How to "Help" Family

Planning for an inheritance for family is a great idea. Most parents, aunts and uncles have many objectives for family. Today we are going to discuss the different ways that a benefit is transferred to children, grandchildren, nephews and nieces. As you will see, these benefits are both in the area of values and of property.

Family "Help"

There are several benefits that parents provide for children. First, all parents would like their children to acquire the characteristics of good behavior. The ability to behave well in any situation is a great benefit for a child both in school and in the workplace. Children who understand the basic principles of good behavior will advance much more quickly in life.

Second, we would like our children to be responsible and capable citizens. Consider the case of mother eagle and her eaglets. While the eaglets are in the nest, mother eagle will provide care and bring food to the eaglets. However, at some point the eaglet leaves the nest and becomes a mature eagle. The eaglet must learn skills and possess initiative so that life as an eagle is successful. An eagle lives out in the challenging world and will need to have the appropriate skills and initiative to take responsibility for itself. Similarly, parents can provide education, care, training, love and support while children are in the home. However, like the eaglet, the children eventually need to learn to live responsibly. This is an essential characteristic of a successful life.

Third, a parent is able to provide resources. Initially, parents are able to assist children with the costs of education. This is one of the best inheritance plans because education will help the child for his or her lifetime. Later, parents are able to provide additional resources that will assist the child. As we will see, a primary goal is to provide resources in a way that does not interfere with the ability of the child to have good behavior and personal responsibility.

Family

- **Father**
  Successful business owner
- **Mother**
  Career and family
- **Three children**
  On their way

Family

Our hypothetical family includes a father who is a successful business owner. He is now at retirement age. Through diligent efforts, he and his wife have accumulated a significant estate.

Mother has also focused on a career, but she has divided her time between career and family. She is particularly interested in ways that the inheritance plan can continue the process of building good values within the children while providing economic resources.

There are three children in our hypothetical family. They now are in their 30s and 40s and have all embarked on their various careers. Two of the three also are married and are building families.

Surviving Spouse

There are several objectives for the surviving spouse. He or she plans to live in the family home. There should be a sufficient amount of liquid assets. Normally, these will be mutual funds, CDs or money market funds. Because of the potential for medical and long-term care costs over a lifetime, it is helpful if by this point the parents are debt-free and the surviving spouse will own the home plus sufficient liquid assets. A starting point for the liquid assets could be $300,000, but that number varies greatly dependent upon income, lifestyle and health. If the parents have long-term care insurance, this $300,000 may be deemed sufficient by them and their financial advisors. However, if they are self-insuring for long-term care, the reserve number may be larger.

The surviving spouse should have sufficient income for the chosen lifestyle. If he or she owns the home and is debt-free at that point, a moderate income may be sufficient.

Finally, there should be a "sleep well" plan. The surviving spouse should rest comfortably at night knowing that his or her needs will be met in an appropriate manner.

Inheritance for Children

After both spouses pass away, there probably will be sufficient assets to provide a good inheritance for children. For parents who have built up a sufficient estate, there are two basic options for this inheritance plan.

Plan "A" is to provide "Added Economic Security." With this plan, parents expect the children to be responsible citizens, to have jobs, an IRA or other retirement plan and to have made some provision for themselves. The parents would like to provide an additional level of security, particularly during the child's retirement years.

Plan "B" is "Provide Everything" for the child. The parent thinks, "I worked very hard for everything, but I don't want the children to have to work if they don't want to." This is a feeling that some parents have and they have resources to provide sufficiently for children that the child does not need any other savings or income.

This is America and parents may freely choose either option. While most will choose the "Added Economic Security" option, parents are free to make either decision. It is helpful for parents to give consideration to this question before they meet with their attorney and other advisors to actually write a will or living trust. Making a general decision about the purpose of the inheritance will be very helpful to both the parents and their advisors.

Goals for Children – I & I

The two basic goals most parents have for the inheritance plan is to facilitate passage of the twin I's – Integrity and Initiative. If the plan is successful in facilitating passage of those two characteristics, it is a good estate plan. If the plan fails in those two areas, even an inheritance of millions of dollars will not achieve a good purpose

One principle that may be helpful is to discuss the good inheritance. Attorney Charles Schultz stated, "A good inheritance is designed to help the child to be a better person."

