A useful strategy for sharing your family's values

An incentive trust is a conditional wealth transfer designed to elicit certain behaviors from a beneficiary in order to receive parts of their inheritance. These trusts are often put in place when there are concerns that a large inheritance could harm the beneficiary in some way or discourage them from leading productive lives knowing they are financially well-off. It's an extension of your values, offering incentive to encourage a beneficiary to step into his or her role as the financial steward of your family's wealth.

Instead of using traditional trust distribution methods, which are generally based on the beneficiary reaching a certain age, distributions from incentive trusts are carefully planned in a way that motivates positive behaviors and reinforces certain values.

The incentives or stipulations that can be put in place are wide-ranging and can be designed to influence the beneficiary's choices for education, career or personal behavior and values. For example:

- If a parent is concerned about a child's spending habits, they might include a provision that requires the trustee to make distributions that match the child's annual savings, rather than their earned income.
- If a child or grandchild has a history of substance abuse, their trust may include a requirement that they remain sober for a certain period of time before receiving funds.
- A parent might include a provision that directs a trustee to make distributions to a child who joins the family business, enters into a certain field of work or starts their own business.
- Parents or grandparents might make provisions for additional distributions to supplement a relatively low income should a child choose a career in public service, religion or with a charitable organization.
- Incentives for distributions could also include earning undergraduate or graduate degrees or volunteering a certain number of hours for a charitable organization.

While you can customize an incentive trust to your wishes, it's important to carefully define your chosen provisions and consider their long-term outcomes so they don't unintentionally backfire. For example, say you set a provision which would distribute funds upon college graduation – but your beneficiary gets in an accident and is unable to finish school? Or, requiring them to enter the family business could keep them from pursuing their true professional interests. Since you can't see into the future, retaining some degree of flexibility will help you avoid running into unexpected conflicts.

BENEFITS OF INCENTIVE TRUSTS

A vehicle to pass both wealth and family values to your loved ones

Serves as an opportunity to motivate positive behaviors of your beneficiaries

Enables you to promote a healthy lifestyle or philanthropic endeavors

NEXT STEPS

Before implementing an incentive trust in your estate plan, be sure to consider all the factors at hand.

- Consider your values of financial stewardship, work ethic, philanthropy or others which you most want to instill in your beneficiaries. How could these be incorporated in an incentive trust?
- Have a conversation with your loved ones about both your wishes for the future and theirs.
- Talk to your financial advisor to learn their recommendations and best practices for utilizing an incentive trust.

Your financial advisor can work closely with you alongside your legal and tax professionals to provide additional guidance for setting up an incentive trust and addressing each of your estate planning needs and goals.

Preserving your family values

INCENTIVE TRUSTS ENCOURAGE POSITIVE BEHAVIORS TO CREATE A BRIGHTER FUTURE FOR YOUR HEIRS

As Harry and Sally considered their wishes for their estate, they knew they wanted to leave the majority of their considerable wealth to their son. However, they were concerned that doing so would deter Tyler from working hard in school and finding a career he was passionate about. As a freshman in college, Tyler focused more on the social aspects – especially parties – of school instead of academics, and the last thing his parents wanted was to fund a lifestyle that would harm him in the long run. Rather, they wanted to find a way to motivate Tyler to take school, his future and the eventual responsibility of significant wealth seriously.

Hoping to reinforce healthy actions rather than enable bad habits, Harry and Sally opted for an incentive trust on the recommendation of their advisor. In the trust documents, they were able to stipulate certain milestones that would lead to payouts for Tyler, including bonuses for earning an undergraduate degree and gaining long-term employment. They decided additional distributions would take place each year he was employed, with the remainder of the trust distributed when he reached age 37.

Of everything they'd pass to their son, Harry and Sally ranked their values highest. As they continued to instill their work ethic and share their values of financial stewardship and integrity with Tyler, they were grateful to have found a financial vehicle that aligned with their efforts and goals.

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This case study is for illustrative purposes only. Individual cases will vary. Any information is not a complete summary or statement of all available data and does not constitute a recommendation. Prior to making any decisions, you should consult with your financial advisor about your individual situation.

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