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Offset the Effects of Inherited Wealth WITH INCENTIVES

For many affluent individuals, estate planning extends well beyond tax planning and involves very personal decisions about the distribution of future wealth. In more traditional estate plans, the **spendthrift trust** is used as a vehicle for distributing trust income, while limiting immediate access to trust principal.

A spendthrift trust can help provide a financial head start for minor children and protect adult heirs from certain creditors and limitations in financial judgment. However, such trusts may provide heirs with little incentive to expand their own professional, academic, or philanthropic horizons. Thus, affluent individuals who are particularly sensitive to the potential ramifications of "handing over" considerable wealth to heirs may choose to establish an *incentive-based* estate plan.

One of the cornerstones of an incentive-based estate plan is the **family incentive trust (FIT)**. Like typical trusts associated with estate planning, a FIT helps trustees implement an affluent grantor's expectations about the uses of his or her estate. Similarly, a FIT can help ensure proper care and financial support if an heir falls on hard times or has special needs. However, a FIT is somewhat unique in that the general distribution of trust income is based on a series of predetermined "incentives."

Promoting Success and Reinforcing Values

The incentives outlined in a FIT are at the discretion of the grantor. Each incentive provides the grantor with the opportunity to encourage specific future behavior. For instance, the trust could have provisions that pay each heir $10,000 on acquiring a bachelor's degree, $25,000 for a master's degree, and $50,000 for a doctorate. A FIT can also be an ideal tool to reward family members who pursue and/or distinguish themselves in a career path of the grantor's choosing, such as the family business, music, the arts, research, or teaching. A FIT can reward younger heirs for

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Optimism About the Economy SHOWS SIGNS OF DECLINING

The level of optimism about the outlook for the U.S. economy declined among business executives in the fourth quarter of 2018, but most of these leaders continue to hold a strongly positive view of their own company's prospects, the results of a quarterly survey of executives and senior financial managers at U.S. companies conducted by the American Institute of CPAs (AICPA) indicated.

The survey, which was conducted November 7-28, 2018, included 938 responses from certified public accountants who hold a leadership position in their company, such as CEO, CFO, or controller. While 57% of survey respondents expressed optimism about the U.S. economy over the next 12 months, researchers noted that this share was down 12 percentage points from last quarter, and represents a steep decline from the post-recession high of 79% set at the start of 2018.

When the respondents who said they have a negative view of the U.S. economy were asked about their reasons for pessimism, they cited concerns about trade issues, rising interest rates, the U.S. deficit, and underlying issues such as corporate and personal debt levels. Meanwhile, the respondents who expressed optimism tended to cite the continued strength of a broad range of economic indicators.

However, when asked about the outlook for their own company, the share of respondents who reported having an optimistic outlook held relatively steady at 69%, down just a single percentage point from the third quarter. Similarly, the percentage of survey respondents who said they expect their company to expand in the next 12 months fell only slightly, from 70% to 67%. Researchers pointed out that from a historical perspective, this rate remains high.

The results of the fourth quarter survey also indicated that the availability of skilled personnel is the top challenge respondents face, followed by employee and benefit costs. Almost half of respondents (48%) said they plan salary, wage, or commission increases in the next 12 months to improve their company's chances of recruiting and retaining employees in the tight labor market, while 18% said they intend to improve their company's benefits. A majority (62%) of respondents who said they plan to increase compensation indicated that they expect the increases to be in the 3% to 5% range.

In addition, the survey showed that hiring plans continue to be strong, although many of the executives reported facing a scarcity of candidates with the right skills and experience. Around half of respondents said their company currently has the right number of employees. Of the 42% of respondents who indicated that their company has too few employees, 14% reported they are reluctant to hire, while 28% said they intend to start hiring immediately. **20/20**

Real Estate: A FORM OF CHARITABLE GIVING

When thoroughly screened and properly structured, real estate gifts can help donors meet their financial planning and philanthropic goals, while providing charities with a fresh source of funding.

Although real estate holdings make up a significant share of the assets for U.S. households, only a small proportion of charitable contributions take the form of land or buildings. Many people who own surplus real estate may prefer to donate their appreciated property to charity rather than sell the property themselves, especially if their goal is to minimize taxes or generate retirement income. Because real estate gifts are more complex and costly for charities to process and manage than cash donations, it is important to consider donating to charitable organizations with a clear set of gift acceptance policies and procedures in place.

Prospective donors should look for policy guidelines that outline the types of properties that will and will not be accepted, such as residential, commercial, or undeveloped land. The types of estate planning structures that donors may use when making these gifts should also be stated, such as charitable remainder trusts, charitable gift annuities, and retained life

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OFFSET THE EFFECTS OF INHERITED WEALTH WITH INCENTIVES

academic success or community involvement. In addition, the trust can match certain levels of income for heirs who are younger than a specified age.