We don't give an inheritance to make our children worse persons. We give an inheritance to help our children be better persons. As we will see, the manner in which we give that inheritance can have sufficient impact on whether the child becomes a better person. A good inheritance plan has the goal of facilitating the passage of "Integrity and Initiative."

Responsible Child Plan

What are some of the characteristics of a responsible child?

First, the greatest gift a parent can provide to a child is the love, approval and affirmation of the parents. Many children would gladly trade their entire financial inheritance for this level of love, approval and affirmation.

Second, most parents find that sending a large check to a child, particularly a younger child, is not a good plan. There are thousands of cases where children received a lump sum. While some were responsible and invested, far too many younger children spent their inheritance within 18 months.

At the end of that 18 month period, a child who spent his inheritance might be asked the question, "Where did it go?"

The child typically responds, "Well, I spent it on boats, cars and vacations and wasted the rest!"

A responsible child plan also includes the expectation that children will make some provision for their own needs. While the parent plans to provide some additional economic security, this works best if the child has employment, regular income and made some plans for his or her retirement.

How to Benefit Children

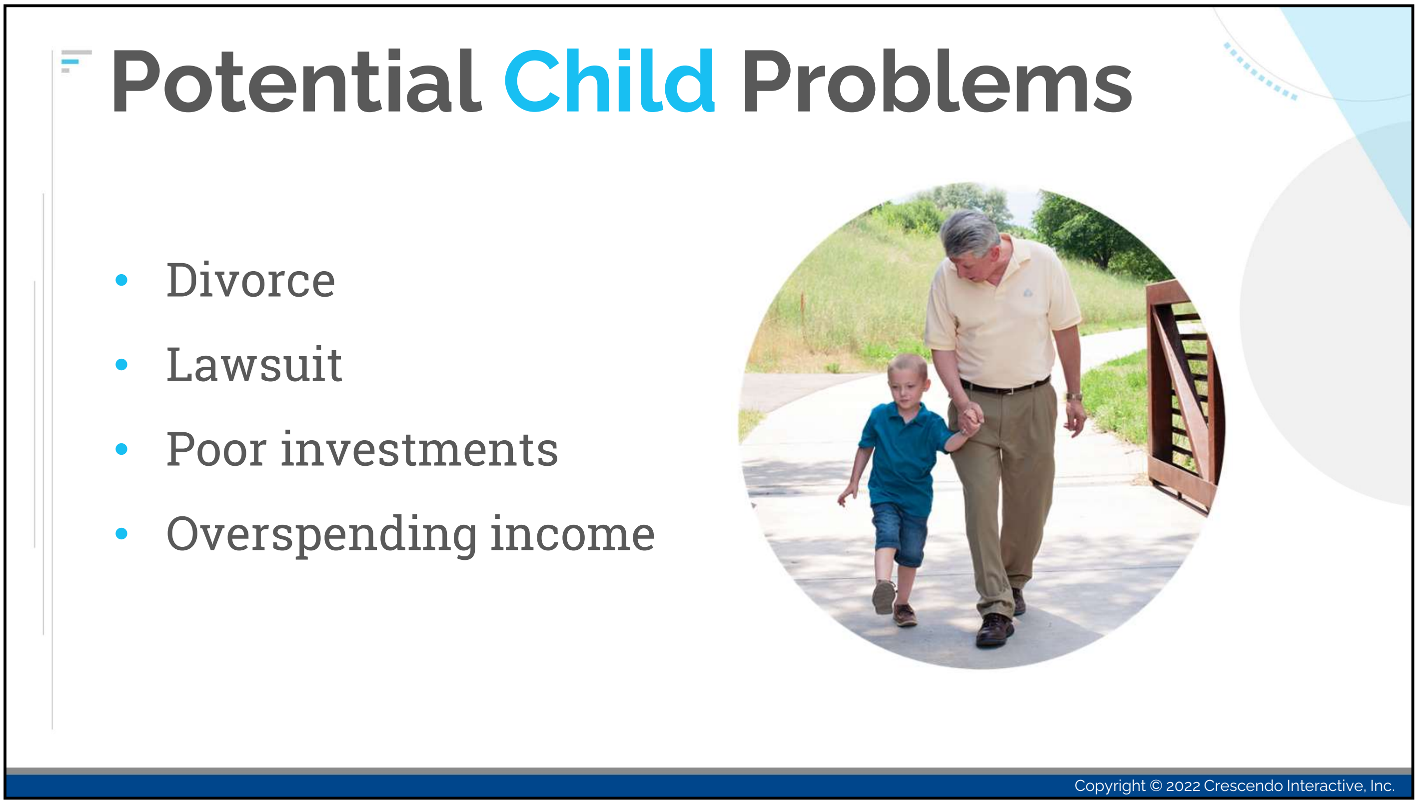
There will be different perspectives on the part of children. Some will be very diligent and faithful at saving and investing. Some will be borderline. And, inevitably, there will be the "creative" child. If he or she receives a substantial sum, it will be spent creatively in three weeks.

