

CUTTING UP THE INHERITED CREDIT CARD: USING INCENTIVE TRUSTS TO DETER IRRESPONSIBLE AND UNPRODUCTIVE BEHAVIOR IN POTENTIAL HEIRS

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I. INTRODUCTION

As the richest country in the world, the United States is home to a large amount of monetary wealth.¹ Where will this money go when the current holders of wealth are gone? A new generation of “trust-fund” babies are closely following the extravagant lifestyles of Hollywood “celebutantes,” relying on inheritances or trust funds as their sole means of income.² They are a generation of “give me’s”—trust fund babies—accustomed to getting what they want when they want it. This air of entitlement stems from never having

1. Central Intelligence Agency, *Country Comparison: GDP (Purchasing Power Parity)*, THE WORLD FACTBOOK Mar. 8, 2011, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html?countryName=United%20States&countryCode=us®ionCode=na&rank=2#us>. In 2010, the United States ranked second among world nations with a gross domestic product (GDP) purchasing parity power estimated at \$14.72 trillion. *Id.* The European Union leads by a little more than \$100 billion, with China in third with an estimated \$9.85 trillion GDP. *Id.* The GDP encompasses the “sum value of all goods and services produced in the country valued at prices prevailing in the United States.” *Id.*

2. “Celebutante,” URBANDICTIONARY.COM, http://www.urbandictionary.com/define.php?_term=celebutante, last visited Mar. 8, 2011.

to work a day in their life and knowing they never will. They live foolishly, extravagantly, and irresponsibly off the hard work of their parents and grandparents. This lackadaisical and lavish lifestyle potentially leads to a new generation of trust fund babies who fail to become productive members of American society.

Celebutante Paris Hilton, one-time heiress to the Hilton Hotel fortune, is an example of how a trust fund baby's reckless actions can quickly make a large inheritance disappear.³ On Christmas Day in 2007, Hilton's grandfather, Barron, announced plans to leave 97% of his wealth to the Conrad N. Hilton Foundation.⁴ Prior to this announcement, Paris was in line to inherit over \$100 million.⁵ After her grandfather's decision, Paris' inheritance diminished to mere pocket change in comparison.⁶ "Jerry Oppenheimer, who profiled the Hilton family in *House of Hilton* (2006), says Barron Hilton was embarrassed by his granddaughter's behavior and believes it has sullied the family name."⁷ Barron Hilton's extreme change in his estate plan occurred just a few months after his granddaughter's short stay in the Century Regional Detention Facility in Lynwood, California.⁸ Paris' jail stay was not the first time her bad behavior embarrassed her grandfather, and it has not been the last.⁹ Barron Hilton's decision to give \$2.4 billion of his estate to charity is one way—a drastic way—to use inheritances and estate plans to reign in unruly beneficiaries, whether to make an example of them or to deter bad behavior.¹⁰

Barron Hilton is not the first billionaire to give away the majority of his estate to charity. In 2006, billionaire Warren Buffett also publicly announced his plan to give the entirety of his fortune to charity.¹¹ Buffett does not believe

3. *Paris Hilton*, WIKIPEDIA, http://en.wikipedia.org/wiki/Paris_Hilton, last visited Mar. 8, 2011; *Paris Hilton loses inheritance*, FROM ALL ANGLES, (July 31, 2007), <http://www.news.com.au/paris-hilton-loses-inheritance/story-e6frfkp9-1111114069570>.

4. *Hilton fortune to go to charity*, BBC NEWS, (Dec. 27, 2007), <http://news.bbc.co.uk/2/hi/business/7161358.stm>. The money will be left to a separate charitable trust that will eventually merge with his father's namesake trust. *Id.*

5. *Paris Hilton*, *supra* note 3.

6. *Id.*

7. *Barron Hilton*, WIKIPEDIA, http://en.wikipedia.org/wiki/Barron_Hilton (last visited Mar. 9, 2011).

8. *Paris Hilton*, *supra* note 3. Hilton, convicted of violating her probation from a 2006 DUI-conviction, spent 2 days of a 45-day sentence in jail after reassignment to "home confinement with an electronic monitoring device." *Id.*

9. *Id.* In 2003, Paris' personal life was exposed when a homemade sex tape made with ex-boyfriend Rick Saloman was leaked to the media. *Id.* In 2010, Paris was arrested in Las Vegas for cocaine possession. *Id.*

10. *Paris Hilton loses inheritance*, *supra* note 3. Barron Hilton's only comment in regard to his decision reflects a wish to "follow in the footsteps of his father, who left nearly all of his fortune to the trust when he died in 1979." *Id.* Peter Walker, *Hilton Grandfather Pledges Fortune to Charity*, N.Y. TIMES, Dec. 27, 2007 (available at <http://www.guardian.co.uk/world/2007/dec/27/usa.haroonsiddique>). The disinheritance means Paris will receive approximately \$5 million instead of the \$100 million she expected. *Id.*

11. Carol J. Loomis, *Warren Buffett Gives Away his Fortune*, CNNMONEY.COM, (June 25, 2006) <http://money.cnn.com/2006/06/25/magazines/fortune/charity1.fortune.index.htm>. In 2006, Buffett announced that he would leave his fortune to charity with most going to the Bill & Melinda Gates Foundation. *Id.*

large amounts of wealth should be allowed to pass to heirs unearned.¹² In an interview, before announcing he was leaving all of his estate to charity, Buffet noted that “he want[ed] to give [his] kids just enough so that they could do anything, but not so much that they would feel like doing nothing.”¹³ It seems Buffett plans to leave behind a legacy stronger than wealth for his children and grandchildren, a legacy built on hard work and modest living.¹⁴

This comment focuses on the use of incentive-based estate planning instruments—particularly trusts—as a way to curb the irresponsible and extravagant lifestyles many beneficiaries of large inheritances and trust funds exhibit. Part II focuses on the detrimental effects of failing to instill responsible money management skills and morals in beneficiaries before giving the beneficiaries access to a large amount of uninhibited wealth. Part III then discusses the basic elements of two different instruments that can be used as part of an incentive-based estate plan—conditional wills and trusts—and, which of these instruments is more beneficial to create an effective incentive-based plan. Part IV addresses the legal and public policy limitations on certain trust provisions, such as the cons of creating an incentive plan that is too inflexible and rigid, and ways to avoid these problems when creating the trust. Part V focuses on how to create an incentive-based trust and includes what purposes an incentive-based trust may be used for and what steps a settlor should take in the creation of a basic incentive-based trust. The comment concludes that incentive-based estate planning can be used to foster hard working, driven individuals out of entitled, spoiled, trust-fund babies.

