Three Types of Trusts to Plan for Minor Children and Grandchildren

There are certain reasons that establishing an estate plan can be of the utmost importance. Having minor children or grandchildren is one of those reasons. Most parents do not have time to keep up with their own tasks, let alone consider what would happen if they died while their children were still minors, but having a comprehensive plan in place for their children is very important. It can be motivating to know that a well thought-out and carefully drafted plan can last over eighteen years. Most parents have carefully considered what values they want to instill upon their children, but you may not realize that establishing a trust can allow you to essentially parent from beyond the grave. In addition, grandparents may want to provide a lasting gift to their grandchildren but may be unsure of how to make a gift that truly has a lasting impact. Trusts are not a “one size fits all” planning method—in fact, there are different forms of trusts that can help your clients accomplish a variety of goals.

1. Health and Education Exclusion Trust

Every parent wants to provide their child with opportunities, and grandparents also find great value in contributing to the success of their grandchildren. Education is often a major stepping stone to bigger opportunities. Many times, grandparents will want to leave funds for their grandchildren’s education. You and your parents may be unaware of a health and education exclusion trust (HEET). These trusts allow grandparents to set aside funds to be used for their grandchildren’s and other distant descendant’s health and/or education expenses, providing you with the ultimate peace of mind in having the trust cover your children’s educational and healthcare costs.

HEETs can pay for tuition costs at any education level. These trusts can be particularly beneficial for high net worth grandparents, as they can serve the dual purpose of adding a charity as a beneficiary. Additionally, grandparents can avoid generation-skipping transfer (GST) tax liability on funds transferred to the trust. Further GST tax (and gift tax) liability can be avoided on funds disbursed as qualified transfers. *Qualified transfers* are defined as funds that are transferred directly from the trust to the educational institution or medical provider.

2. Incentive Trusts

How likely are children to do the dishes, walk the dog, clean their room, or offer to cook dinner? How much does the likelihood increase when they are offered money to complete these tasks? Most parents would agree that incentivizing young children works like magic. How surprised would you be to learn that even if you are not around, you can continue to guide and motivate your children by incentivizing them from beyond the grave?

Incentive trusts are becoming a popular choice for parents of young children that want their children to achieve certain goals in life. Incentive trusts provide parents with the flexibility to set goals and appropriate rewards through distributions once a child reaches the goal. Parents can set multiple and separate goals for each child.

There are a variety of goals that can be addressed with incentive trusts. Some of the more common goals are achieving a higher education, receiving good grades, starting a business, and maintaining a paying job. As you can imagine, these goals are best defined by you, who knows your children’s abilities and limitations.

Imagining not being a part of your young children's lives can be difficult. However, incentive trusts can offer your children guidance and support if you are unable.

3. Beneficiary-Controlled Trust

You may feel that your children are financially responsible and exercise good judgment, and you may want to avoid giving another individual control of the money you leave them. Even with strong financial management skills, the money left to children is still vulnerable to creditors' claims, divorce, lawsuits, or estate taxes. By using a beneficiary-controlled trust, the risks can be reduced while allowing your children some control over their own trusts. A beneficiary-controlled trust is much like it sounds, in that a trust can be established for a beneficiary, who can also serve as the sole trustee or a co-trustee.

These trusts grant the beneficiary a considerable amount of control over their inheritance while still allowing you to place certain restrictions on its use. When a beneficiary acts as sole trustee, they can be allowed to make distributions based on an ascertainable standard—for example, distributions for the beneficiary's health, education, maintenance, and support (HEMS). In circumstances in which the beneficiary acts as sole trustee, under many states' laws, most creditors cannot reach the beneficiary's interest or compel a distribution when the trust contains the HEMS standard. However, once a distribution has been made to the beneficiary, it may be susceptible to the beneficiary's creditors.

You can save money on the cost of trust administration when your beneficiary serves as the sole trustee. However, there may be benefits to appointing a co-trustee to serve and giving your beneficiary the ability to remove and replace the co-trustee, if necessary.

As you can see, trusts are not "one size fits all." The type of trust you choose can address your specific concerns. It is best to work with a qualified estate planning professional who can analyze your situation and fully discuss your goals in establishing a trust, and ultimately provide you with a comprehensive plan that protects the future of both you and your family.