How Beneficiaries Can Inherit Assets

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INTRODUCTION

There are two primary ways in which you can leave assets to your heirs — outright or in trust. Knowing the difference between these two, and having some knowledge of how trusts can create fences around assets, will assist you in creating an estate plan which ***fulfills your financial goals, protects your heirs, and perpetuates your legacy***.

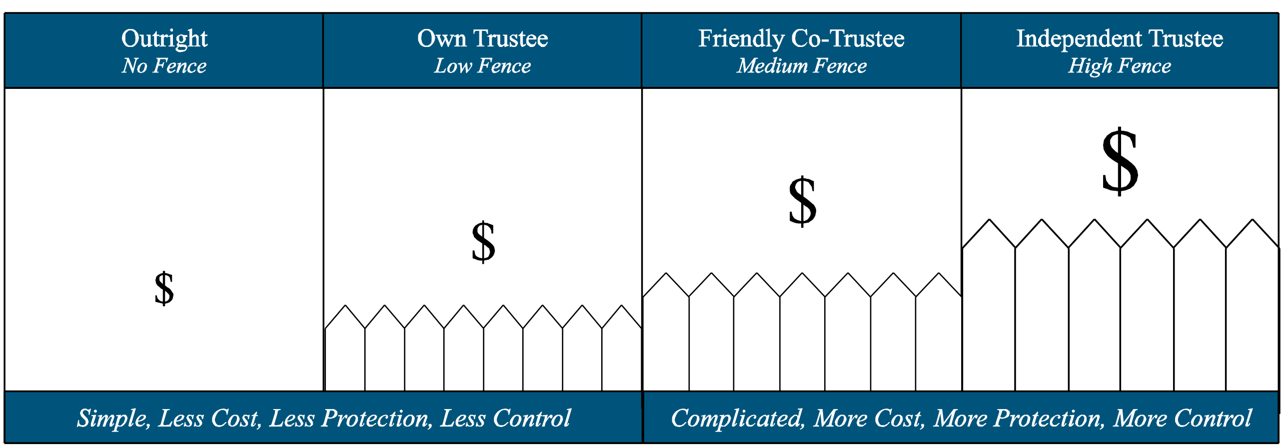
This paper explains a number of ways in which assets can flow to beneficiaries. The list is not exhaustive, but these strategies represent the scope of planning tools applicable in most situations.[1] One or more of these strategies may be appropriate for your plan.

After distinguishing between outright distributions and distributions to trusts, we describe three types of trusts, which can be differentiated based upon the type of trustee.[2] Depending on the type of trustee appointed, you can create a trust with a "low," "medium," or "high" fence, depending on your desire for control and protection of the assets within it.

Simply stated, a beneficiary can inherit assets:

(1) ***Outright***
(2) In trust as one's ***own trustee*** (low fence)
(3) In trust with a ***friendly co-trustee*** (medium fence)
(4) In trust with an ***independent/corporate trustee*** (high fence)

One way to conceptualize these options is on a spectrum, with ***outright*** distribution on one end and an ***independent trustee*** on the other. As you move along the spectrum, both the restrictions on the assets and the protection of the assets increase. At the same time, the administrative, cost, and compliance burdens go up as well.



[1] The planning concepts discussed in this paper constitute neither legal nor tax advice. When doing any estate planning, it is critical that you speak with a licensed attorney. This paper merely presents a big-picture discussion regarding certain factors to consider when doing estate planning.
[2] Note that there are many other factors that can impact how a trust operates; however, they are beyond the scope of this paper.

OUTRIGHT DISTRIBUTIONS

The reason to choose an ***outright*** distribution is because of its simplicity and low cost. In this scenario, your beneficiary receives assets in his or her own name with no restrictions and with no strings attached. *There is nothing connecting the assets back to their source that would prevent your beneficiary from spending the inheritance all at once, and there is no protection for your beneficiary from creditors.* There may be limited protection in the case of divorce, but this is dependent upon the beneficiary maintaining the inheritance as separate property.