II. THE PROBLEM OF WEALTH

The settlor, the creator of the estate plan, has a lot to consider when drafting an effective estate plan, including how the terms of the estate plan will affect the recipients of the estate’s benefits, the beneficiaries.¹⁵ The intentions of most settlors are to promote the future welfare of the trust’s beneficiaries. However, what is best for one generation at the present may not be best for future generations.¹⁶

The wealth transfer from the baby boomers to the children of Generation Y is potentially the largest transfer of wealth in the history of the United

12. *Id.*; see also *Warren Buffett*, WIKIPEDIA, http://en.wikipedia.org/wiki/Warren_Buffett (last visited Nov. 5, 2010).

13. *Warren Buffet*, *supra* note 12. Buffett continues to live a modest lifestyle; he does not carry a cell phone, does not own a home computer, and does not have a personal driver—a status symbol of among the extremely wealthy. *Id.*

14. *Id.*

15. GERRY W. BEYER, *TEXAS TRUST LAW: CASES AND MATERIALS* 2 (2nd ed.).

16. See Neil H. Buchanan, *What Do We Owe Future Generations?*, 77 GEO. WASH. L. REV. 1237, 1242 (2009) (average standard of living costs will increase for future generations raising questions of whether current generations have prepared too much or too little for the well-being of their children and grandchildren).

States.¹⁷ The baby boomer generation will pass an estimated \$25 trillion dollars through inheritances over the next fifty years.¹⁸ Despite the great passage of wealth looming in the distance, “passing along ‘values and life lessons’ is [still] considered the most important legacy by more than 75 percent of baby boomers and their parents.”¹⁹ The future heirs to this wealth, members of Generation Y born between 1982 and 2002, are one of the most technologically advanced generations to date, and yet, commonly enter the working world “without any true sense of the real world.”²⁰ Though exposed to adult issues earlier and earlier in life, their grandparents and parents—the future settlors of unprecedented wealth—worry that this generation is unmotivated to “work and make something of themselves” since their financial needs are already met.²¹

Parents and grandparents leaving large amounts of wealth to their children and grandchildren usually have the best of intentions, but the detriments of inherited wealth sometimes outweigh the benefits. Large sums of money, whether inherited or just readily available, at too young of an age, with too little knowledge of the responsibilities wealth brings, can lead the beneficiaries of that wealth down the wrong road.²² Whether the family fortune is worth hundreds of billions of dollars or a mere couple of million, wealth “handled poorly . . . [can] remove any incentives for the next generation.”²³ The problem with inherited wealth, is not that the children of these wealthy families are naturally prone to get into trouble; they simply have more opportunities to make

17. Lauren J. Wolven & G. Scott Clemons, *Transmitting Wisdom Along With Wealth*, AMERICAN BAR ASSOCIATION CONTINUING LEGAL EDUCATION 5 (2009). In 2009, Generation Y ranged from ages 7 to 26 years old, and is the largest generation since the Baby Boomers, three times the size of Generation X. *Id.*

18. Steiner, *infra* note 38, at 897. Another study estimates that baby boomers will leave between \$12–\$18 trillion from 1998 to 2007. *Family Incentive Trusts Ensure Financial Responsibility*, Wilmington Trust, <http://www.wilmingtontrust.com/wtcom/index.jsp?fileid=3000305> (last visited Mar. 9, 2011). To add to these conflicting figures, another study places the figure at a whopping \$48 trillion. Catherine M. Allchin, *In Some Trusts, the Heirs Must Work for the Money*, N.Y. TIMES, Jan. 29, 2006, available at <http://www.nytimes.com/2006/01/29/business/yourmoney/29trust.html>.

19. Allchin, *supra* note 18.

20. *Id.* A recent survey of U.S. college students show that 97% own a computer, 94% own a cell phone, 75% have a Facebook account, 24% use websites as their primary source of news and 60% own some type of portable music and/or video device such as an iPod. *Id.* Nicknamed “The Cyber Generation,” “[f]our out of five” Generation Y members use their computers as a primary news source and “nine out of [ten] . . . send and receive e-mails on a daily . . . basis, compared with only 13 percent who write letters by hand.” DAVE MURPHY, *The Cyber Generation: An excerpt from Generation 2001: Techno-Confident*, <http://www.sachem.edu/dept/sd/mst/CyberGeneration.html> (Nov. 11, 2011).

21. *Family Incentive Trusts*, *supra* note 18. “In this era of unprecedented affluence, parents and grandparents are increasingly concerned about the negative consequences inherited wealth may have on their [prospective] heirs.” *Id.*

22. See generally Andy Serwer, *Too Young, Too Rich? The problem of inherited wealth, seen through the camera of an heir*, CNNMONEY.COM, Nov. 24, 2003, http://money.cnn.com/maazines/fortune/fortune_archive/2003/11/24/353786/index.htm.

23. *Id.*

mistakes.²⁴ Children of wealthy families “have the means, the money, and the time to indulge in bad behavior.”²⁵

Generally, wealthier parents tend to be around less and, therefore, their children are under less supervision than most.²⁶ “Jamie Johnson, a fourth-generation heir to the Johnson & Johnson fortune,” shed light into the world of the “twentysomething children of the super-rich” in his semiautobiographical documentary, *Born Rich*.²⁷ Johnson believes that “a parent’s failure to discuss family finances . . . contributes greatly to dysfunctionality” and bad financial decisions.²⁸ Johnson’s beliefs are based on his own parent’s failure to discuss the family finances, and the consequences of that decision.²⁹ Inherited wealth is essentially the opposite of the so-called American dream; where a person earns his fortune through the proverbial blood, sweat and tears.³⁰ Though money earned by any means has the potential to corrupt a person’s life, more often than not simply inheriting millions unimpeded by financial knowledge leads to disaster.³¹

The Johnson dynasty is an excellent example of what can happen when inherited wealth goes wrong.³² The 1983 contest of Seward Johnson’s will led to the humiliation of the Johnson legacy.³³ As the largest will contest in U.S. history, litigation over the elder Johnson’s will painted an embarrassing portrait of the whole Johnson family, including tales of “murder for hire, sexual deviance, drugs, and suicide.”³⁴ These were all the result of the unearned

24. *Id.* (Comparing twenty-something children of wealthy families to twenty-something children of working class families).

