

Structuring an Inheritance

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Planning how to leave your assets to your intended beneficiaries is often as important as what assets you leave them. However, understanding your options can be overwhelming. In general, there are five main categories of how to structure an inheritance for individual beneficiaries:

1. Outright Distribution

Beneficiaries who receive their inheritance outright become the legal owners of the subject property upon the benefactor's death. While perfectly appropriate for mature, responsible beneficiaries, this format does not work well for younger, maturing beneficiaries or adult beneficiaries who may need some assistance managing their assets. However, when used for minor beneficiaries, this format will result in need for a guardianship of the estate of the minor beneficiary - typically with the beneficiary receiving full outright ownership at age 18 or 21.

2. Hold Assets in Trust, and Distribute at a Certain Age or Upon the Occurrence of a Certain Event

It is very common to retain assets in trust and defer a younger beneficiary's control over inheritance until he or she reaches a certain age or until the occurrence of a particular event. This structure is often preferable to an outright distribution in the case of young beneficiaries, because it prevents the beneficiary from having too much control over the inherited property until he or she is more capable of assuming stewardship over the property. This option is also helpful when planning for adult beneficiaries who have difficulties managing assets or maybe are experiencing creditor issues or going through a divorce.

3. Hold Assets in Trust, and Allow Beneficiary to Withdraw at a Certain Age or Event

Under this option, rather than direct a distribution of trust assets be made at a certain age or upon a particular event, the beneficiary is given a right to withdraw certain trust assets at such time. Similar to the previous option, this trust structure protects a beneficiary from having too much control over his or her inheritance until he or she is more likely to be able to manage it properly. However, withdrawal rights have one distinct advantage over required distributions: if the beneficiary is unable to manage his or her inheritance due to an incapacity, the trust may continue for the beneficiary past the set age or after the occurrence of the event without the need for a guardianship of the estate. Given the limitations in our guardianship law, this is a significant advantage should an incapacity occur.

4. Hold Assets in Trust, but Stage the Distributions or Withdrawal Rights

Perhaps the most common structure in trust documents, this structure allows a beneficiary staggered access to trust funds (e.g., 1/2 at age 30 and the balance at age 35). The theory behind this structure is that if the beneficiary deals poorly with the first portion of the inheritance, the beneficiary will learn from the experience and deal better with the second portion. While many people like this strategy, it is possible that this structure would allow the beneficiary to make poor choices and be "bailed out" by the availability of the second portion of the inheritance. While both possibilities need to be considered, the potential positive results of this strategy and the protection it affords often make may suggest that the staggered approach is preferable to an "all at once" approach.

5. Continuing Trusts

The final option is maintaining the trust structure for a beneficiary's lifetime. This structure allows the trust funds to be used for the benefit of the beneficiary during his or her lifetime without ever transferring assets to him or her outright. While in the past this structure was reserved for beneficiaries with creditor problems, there are a number of reasons why this structure has become more appealing for many clients. These reasons include:

Divorce Protection - Many clients are concerned with the potential impact a beneficiary's divorce will have on his or her inheritance. Although many states (including Wisconsin) presume inherited assets to be individual property, most divorce courts are not prevented from partitioning such assets. And, in fact, because many beneficiaries blend inherited assets with other assets of the marriage, it may be impossible to trace such inherited assets to determine what assets are not subject to division. Prenuptial agreements can alleviate some of these problems, but many beneficiaries are reluctant to execute these agreements, particularly in first marriages. Lifetime trusts can provide protection in these situations.

Protection from Loss Due to Remarriage - Keeping assets in trust may also help insure that your family retains the benefit of the inherited property. If, for example, an heir that received his or her inheritance dies, it is not uncommon for that heir to direct his or her property be given to the heir's spouse. If that spouse has children from a prior relationship or remarriage, there is a significant risk that some or all of the inherited property will be directed away from the family at the spouse's death, if not before. However, a lifetime trust would allow you to direct what happens to the trust assets upon the heir's death.

Creditor Protection - Another method an heir can be separated from his or her inheritance is a lawsuit or other legal action by his or her creditors (e.g. the litigation resulting from a beneficiary's involvement in an automobile accident for which he is proven liable for the injuries of another party). If the beneficiary does not have adequate insurance, the injured party can lay claim to that beneficiary's personal assets. Assets distributed, withdrawn or available to be withdrawn are reachable by the injured party – assets kept in trust, however, are not.

Tax Protection - More and more individuals are concerned about the tax implications of leaving and receiving an inheritance. While trust planning to reduce estate practices has been common for decades, many people need a better understanding of the potential transfer tax savings for the family as a whole that are available with extended trust planning.

Which of the above structures works best for a client depends on many factors, including family dynamics, the economic and personal circumstances of the intended beneficiaries, and the amount and type of assets. A qualified estate planning attorney can assist the client in evaluating these options and recommend and implement an appropriate plan based on the client's objectives.

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