A FIT may also be an appropriate vehicle for education funding. Unlike a custodial account, which generally becomes the property of the child once he or she attains the age of majority (determined by state law), a FIT can dictate that some trust assets be used to help cover education costs. Thus, the trust—rather than a young, inexperienced adult—can maintain control of monies earmarked for education.

Another interesting use of a FIT is treating the trust principal as a "family bank." The FIT can offer low-interest-rate loans for start-up business ventures or the purchase of a primary residence. To minimize risk to the trust, a lending process similar to that of a traditional lending institution can be established.

Philanthropy creates another possibility for an incentive-based estate plan. Certainly, many affluent individuals consider philanthropic pursuits to be important endeavors. A FIT can be used to match the charitable contributions of a beneficiary. Also, the FIT's matching contribution can be arranged as a distribution to the beneficiary, who then contributes it to the charity. Thus, the beneficiary can reap the benefits of a charitable deduction for his or her contribution, as well as the FIT's matching contribution. As an alternative, any remaining trust income that has not been distributed through incentives may be used to make a charitable contribution. Such contributions can also be arranged to be made on behalf of trust beneficiaries.

Sometimes, inherited wealth can have a negative impact on the motivation of heirs. For instance, when some heirs receive a substantial inheritance, they may be content with a life of leisure. Thus, the reasoning behind incentive-based estate planning is fairly straightforward. Assets and income are distributed to assist heirs who are realizing career or academic goals and/or whose actions are consistent with the expectations of an affluent grantor. By adopting some of the principles of incentive-based estate planning, the affluent grantor can promote a family legacy of excellence and productivity for generations to come. **20/20**

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REAL ESTATE: A FORM OF CHARITABLE GIVING

estates. In addition, find out if there are stipulations on the charity's acceptance of properties that come with mortgages or other risk factors.

How It Works

After a real estate gift has been approved on a preliminary basis by a charity, the donor may then be asked to provide more complete information about the property. This due diligence phase generally includes an investigation of the title with the help of a real estate attorney, assessments of the local market and environmental conditions, a professional inspection, and a site visit by the organization's representative. Typically, the charitable organization covers the costs of conducting these studies. After the due diligence has been completed and the charity has agreed to accept the gift, the donor would be notified of the findings of the investigations, and of plans for how the final transfer of the property will occur.

When considering charitable gifts of real estate, there are multiple advantages for donors, including generating income, deferring or lowering taxes, and eliminating ongoing expenses of property maintenance. Be sure to consult your tax professional for more information about real estate contributions to charities. **20/20**

The Changing Face of America:

DUAL INCOME FAMILIES

The concept of the "traditional" American family is continually changing. The dual income family—with both spouses maintaining separate careers and contributing to the financial success of the household—has now become commonplace.

The economic challenges and opportunities of this century may often require two incomes to meet overall family expenses. Many families ask themselves, "How will we be able to plan for our retirement, save for our children's education, and perhaps help our aging parents deal with some of their financial burdens?" These concerns may be especially pressing given today's high cost of living and the current economic climate.

The Cost of Working

Although it may seem that dual income families will have more disposable income to afford life's necessities, this may not always be the case. Families with both spouses working often lose some portion of the second paycheck to extra expenses, such as unreimbursed childcare, domestic help, job-related transportation, business attire and dry cleaning, lunches and dinners at restaurants, and take-out meals. These additional, daily expenses all eat away at that second income.

When both parents work outside the home, childcare concerns are especially critical. Quality childcare is a major expense for many families with working parents—after housing, food, and taxes. It is this cost that often reduces the income that could be used to help fund education or retirement.

As American businesses continue to restructure and downsize, some dual income families may face the possibility of living on a single or reduced income for an unspecified period of time. For those who need the additional income to help pay for basic expenses, a loss or reduction of one income could have a serious impact on the family finances.

Protecting Your Family's Future

How would your family protect its income if either working parent should die or become disabled? One solution may be to purchase a permanent life insurance policy that will pay a death benefit upon the death of the insured spouse. There are several advantages to life insurance plans: For example, policies bought at a younger age may have lower premiums, and some policies maintain level premiums and build cash value.

Generally, the cost for life insurance policies is lower when purchased relatively early in life. However, it is important to re-evaluate insurance coverage as time goes on and circumstances change. The protection that life insurance policies provide for dual income families can best be calculated by periodically analyzing all life insurance needs in order to determine the best plan for your family.

Now, what about loss of family income due to disability? This possibility is not as unlikely as you might think. According to the Social Security Administration*, studies show that just over 1 in 4 of today's 20 year-olds will become disabled before reaching age 67.

A debilitating illness or injury that eliminates or reduces your family's primary source of income can be financially devastating. An individual disability income insurance policy to help replace a portion of those lost dollars would be a worthwhile consideration.

Dual income families have become a fixture in today's society. Although individuals may have different motives for working, most families come to depend upon that second income, whether it is used to meet current or future needs. Thus, it is important to ensure that both spousal incomes are protected from loss with life and disability income insurance. **20/20**

*Source: Social Security Administration, 2018. http://www.ssa.gov/dibplan/