25. *Id.*

26. *Id.* Arlyn Davich, one of the subjects of Jamie Johnson’s semi-autobiography *Born Rich*, speaks of having “parties at the wealthiest kids’ houses because the parents seemed the most likely not to be home.” *Id.*

27. *Id.*

28. *Id.*

29. *Id.* Growing up, Johnson’s family did not talk about money because it was “impolite.” *Id.*

30. *Id.* “People in America love to think of this as a society where everyone earns what they have, and in some ways [inherited wealth] contradicts that notion.”

31. *Id.*

32. *Id.*

33. *Id.* The contest came in the form of three separate battles: (1) questioning Johnson’s mental competence at the time of will execution, resulting in the six children being granted 12% of the estate, (2) a twelve year battle concerning the eligibility of Mary Lea Johnson Richards’ husband’s share of the estate, and (3) a battle over the eligibility of John Seward Johnson II’s daughter’s ability to take some of the estate. Kristin McMurran, *The Band-Aid Heir Left All He Owned to His Widow, but His Children Claim it Was Just Seward’s Folly*, PEOPLE, May 26, 1986, <http://www.people.com/people/archive/0,,20093924,00.html>; Susan Warner, *The Family Behind the Company*, NY TIMES, April 10, 2005, <http://query.nytimes.com/gst/fullpage.html?res=9A00EFDC173EF933A25757C0A9639C8B63>; David Margolick, *Mary Lea Johnson Richards, 63, Founder of Production Company*, NY TIMES, May 4, 1990, <http://www.nytimes.com/1990/05/04/obituaries/mary-lea-johnson-richards-63-founder-of-production-company.html?scp=15&sq=seward%20johnson&st=cse>; Anthony Ramirez, *New Jersey Court’s Ruling Ends 12-year Firhgt Among Johnson and Johnson Heirs*, NY TIMES, April 4, 2008, http://www.nytimes.com/2008/04/04/nyregion/04johnson.html?_r=2&scp=10&sq=seward%20johnson&st=cse.

34. *Id.*

wealth later generations had been privy to and were expecting to receive after Seward Johnson's death.³⁵

The potential heir to millions, Jamie Johnson is a rarity among the extremely wealthy.³⁶ Despite his family's failure to discuss the responsibilities that come with such large amounts of wealth, Johnson realized early in life that a decadent, lavish, irresponsible lifestyle can be prevented by hard work.³⁷ Not all potential heirs are so enlightened; most need some form of encouragement to live a motivated, successful, self-achieving life.

A. *The Settlor's Legacy: Wealth or the Ability to Create Wealth?*

An increasing number of wealthy individuals, and even the financially comfortable, are searching for ways to have some control over their prospective heirs' life decisions long after their own lives have ended.³⁸ In generations past, inheritances focused on the preservation of wealth.³⁹ When choosing to leave, or not to leave, behind a large amount of monetary wealth or property, the settlor must first decide the type of legacy he or she wants remembered. Protecting and preserving family values is an increasingly popular goal of estate planning.⁴⁰ A recent "survey found that 35% [of wealthy parents] 'believe [their] children may be too spoiled by money and have too many material possessions . . . [51%] believe the recession has changed the way their children will manage their finances and 47% are now discussing money management with their children.'"⁴¹ In 2007, another survey found that 62% of wealthy individuals believe that their children and grandchildren are responsible for achieving their own financial success.⁴² Mirroring the wishes of billionaires Conrad Hilton and Warren Buffett, many settlors choose not to put the emphasis on the monetary value of the estate they leave behind, but on how they will be remembered as a person.

However, unlike Conrad Hilton and Warren Buffet, many potential settlors want to ensure that the beneficiaries of the trust—usually children, grandchildren, or other lineal descendants—will have opportunities they did not

35. *Id.* In 1971, Seward Johnson left his entire fortune in a will he rewrote two months before his death to his third wife, his former Polish maid. The will cut all six of his children out.

36. *Id.*

37. *Id.*

38. Shelly Steiner, *Incentive Conditions: The Validity of Innovative Financial Parenting by Passing Along Wealth and Values*, 40 VAL. U. L. REV. 897, 906 (2005).

39. *Id.*

40. *Id.*

41. Ruthie Ackerman, *Preventing Spoiled Children Through Incentive Trusts*, Bank Inv. Consultant, Jan. 25, 2010, available at <http://www.bankinvestmentconsultant.com/news/Freeman-incentive-trusts-2665551-1.html> (last visited Mar. 10, 2011).

42. Robert Frank, *The Wrong Way to Leave Money to Heirs*, WALL ST. J., May 15, 2007, available at <http://blogs.wsj.com/wealth/2007/05/15/the-wrong-way-to-leave-money-to-heirs/>. Despite these findings, the same survey reported that only 30[%] of high-net-worth [individuals surveyed] use[d] incentive trusts."

have.⁴³ The “Better Than Me” standard “has been described as being a fundamental part of ‘the American dream.’”⁴⁴ This standard has several problems, including the focus of the bulk of this comment—creating a legacy based on the monetary value of the estate instead of the motives and values behind creating the trust.⁴⁵ This type of thinking is one of the antagonists creating the problem of inherited wealth.

Avoiding implementing the “Better than Me” standard is a key component in drafting an effective incentive-based estate plan. A settlor taking the time to weigh all possible options and consequences of his or her estate plan is more likely to create a plan that will achieve the settlor’s desired results.