However, for all of these different children, there are some general principles for a sound inheritance plan.

First, it is desirable to provide additional retirement income. A supplementary retirement income plan increases the security of the child. The children will always have a roof over their heads, food, clothing and be able to purchase their Medigap insurance. The income benefit could potentially cover ages 50 to 90, so this may be appropriate over a fairly lengthy period of time.

It is desirable to provide inflation protection and modest investment risk. Most financial planners suggest that a withdrawal rate of approximately 4% will provide a high level of economic security and reduce risk that a person will "run out of money" before the end of his or her lifetime. Therefore, a withdrawal rate of perhaps 5% may be contemplated, but that is the highest rate that makes good financial sense.

The other concern is to reduce investment risk. This is typically done by funding a portfolio that has a substantial fixed income component with the balance in equity funds. A portfolio of index funds with the equities diversified between domestic and foreign, small, midcap and large cap mutual funds is desirable. This stock-bond portfolio with appropriate diversification provides the best possible protection against the inevitable ups and downs of the marketplace.



Potential Child Problems

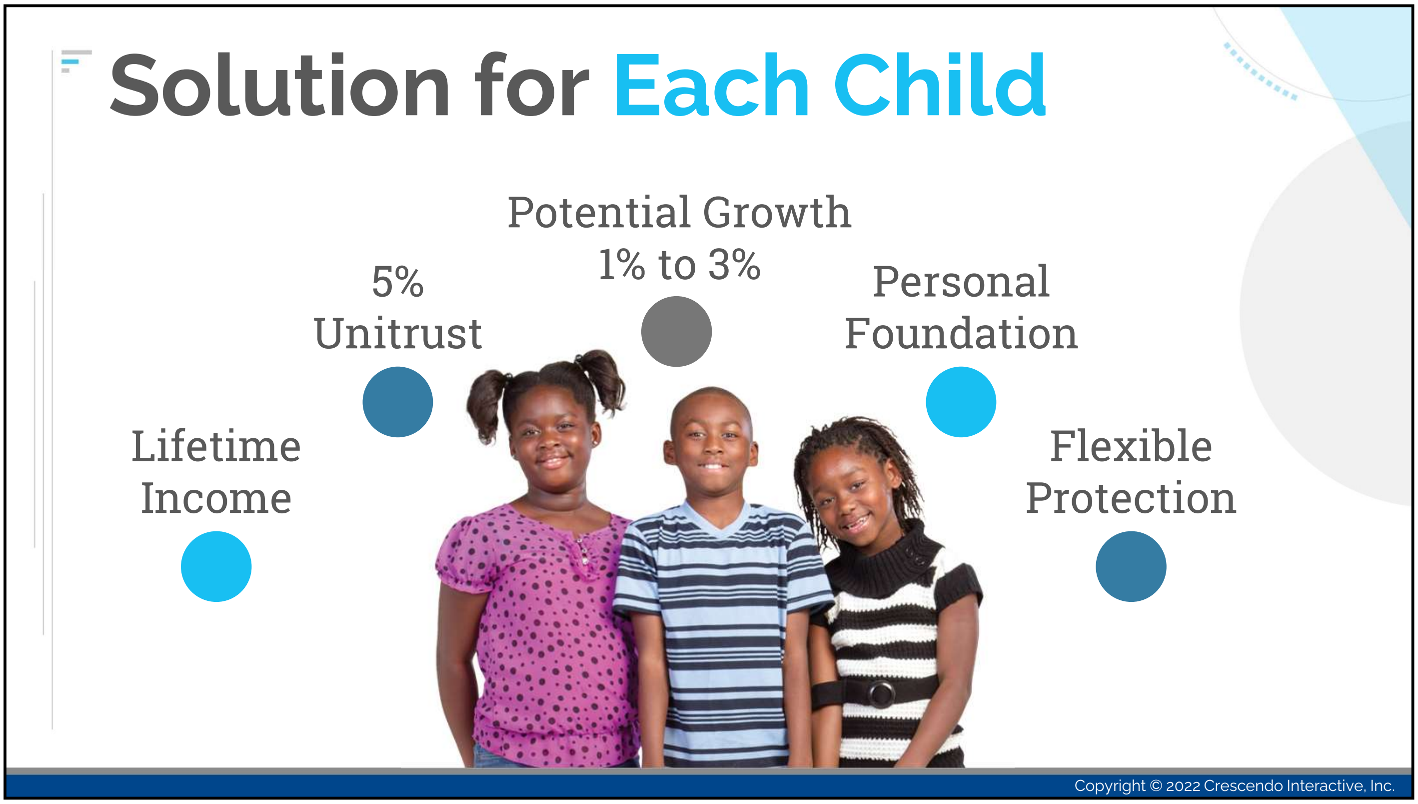
While a parent cannot know the future, there are some obvious potential icebergs in the path of the child's ship. The first is a divorce. In both common law and community property states, an inheritance transferred to a child that is comingled with other assets will give the spouse a claim on that asset. Generally, inheritance from a parent that is kept separate, such as income from a trust, is not subject to the claims of the spouse.