DISTRIBTUTIONS IN TRUST

A reason to choose a ***trust*** is that it creates a "fence" around certain assets. Among other things, a trust can help ensure that:

- Assets are distributed to beneficiaries in a controlled, thoughtful, and prudent manner
- Assets are segregated in a manner that may offer more protection in case of a divorce
- In certain circumstances, trusts can offer protection from creditors
- Trusts can add some assurance that funds will remain within a family's bloodline and flow to children, grandchildren and other descendants, rather than flowing outside of a family
- A connection is created between the source of the funds and the beneficiary

Trusts can also provide tax planning and other benefits, as in the case of a life insurance or supplemental needs trust. If you would like more information about these options we encourage you to speak with your financial planner or estate planning attorney.

How High a Fence?

The height of your fence depends on the level of control you want to exert on your beneficiaries, as well as the amount of protection you want to provide.

Low Fence
A ***low fence*** provides the least control, but also allows for the most flexibility and ease of administration. In most instances a ***low fence*** is more of a "decorative fence"; it is there for the beneficiary to see, but there is really nothing preventing him or her from stepping right over it or tearing it down. If you have financially responsible adult beneficiaries, then this type of trust may be appropriate for you.

Medium Fence
A slightly higher, medium fence is one where a co-trustee is named to help the beneficiary manage trust assets and whose input is needed for making discretionary distributions from the trust. This co-trustee can be a trusted friend or another family member.[3] This co-trustee may be persuaded by the beneficiary to act, but the hope is that he or she would act as a voice of conscience and reason with respect to trust assets. Depending on who the co-trustee is and what provisions the trust provides for appointing and removing this individual, this fence may be thought of as one that is not impossible to scale, but will significantly slow down anyone who is trying to bypass it. Whether it is the beneficiary trying to get assets, or an outsider trying to access the funds of the trust, one would need to stop and think before trying to climb the fence around this trust.. If you are uncertain about your beneficiaries' creditor issues, or have beneficiaries who are not yet mature enough to handle assets on their own, then a medium fence may be appropriate.

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[3] The type of relationship between the beneficiary and the trustee may have tax or other implications, and the selection of this trustee should be made with the assistance of your estate planning attorney.

High Fence

Finally, as the name implies, the high fence provides the most protection and control, but also has the highest administrative burden. The main feature of this trust is an ***independent trustee***. An independent trustee is a non-related individual or an institution who has sole authority to make decisions about trust distributions (and often will make all decisions regarding the investment of trust assets as well). If there are foreseeable creditor concerns, if a beneficiary cannot be trusted to handle or manage assets, or if a trust owns a unique asset such as a family business, then a high-fence trust may be appropriate for your situation. This is because it is very difficult for a creditor or a beneficiary to tear down this type of trust and get access to the funds within it.

Just because there is a high fence, however, does not mean that distributions cannot be made. As the creator, or grantor, of a trust, you can instruct the trustee to make distributions for certain items or at specific times. For example, a trustee could be required to distribute funds to a beneficiary for education, a wedding, starting a business, a down payment on a home, or at a specified age.

Other Considerations:

Regardless of how restrictive or permissive a trust is, it reinforces the connection between the grantor, who created the trust, and the beneficiary. Thus a trust can serve as both a carrot and a stick. The stick is intended to dissuade a beneficiary from spending inherited assets in a way that is inconsistent with a family's values. The carrot empowers a beneficiary to use trust assets to perpetuate the grantor's legacy.

The low-, medium-, and high-fence models can also be used together to create a system for giving increasing control to a beneficiary over time, as he or she grows and matures. For example, an independent trustee may be encouraged to make small distributions to a young beneficiary so that he or she can learn about managing money and demonstrate some financial responsibility. At a set age, a beneficiary may be invited to participate in making investment decisions over trust assets. Periodically, a beneficiary may be permitted to withdraw a fixed amount of assets from the trust. Or, the beneficiary may serve as a co-trustee and then eventually be able to serve as his or her own trustee, when ready.

WHICH STYLE IS RIGHT FOR YOU AND YOUR FAMILY?

Choosing which type of inheritance is right for you and your family depends upon many factors, including the age of your children, their experience managing money, and your desire for creating a legacy, among others. You may know what you want and be able to make a decision quickly. Or you may want to further educate yourself about the options, discussing them with your children or other beneficiaries and consulting with Affiance, your attorney, and other trusted advisors.

There is no single right answer, and the options are actually much broader than those described in this short paper. Starting the conversation, however, is often the most challenging part of the process. Spending time thinking and discussing some initial options can help create clarity, both for your plan today and for your heirs in the future, giving them awareness and appreciation for the intentionality that went into your plan for passing on wealth to future generations.

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