III. DRAFTING AN INCENTIVE-BASED ESTATE PLAN—THE BASICS

Using an incentive-based estate plan to pass on both the settlor’s monetary and moral legacy is an effective way to keep ideals alive and build morally and financially responsible generations. This section will focus on the use of two methods in creating an incentive-based estate plan: using a conditional gift or using an incentive trust. Before discussing some essential elements that must exist, or cannot exist, for an incentive trust to be valid in Texas, this section first discusses how these documents can be used to promote productive and financially responsible traits in beneficiaries.

A. *Leaving a Legacy Behind*

An incentive trust allows the creator to promote the morals and values he would like to instill in his beneficiaries, all while defining the legacy of the settlor both financially and morally. The Conrad N. Hilton Foundation, established in 1944 by its namesake hotel entrepreneur Conrad Hilton, is one example of leaving behind a charitable legacy.⁴⁶ The decision of Barron Hilton to disinherit his granddaughter and leave 97% of his estate to his father’s trust is a quasi-incentive.⁴⁷ By disinheriting his famous “bad girl” granddaughter

43. Buchanan, *supra* note 16, at 1258.

44. *Id.* at 1257–58. The “Better Than Me” standard is the “basic desire to help one’s children” to have a better future than you did. *Id.*

45. *Id.* Problems with the “Better Than Me” standard include basing the motive for trust creation on the settlor’s current living situation, believing that the beneficiary will not have a good life without the settlor’s help, and how the standard affects future distributions of the trust property.

46. Conrad N. Hilton Foundation, History of the Hilton Humanitarian Prize, <http://www.hiltonfoundation.org/prize/history> (last visited on Mar. 20, 2011). The Conrad N. Hilton Foundation awards \$1.5 million of unrestricted funds each year to a deserving charity. Past winners include Operation Smile (1996), Doctors Without Borders (1998), Casa Alianza (2000), the International Rehabilitation Council for Torture Victims (2003), the Bangladesh Rural Advancement Committee (2008) and the Aravind Eye Care System (2010). Conrad N. Hilton Foundation, Hilton Humanitarian Prize Laureates, <http://www.hiltonfoundation.org/prize/laureates> (last visited on Mar. 20, 2011).

47. See Hilton Fortune, *supra* note 4.

and other beneficiaries, Barron Hilton made his distaste for bad behavior loud and clear.⁴⁸

In recent years, a growing number of parents have expressed “concerns of leaving their children with too much money and too little direction. . . .”⁴⁹ Placing incentives within a trust helps avoid completely rewriting an entire will or estate plan when beneficiaries suffer from chronic bad behavior.⁵⁰ A trust can be used to do more than just pass on property and arrange financial affairs; it can leave behind memories of a person’s values for generations to come.⁵¹ An incentive trust can be used to create a unified and healthy estate for all future generations.⁵² Achieving the trust creator’s desired goal depends on both the cooperation of family members and the creation of a trust that does not single out any one beneficiary in a positive or negative way.⁵³ If the beneficiaries are involved during the planning process and understand the terms and conditions surrounding the distribution of the property, the chances that they will resent the outcome lessens.⁵⁴

“[I]nheritance is not simply a transfer of property but rather a significant social institution that has a valuable function in family life.”⁵⁵ The legacy of a settlor is based just as much on what he or she leaves behind as what they do not.⁵⁶ Even the mere threat of disinheritance sends a strong message to trust beneficiaries.⁵⁷ For many potential heirs, disinheritance is not just a financial setback, but also an altogether rejection of familial affection and love.⁵⁸ Upfront incentives clearly outlining the behavioral requirements beneficiaries must meet to receive trust distributions will make total disinheritance less likely to occur.

48. *Id.* Hilton’s only comments regarding Paris’ disinheritance have referenced his desire to honor the charitable legacy of his father.

49. STOUT, *infra* note 66 at 28.

50. *Id.*

51. Broadway Bank Wealth Management, Legacy Planning: Is money the most important part of your legacy?, <http://www.broadwaybank.com/wealthmanagement/LegacyPlanning.html> (last visited Mar. 14, 2010).

52. *Id.*

53. *Id.*

54. *Id.* If a child knows the consequences of breaking a rule before he breaks that rule, he will not be surprised by the outcome. E.g., Tommy, if you are not home at 10 p.m., you are grounded for a week. Tommy gets home at 11 p.m., he already knows he will be grounded. This works the same when clearly expressing the way the incentive will work. E.g., if Tonya becomes addicted to drugs, she will not receive any trust distributions until she has provided proof of long term sobriety. Tonya cannot legitimately be upset when known potential consequences occur.

55. Shelly Kreiczler-Levy, *Religiously Inspired Gender-Bias Disinheritance-What’s Law Got to Do With It?*, 43 CREIGHTON L. REV. 669, 691 (2010).

56. *See generally id.*

57. *Id.* at 691.

58. *Id.* at 689-90. “The meaning attached to disinheritance depends on its reasons.” *Id.* at 690.

B. Incentives & Trusts

A 2008 survey found that 62% of people believe each generation should take responsibility for building its own wealth.⁵⁹ Despite these findings, using an estate-planning document to force beneficiaries to meet certain moral, educational, and employment goals is still a rarity.⁶⁰ Only 30% of those polled use their estate planning documents to specifically outline standards heirs must meet before receiving their inheritance.⁶¹ The reasons for such a small percentage are unknown, but as knowledge of the capabilities of incentive trusts grows, so does the popularity of their use.⁶²

Creating an incentive-based trust lends itself to numerous innovative methods of weaving different types of incentives into the trust.⁶³ Trusts can be used to persuade beneficiaries to attend a university by alleviating financial roadblocks like expensive books or tuition, or reward a beneficiary who secures valuable and competitive employment by using assets from the trust to “match the income of . . . [the beneficiary] dollar for dollar.”⁶⁴ Incentives can also be used to promote community awareness, active volunteering with a nonprofit organization, or entrepreneurial activities.⁶⁵ By including specific language in a trust that “encourage[s] . . . positive behavior and discourage[s] . . . negative behaviors,” a beneficiary knows he or she is expected to conform to the requirements outlined if he or she wants to reap the benefits of the trust.⁶⁶

In a nutshell, “incentives” are conditional gifts that are contingent upon the happening, or not happening, of certain events or if the recipient of the gift agrees to live the lifestyle the giver thinks is best.⁶⁷

Numerous different provisions signify the existence of an incentive trust.⁶⁸ Provisions basing distribution on the beneficiary’s receipt of a high school diploma, or a bachelor’s, master’s, or even doctoral degree are common

59. Christopher J. Berry, *Incentives for the Heirs*, MICHIGAN ESTATE PLANNING LAWYER BLOG, July 23, 2008, <http://www.michiganestateplanninglawyerblog.com/2008/07/incentives-for-the-heirs-2.html> (last visited Mar. 14, 2011).