Second, we live in a litigious society. There are lawsuits over every conceivable issue. While auto, home and umbrella insurance are helpful, it is always possible for a child to be involved in a lawsuit. By entering into a business transaction, a child could eventually face a lawsuit with a large judgment. It would be desirable to reduce the risk that the child would lose his or her financial security through a lawsuit.

Children are human. The investment world realizes that the majority of investors who regularly buy and sell stocks have fairly poor results. Far too often, the investor will buy at the peak and sell at the low. Similarly, many individuals have purchased real estate at high levels and, in the ensuing crash, experienced great losses. Even responsible children could make serious investment mistakes and suffer major losses.

Finally, the problem the "creative child" has is overspending. As Ben Franklin noted, spending less than you make leads to happiness, while spending more than your income leads to great sadness.

Parents hope to raise responsible children who don't face these issues, but the potential is always there for some of these problems to occur. A good inheritance plan tries to protect the children to the extent legally possible and reduce the risk of a bad result.



Solution for Each Child

If we wish to provide "added economic security," then a great solution is to provide lifetime income. A 5% charitable remainder unitrust provides that income while giving substantial protection against all of the previously-outlined potential problems. Assuming a 40% fixed and 60% equities index fund portfolio with modest cost for investment and trustee fees, there may be potential growth of 1% to 3%. That is, the trust will be able to pay the 5% to the child and experience some growth. Because this may be a very long-term trust, this growth may offset part or all of future inflation. This protection against inflation is an important aspect of this plan.

If the children have substantial income, it may save hundreds of thousands of future income tax to set up a flex-FLIP unitrust. The flex-FLIP unitrust is a net income plus make up trust that includes one nonmarketable asset. During the early years of the existence of the trust, it may be invested for growth. Because the growth is tax-free inside the trust (somewhat like a qualified IRA or other retirement plan), the trust can increase substantially in value. Only the actual earnings of the trust, regardless how small, are required to be distributed and taxed each year.

