taxation don't think they need estate planning and the other is that we must now focus on family dynamics and the real concerns of clients in leaving assets to their heirs. As one study concluded, we have for decades prepared the assets for the heirs, now we need to focus on preparing the heirs for the assets.

This is a more difficult conversation, both for the advisor as well as for the client. We are no longer just running numbers, we are talking about soft issues about people and society, personal feelings, and in some cases failings. Sometimes we become successful by not spending as much time with children as we could, giving them guidance that only a parent can provide, and developing a relationship only parents and children can have. In the movie "The Bucket List" we see this emerge with Jack Nicholson's character who, while wildly financially successful, has lost touch with his daughter and as a result his grandchild. This is not something that writing a check will change. As one well-known estate planning attorney queried, "why do you think I can write 4 paragraphs in your will that will make up for 40 years of bad parenting?" Ouch.

So, where does this leave us? There are three key issues to address. One is the client's desired use of the funds by the heirs, the second is the heirs' ability to handle the funds responsibly, and the third is the protection from third party dysfunction like lawsuits, creditors, taxation, and divorce.

First, does the client have the confidence in the heirs to handle the money responsibly, or do they even care if they do? We find most clients perfectly comfortable with their children, whom they feel they raised well and gave a good education and life lessons. So, outright disposition is very often used in estate planning, but even with confidence in the children, issue three related to third party protections should be considered; more on that later. When the client is not confident the children will behave in the manner that they desire, so-called "incentive trust" language can be devised. As long as it does not violate public policy and stays within the bounds of being legal and possible, incentive trusts can provide guidance to heirs by creating a variety of incentives to perform certain behaviors or avoid certain behaviors desired by the client. Examples include not smoking, not using drugs, age attainment, achieving education objectives, or marrying within one's faith, having a prenuptial agreement prior to marriage, and other behaviors. Using an experienced estate planning lawyer will help the client word these issues properly so as to not violate public policy rendering the clause unenforceable or stating it in an overly general manner, such as "$250,000 when he marries" leading to over a dozen marriages in one famous case. This can be a fascinating conversation with clients that helps you to discover their most important concerns.

Second, do the heirs have the capability to handle the assets properly? Special needs trusts for disabled beneficiaries, trusts for minors too young to make their own decisions about money, beneficiaries with a history of drugs, prison, gambling, or uncontrolled spending and debt. Parents naturally want to protect those children who cannot protect themselves, and trusts with discretionary language in the hands of a trustee, sometimes aided by a "letter of wishes" giving insight to the client's concerns can be the right way to structure an inheritance.

Third, is the client concerned about having the beneficiaries and funds protected from third party issues like lawsuits, creditors, taxation, and divorce? If so, trusts often make sense, not because the children can't handle the money, but just the opposite, because they are likely to be so successful on their own that they may have careers in medicine or architecture for example, where lawsuits are common. In addition, their success may mean that, while your client may not have a taxable estate, the children may have one, so why pile money they would pass through to their children on top of their already taxable estate. Using an irrevocable trust, you can have the best of both worlds; available to them if they need it, and not part of their estate nor accessible to their creditors if they don't. This is to say nothing of the fact that we don't know what estate tax will be a generation into the future. With a divorce rate often cited as near 50% it is understandable that many clients might be concerned about the potential erosion of inheritance to divorcing spouses and sometimes going so far as to require prenuptial agreements with certain provisions to protect the trust funds. Business can afford the same issues, when the very behaviors desired by a parent of a child taking risks to pursue a business interest that will provide for them and their family and further some noble purpose or product, yet if the business fails then they could lose their livelihood and the inheritance safety net that could otherwise be shielded from creditors inside a trust.

Philanthropy is a type of inheritance unto itself, yet often structured in a similar manner, giving the beneficiary the gift of giving, rather than the funds for personal use. This can allow the successful child to continue the family legacy and pass it on to their children, can protect those who can't handle money from losing those funds and yet make choices to improve the world around them, and maintain those assets outside the threats of taxation and creditors. What causes does your client support and why are those issues important to them?

Knowing how these issues affect your clients and their estate plans can draw you closer than ever to to them and their families and secure your position as a trusted advisor for them and future generations. The ability to discuss the details of the client's desires and known or potential dysfunction are always central to planning regardless of the effects of estate taxation.