60. *Id.*

61. *Id.*

62. Nancy G. Henderson, Managing “Carrot and Stick” Provisions: Selected Fiduciary Issues in Drafting and Administering Trusts with “Incentive” Provisions, SP004 A.L.I.-A.B.A. COURSE OF STUDY 485 (2008).

63. See Berry, *supra* note 59.

64. *Id.* Dollar for dollar trusts can be unfair when they involve multiple beneficiaries “because it gives big rewards to already-successful business people and much smaller amounts to heirs who may work just as hard” but chose lower-payer careers, e.g., as an elementary teacher. See Allchin, *supra* note 18.

65. Berry, *supra* note 59.

66. Judy Barber, *The Psychology of Conditional Giving*, 21 PROB. & PROP. 57, 58 (Dec. 2007).

67. *Id.*

68. Bruce L. Stout, *Incentive Trusts: A Potential Tool for Every Estate Plan*, W. VA. L. REV., Sept. 2009, at 28.

incentive provisions promoting educational achievement.⁶⁹ Other provisions that signal the existence of an incentive trust include distribution restrictions based on the beneficiary's use of drugs or alcohol, ability to maintain a clear criminal record, or provisions that impose the settlor's moral or religious standards.⁷⁰ The benefits of an incentive trust are infinite.⁷¹

1. *The Benefits of an Incentive Trust*

Almost all people in almost all circumstances respond to incentives.⁷² Whether in an educational, personal, or professional setting, incentives are effective tools to achieve specific goals from the people they are aimed towards.⁷³ The incentive does not need to be enormous to be effective—the main goal is to communicate the settlors' desired morals and values.⁷⁴ Large or small, incentive trusts help shape values in beneficiaries of all ages.⁷⁵ Many attorneys recommend using an incentive trust in estate plans, specifically those involving young children.⁷⁶ Doing so allows parents to promote “a strong work ethic and a good sense of values” in their children, even if they are unable to teach the lessons themselves.⁷⁷ Whether the beneficiary receives distribution from the trust at 8 or 80, there are numerous benefits from controlled, inherited wealth.⁷⁸

These benefits include, but are not limited to, increasing the security and safety for the beneficiary's current lifestyle, allowing the beneficiary to pursue opportunities or other rewarding activities he or she would not normally be able to pursue, giving the beneficiary the financial opportunity to participate in philanthropic activities, and increasing the beneficiary's influence in his or her community.⁷⁹ In drafting the trust, the settlor, and his or her attorney, has an opportunity to kill two birds with one stone—leave behind a legacy of his or her own desire, and give the beneficiary the opportunity for a better life with as few restrictions as possible.⁸⁰

69. *Id.* Settlors may promote education by including GPA requirements, specified majors, or even specified time restrictions in which the beneficiary must complete his or her education in order to receive distributions. See *infra* Part III.2 (discussing the inflexibility problem of these provisions).

70. Stout, *supra* note 68.

71. See *id.*

72. Allchin, *supra* note 18.

73. See Stout, *supra* note 68, at 28–29.

74. Allchin, *supra* note 18. Incentive trusts are one of the most effective ways parents and grandparents may shape values after they die. *Id.*

75. Stout, *supra* note 68.

76. *Id.*

77. *Id.* Seattle estate planning attorney, George S. Holzapfel, reported in 2006 that 60% of his clients with “young children and assets of \$10 million or more” used incentive trusts to pass on their wealth. *Id.*

78. See Henderson, *supra* note 62.

79. *Id.* Inherited wealth can allow a beneficiary to maintain his or her lifestyle despite “despite illness, disability, unemployment, divorce, the death of a spouse . . . or [everyday] ups and downs in the economy.”

80. Allchin, *supra* note 18.

The trust itself is only limited by the creativity of the drafter and by a few legal limitations.⁸¹ The *Restatement (Third) of Trusts* lists three prospective conditions that, if not met, would invalidate the trust.⁸² These conditions would invalidate a trust if the provision “requires the beneficiary to commit a criminal or tortious act . . . violates the applicable Rule Against Perpetuities [or RAP] or if it is against public policy.”⁸³ Not all states have officially codified these trust conditions in their entirety, and a few states have created statutes specifically limiting the scope of these provisions.⁸⁴

C. The Elements of Conditional Gifts and Trusts

A settlor may use a conditional gift or a trust to create his or her incentive-based plan. A conditional gift, the more vulnerable of the two and not the focus of this comment, makes receipt of the gift contingent on a certain condition.⁸⁵ This section will briefly outline the basic elements of a conditional gift for future reference when distinguishing between the two arises in practice. The more stable and effective instrument, the trust, is created when the owner of property divides the title of that property into separate equitable and legal interests of which the beneficiary is the recipient of the equitable interest in the property.⁸⁶

A testator has the option to condition a specific gift on numerous events, ranging from the behavior of the beneficiary to the happening, or not happening, of a certain event.⁸⁷ There are two types of conditional gifts: a condition precedent and a condition subsequent.⁸⁸ A condition precedent means a specified event must happen for the beneficiary to actually receive the gift; if the event never occurs then the gift never occurs.⁸⁹ A condition subsequent allows the beneficiary to keep the gift so long as the condition is not violated.⁹⁰ Once the condition is violated, the beneficiary loses the gift.⁹¹

81. Berry, *supra* note 59; Steiner, *supra* note 38, at 910.

82. Steiner, *supra* note 37, at 910.

83. *Id.* at 910-11. Under the Restatement, if any one of these conditions is not met, the trust provision is invalidated. *Id.* A trust in Texas will fail the RAP test if the interest does not vest within twenty-one years of the end of a life in being, who was present at the time of trust creation. BEYER, *supra* note 15, at 41.