When the child retires or when the first spouse passes away, the decision may be made to change to a standard 5% payout. The nonmarketable asset (that could be a city lot or even a diamond) is sold and on the next January 1, the trust becomes a standard 5% payout charitable trust. The ability to build up substantial principal tax free and later convert the larger principal to a 5% payout could save hundreds of thousands of income tax in a large trust. If the child has a substantial income and is in a high tax bracket, the flex-FLIP unitrust is a very wise tax-saving strategy.

Another option is to put a provision in the trust that allows the child to make a gift of part of the trust principal to charity on December 31 of any year. This method has been used to allow a unitrust to act as a "Personal Foundation." In the years when the trust has substantial growth, the child may direct the trustee to make a December 31 gift to charity. If there is a vested remainder interest, then the income interest is normally given to that same charity. If the child has the right to designate the charity for part or all of the trust principal, then that portion of the gift may go to the designated charity.

The child who makes this gift will receive a charitable income tax deduction for the value of the transferred income interest, because that is what he or she actually owns in the trust. However, this could be a great way for children to receive a charitable deduction and benefit charities currently with a portion of their trust. For that reason, this "Personal Foundation" is a very low-cost method for a child to have a charitable fund and make annual gifts.

The final benefit is flexible protection. For the creative child, it may be desirable to have both a unitrust and a non-charitable trust with a family advisor as trustee who has discretionary distribution power. However, even the creative child will receive the majority of his or her income through the 5% unitrust. In estates where the trust is sufficiently large that each child may have his or her own trust, the flexibility is welcome. For children with larger estates, the flex-FLIP trusts may be used for accumulation. Alternatively, each child may choose the time when his or her trust changes to the standard 5% payout. The flexibility to tailor individual solutions is very welcome. In addition, each trust also may be structured with an appropriate investment strategy for the temperament and circumstances of the child.

How Much Added Lifestyle?

"What level of added lifestyle is the right plan for our children?"

Unitrust Value	Payout of 5%*
$500,000	$25,000
$1,000,000	$50,000
$1,500,000	$75,000
$2,000,000	$100,000

*Payout amount plus current income equals total income.

How Much Added Lifestyle?

If the parents have a substantial estate, they may wish to consider the "What is the right amount of added economic security" question. A unitrust paying 5% could provide added income of $25, 000 ($500,000 UT), $50,000 ($1 Million UT), $75,000 ($1.5 Million UT), $100,000 ($2 Million UT) or more. Because the income is added to the child's other income, it will increase their total income and tax rate. Most parents desire to provide food, shelter clothing and Medigap insurance, but also recognize that at some increased income level, the funds are now buying the child a bigger boat. With a larger estate, parents may choose to set a funding level for the trusts and leave a charitable bequest of the balance.

For example a husband and wife with a large estate asked, "What level of added lifestyle is the right plan for our children?" They decided that $75,000 (a trust of $1.5 million) per year for each of their two children was the right balance of inheritance and personal responsibility. The balance of the estate over the $3 million in the two unitrusts was a bequest to charity to start the Legacy Plan.

Legacy Gift Plan

A major benefit of the plan is that there will be a substantial remainder that can be transferred to favorite charity or a charitable foundation. Many donors choose to fund a field of interest endowment. Because an endowment lasts perpetually, it should be a general gift area such as scholarships, medical research, relief or other general charitable purpose.

Some parents choose to create a donor advised fund or supporting organization. Many community foundations and other charitable entities utilize these strategies. With a donor advised fund or a supporting organization, the children are permitted to make grant recommendations. A goal of many parents is to involve their children in philanthropy. Not only will this help charities, but parents who often desire to help the needy believe that the child's values and character will be enhanced by participating in philanthropy.

Enormous Satisfaction

Parents rightly can feel a sense of great satisfaction with this plan. They quite often have been quite careful and accumulated resources over 30, 40 or even 50 years. While they used those resources to provide security for themselves during life, there also was a substantial inheritance for family.

This inheritance plan provides a lifetime benefit for children and increases their economic security, particularly during retirement years.

Finally, there are emotional and tangible benefits to children, grandchildren, nephews and nieces, but also great ultimate benefit to the world family. The world family of the parents is represented by their favorite charitable organization and their designated charitable purpose.

Truly, with this plan the parents can feel a great sense of satisfaction that they have been good and faithful caretakers of the property entrusted to them.