84. Steiner, *supra* note 38, at 910. Examples of these restrictions, such as requiring a daughter to divorce her husband in order to receive trust distributions, and examples of how to avoid the problems they can cause are discussed in detail in Part IV of this comment. *Id.* at 910-14. See also *infra* Part IV.1.

85. GERRY W. BEYER, TEXAS WILLS AND ESTATES: CASES AND MATERIALS, 6th ed., at 306.

86. BEYER, *supra* note 15, at 1.

87. BEYER, *supra* note 85, at 306.

88. *Id.*

89. *Id.* E.g., I leave \$100,000 to my daughter, Jane, if she is at least twenty-two years of age at the time of my death. If not, then the \$100,000 passes to the American Red Cross. Jane's ability to inherit the \$100,000 is conditioned on her being at least twenty-two years old at the time of her father's death; therefore, if Jane is only twenty-one when her father passes, she will be unable to receive the gift.

90. *Id.* E.g., I leave my house in San Angelo to my daughter, Mikena, but if she is convicted of **any** crime, the house should pass to my nephew, Tanden.

Conditional gifts cannot be illegal, be against public policy, or be excessively harsh or restrictive.⁹² The language of the condition must be strong and precise—a recommendation of what the testator thinks should be done is not sufficient to qualify as a conditional gift and will not be treated as such by the court probating the will.⁹³

Conditional gifts are vulnerable to contests if not carefully and specifically written to depict exactly how the condition should be enforced.⁹⁴ The most common problem is determining whether the donor of the gift actually intended the gift to be conditional.⁹⁵ Problems may also arise when the terms of the condition are unclear and therefore left to the court for interpretation, or when the donor of the gift wants to revoke the gift to the donee after it has already been given.⁹⁶ Due to their vulnerability, this comment will not focus on the use of conditional gifts as a means of creating an effective incentive-based estate plan.

The second incentive-based estate planning tool, and focus of this section, is called a trust. A trust is a unique probate instrument.⁹⁷ Generally, a trust is created when the owner of some property, such as a piece of farmland, a private business, or a large amount of monetary assets, divides the title to the property into separate legal and equitable interest.⁹⁸ The legal title to the property is given to a trustee, who manages the property as if he or she is the owner.⁹⁹ The beneficiary of the trust receives “the equitable interest in the trust property.”¹⁰⁰ He takes advantage of all the benefits of the property with one long string attached—he has virtually no legal control over the property.¹⁰¹ After the property is separated into the two distinct interests, “the owner [and creator of the trust] must impose fiduciary duties on the holder of the legal title to deal

91. *Id.* E.g., Sage receives \$100,000 from the trust each year he does not receive a DWI; if he receives a DWI, the trust property passes to the St. Jude Children’s Hospital. Sage receives a DWI before the third trust distribution. The third distribution is therefore not made, and all proceeds pass to St. Jude’s.

92. BEYER, *supra* note 81, at 306. E.g., if the motivation of the gift is to keep someone from getting married or from getting a divorce, courts are unlikely to enforce the condition.

93. *Id.*

94. *Id.*

95. *See Courts v. Annie Penn Mem’l Hosp., Inc.*, 431 S.E.2d 864, 866 (N.C. Ct. App. 1993) (citing *Charlotte Park & Recreation Comm’n v. Barringer*, 88 S.E.2d 114, 123 (1955)).

“A person has the right to give away his or her property as he or she chooses and ‘may limit a gift to a particular purposes, and render is so conditioned and dependent upon an expected state of facts that, failing that state of facts, the gift should fail with it.’” *Id.*

96. *See Courts*, 431 S.E.2d at 866; *see also Newlon v. Newlon*, 220 S.W.2d 961, 963–64 (Ky. Ct. App. 1941) (holding that a savings account created by a father for his son and given to the son twenty-one years later for the purpose of funding his education could not be revoked following the son’s failure to use the money for educational purposes).

97. BEYER, *supra* note 15, at 1.

98. *Id.*

99. *Id.* “The trustee has all of the responsibilities related to property ownership but receives none of the benefits.” *Id.*

100. *Id.*

101. *Id.*

with the property for the benefit of the holder of the equitable title.”¹⁰² The beneficiary, and holder of the equitable interest in the property, may try to make recommendations, but ultimately the trustee is bound by the instructions of the trust and governing state law.¹⁰³

Using a trust is perfect for passing large monetary estates and property on to beneficiaries lacking the ability to manage the estate.¹⁰⁴ Trusts are typically used to pass large estates on to minors, incompetents, beneficiaries who lack the necessary skills to manage the trust property, and “spendthrifts,” beneficiaries that are capable of managing the property but will spend it “in an excessive or frivolous manner.”¹⁰⁵ Trusts hold assets or property until beneficiaries reach specified benchmarks, such as graduating from high school or reaching a sufficiently responsible age.¹⁰⁶ This method of estate planning is a way for settlors to prevent unprepared beneficiaries for the responsibility of wealth from damaging their future.¹⁰⁷ It is extremely important to be aware of not only the benefits of using a trust to convey property, but the detriments of improper trust creation as well.

IV. POTENTIAL PROBLEMS WHEN CREATING AN INCENTIVE-BASED TRUST

Using an incentive based estate plan is as tricky as it is helpful. Incentive trust provisions are extremely delicate legal creatures. Though the settlor has the opportunity to pass on a family legacy of morals and values, he must be careful to ensure that the requirements laid out in the trust do not violate law or public policy.¹⁰⁸ Provisions must also be written carefully, avoiding inflexibility or massive loopholes that constrain the beneficiary or make it too easy for the beneficiary to get around.¹⁰⁹

102. *Id.*

103. *Id.* at 2. “[P]ayments made to or for the benefit of the beneficiary must be consistent with the instructions in the trust instrument.” *Id.* State law also controls the trustee’s actions. *Id.*

104. *Id.* at 3.

105. *Id.* For an express trust to be valid, it must contain the following elements: intent, capacity, compliance with the statute of frauds, a purpose that is legal and compliant with public policy, property the trust is designed to dispose of, a designated trustee and beneficiary, and compliance with the rule of perpetuities. *Id.* at 11. All requirements listed are Texas specific. *Id.* Many states have abolished the rule of perpetuities. *Id.*

106. *Understanding basic estate planning concepts*, TEXAS ESTATE PLANNING, <http://texas-estateplanning.com> (last visited Oct. 14, 2010).

107. Allchin, *supra* note 18. Money is often defined as a “double-edged sword,” with the potential to improve the life of the recipient exponentially, or destroy it. *Id.*

108. BEYER, *supra* note 15, at 11.

109. James F. Wood, *Incentive Trusts: A Cure for ‘Affluenza’ or A Ruse for Control Beyond the Grave?*, STOEL RIVES, LLP, May 19, 2000, available at <http://www.estateplanners.org/Articles/Wood.html> (last visited Mar. 20, 2011).

A. Incentives that Violate Social and Legal Standards

Settlors should avoid including incentive trust provisions that violate legal and moral standards.¹¹⁰ Generally, “conditions pertaining to family relationships are invalid,” for example, provisions requiring a beneficiary to divorce his or her spouse in order to receive the proceeds of the trust.¹¹¹ Trust provisions relying on the death of a beneficiary’s spouse, or any human being for that matter, are normally found against public policy because they have the potential to induce a criminal act.¹¹² However, there are exceptions to the rule.¹¹³ A New York court held that a provision conditioning the trust on the widowhood of the designated beneficiary did not violate public policy because the condition was “beyond the control of the parties” and was a “limitation rather than [a] restraint of marriage.”¹¹⁴ Other courts have allowed for “maintenance” provisions that can be cut off when the beneficiary marries or remarries and no longer needs the trust’s support.¹¹⁵ Though these types of provisions have occasionally been upheld, such borderline provisions should be used rarely, if at all; however, many other moral-based incentives that have proven more easily enforceable.

Though a settlor cannot disallow the trust beneficiaries to marry or require them to divorce, he can weave his personal religious beliefs into the terms of the trust.¹¹⁶ The general rule is that since a settlor has the freedom to promote his or her religious views among others during their lifetime, there is no reason that the settlor may not exercise religious freedom from beyond the grave.¹¹⁷ A 1954 court upheld a trust provision preventing the settlor’s daughter from receiving any trust proceeds if she followed her husband’s religious beliefs.¹¹⁸ The inability of the court to enforce the provisions or ascertain the exact standards that the settlor was trying to create is more likely to invalidate a

110. *Id.* The purpose of a valid express trust must not be illegal or against public policy. “The terms of the trust may not require the trustee to commit an act that is criminal, tortious, or contrary to public policy.” *Id.* at 49.

111. Steiner, *supra* note 38, at 916; *see also* Stout *supra* note 66 at 2; Moore v. Moore, 654 N.E.2d 904, 905 (Ind. App. 1995) (discussing that a trust provision requiring a wife to divorce her husband, or that her husband die, before she could receive trust distributions is against public policy).

112. *See* Hunt, *infra* note 120, at 436.

113. Steiner, *supra* note 38, at 917; *see also* Stout, *supra* note 66. “Encouraging divorce in a trust is against public policy.” *Id.* Settlers include provisions to get around this rule by basing distributions on the combined income of the beneficiary and his or her spouse, increasing those distributions if the beneficiary does not remain married. *Id.*

114. *In re Rosenberg’s Will*, 110 N.Y.S.2d 573, 574 (N.Y. Sur. 1952).

115. Steiner, *supra* note 38, at 917 (*citing* Lewis v. Searles, 452 S.W.2d 152 (Mo. 1970)). Missouri Supreme Court held the condition valid because it was intended to aid the plaintiff while she was single, not punish her for remarrying. *Id.*

116. *Id.*

117. Steiner, *supra* note 38, at 919. Since an individual has the power to completely disinherit someone without reason, it seems only fair that the settlor would be able to include provisions disinheriting the beneficiaries of the estate for failing to meet religious standards. *Id.*

118. *Id.* (*citing* United States Nat’l Bank of Portland v. Snodgrass, 275 P.2d 860, 870 (Or. 1954)).

religious-based incentive than the religion itself.¹¹⁹ Frequently, a provision is deemed invalid because of its potential to incite an illegal act to occur rather than facial illegality.¹²⁰

Courts use two different approaches to determine whether a trust is legal.¹²¹ The majority approach focuses on both the settlor's intent and how the trust's mere existence changes beneficiaries' behavior.¹²² A trust is illegal if its mere existence could induce the beneficiary to commit a crime.¹²³ If it is apparent that the settlor's intention was to illicit an illegal act or act against public policy from the beneficiary, then the trust will not be upheld no matter how innocently-worded the provision may have been.¹²⁴

Trust provisions cannot interfere with the court's ability to enforce or administer the trust.¹²⁵ Settlers using trusts that limit beneficiary distributions because of "religion, sex, race, or national origin" cause an immense amount of problems for enforcement of the trust.¹²⁶ Though private persons are allowed to discriminate as they wish, courts cannot use their power or authority to enforce the discriminatory provisions.¹²⁷ Litigation over discriminatory provisions has increased over recent years, yet court decisions continue to differ on how to handle these provisions.¹²⁸ Though some courts uphold "good cause" restrictions, despite their discriminatory tone, these types of provisions are more hassle than they are worth and should be avoided when creating any sort of incentive trust.¹²⁹ If a court rules that a provision is illegal, the court has the

119. Steiner, *supra* note 37, at 922–23. "[I]n addition to looking at the validity of the condition itself, courts look to the language of the condition and the standards by which to measure the behavior of an individual in order to determine the validity of an incentive condition." *Id.*

120. See BEYER, *supra* note 15, at 49.

121. *Id.*

122. *Id.*

123. *Id.* Under the majority approach, the trust does not have to require the trustee to commit an illegal act or an act against public policy, but the trust must simply have the capability of inducing the beneficiary or another party affected by the trust to commit an illegal act or act against public policy. *Id.* The minority approach is to concentrate on "how the trust property is actually used, rather than on the motives of the settlor." *Id.*

124. See *id.* See also, *Hunt v. Carroll*, 157 S.W. 2d 429, 435–36 (Tex. App.—Beaumont 1941, *aff'd* on other grounds) (holding that a settlor's decision to allow trust distributions to his daughter for support in case she divorced her husband were not invalid or against public policy because the settlor's intention was not to effectuate a divorce).

125. See *Stewart v. Republicbank*, 698 S.W.2d 786, 786–87 (Tex. App.—Fort Worth 1985, writ *ref'd* n.r.e.) (determining that provisions disinheriting nieces because the court appointed certain third persons as their guardians are void as against public policy).

126. BEYER, *supra* note 15, at 59.

127. *Id.* "The equal protection clause of the Fourteenth Amendment to the United States Constitution prohibits the use of state action to carry out an individual's desire to discriminate." *Id.*

128. *Id.* Many courts refuse to enforce any type of discriminatory provisions—including provisions written for a "good" cause—because those causes can be protected using charitable trusts.

129. *Id.* "[S]ome courts treat judicial involvement in [good cause] trusts as relatively *de minimis*, cite the public benefit of providing benefits to members of certain classes, especially if that class had been previously subject to discrimination, and hold that these provisions are valid." *Id.*

option to either remove the restriction or invalidate the trust.¹³⁰ Dealing with illegal trust provisions is much more clear-cut than managing problems caused by inflexible or vague provisions.

B. Loopholes and Inflexibility

When writing an incentive trust, the creator of the trust must avoid making the conditions too inflexible or too easy for the beneficiary to get around. It is impossible to draft a trust that will cover every contingency and trying to do so will only cause more harm than good.¹³¹ Instead, the settlor must carefully find common ground between a provision that is “too restrictive and not restrictive enough.”¹³² The requirements must be flexible enough to work with unanticipated circumstances.¹³³ Writing a laundry list of distributions will not allow the trust to bend and flow.¹³⁴ The settlor cannot be expected to have psychic abilities when creating his or her estate plan.

It is impossible to prepare for every unforeseen and unwanted consequence that arises from the creation of the trust.¹³⁵ The extreme tension that exists when comparing the restrictiveness of the settlor’s values and the flexibility of the beneficiary’s values is often hard for the settlor to imagine.¹³⁶ The trust creator should avoid using terms that are ambiguous, such as “productive member of society, which are not easily defined.”¹³⁷ If potentially ambiguous terms are used in the trust, the drafter should be careful to include the definition the trustee should use in determining whether the beneficiary has complied with the conditions of the trust.¹³⁸ With the need for careful drafting

130. *See* *Coffee v. William Marsh Rice Univ.*, 408 S.W.2d 269, 274 (Tex. Civ. App.—Houston 1996, writ. ref’d n.r.e.) (stating that “. . . the intention of the parties must be determined from the language of the instrument and circumstances surrounding the trust”, and may weigh on the court’s decision to invalidate the entire trust or remove or change a portion of the trust).

131. Wood, *supra* note 109.

132. ACKERMAN, *supra* note 41.

133. *See id.*

134. *Id.*

135. *Id.* E.g., A client sets up a trust for his three young children, giving each a mandatory distribution to match his or her salary for a specific year. Child #1 becomes a surgeon and earns a \$1 million salary (and would do anything to keep his mandatory distribution to remain in the trust, safely away from his creditors and soon-to-be ex-wife). Child #2 is a preschool teacher who actively volunteers a large amount of her time to charities and serves as an obviously deserving candidate for more than the \$20,000 she will get from the trust to match her salary. Child #3 grows up to be Taylor Swift, earning millions of dollars each year from record sales, and, is clearly in no need of receiving the mandatory distribution of the trust. Child #3’s distribution also has the potential to wipe out the entirety of the trust property to the detriment of the other beneficiaries. So, now what happens?

136. ACKERMAN, *supra* note 41. “[T]he danger in drafting a trust too narrowly is that in 50 to 100 years family members may be struggling in a world very different than the one we are living in now.”

137. *See id.*

138. *See id.* By including the definition the trustee should use in the terms of the trust, both the trustee and any judge reviewing the validity or meaning of the provision have a clear guideline as to the intentions of the settlor. *See id.* If the definition is not included, the trustee or reviewing judge will simply have to guess as to what they think the settlor would have wanted—a potentially disastrous scenario. *See id.*

in mind, the settlor is ready to move forward with creating his or her incentive trust.

V. CREATING PERSONALIZED INCENTIVE-BASED PLAN

After considering all the basic requirements of creating a trust—avoiding provisions that are illegal or against public policy—and taking into account the rights of the beneficiaries to still have a reasonable power of choice over their lives, the settlor should set to work making an incentive-based estate plan that is right for the circumstances surrounding trust creation. No two situations are the same and what works for one settlor does not always work for another.¹³⁹

A. *Lessons in Financial Planning*

Not every wealthy family treats the passage of its abundance of wealth like an entitlement.¹⁴⁰ Many families prepare future beneficiaries for money management at a very early age.¹⁴¹ Some families focus on the importance of exchanging work for money; while others focus on the importance of getting as much value for a dollar as possible, and still others focus on giving back to the community.¹⁴² A settlor creating an inter vivos incentive-based trust writes provisions differently depending on the size of his or her family, the age and number of any children or grandchildren, and the morals and life lessons he or she wishes to pass on.¹⁴³ While younger children may learn lessons by using small amounts of money or repetitive actions, high school or college-age children may learn more effectively through a process that allows them to learn exactly how responsible money management works and the benefits of smart financial planning.¹⁴⁴ Whether through smart investing, charitable giving, or

139. See WOLVEN, *supra* note 17, at 5.

140. See generally SERWER, *supra* note 22.

141. See WOLVEN, *supra* note 17, at 5–6.

142. *Id.*

143. *Id.* An inter vivos trust is a trust created during the life of the settlor, which also takes effect during the lifetime of the settlor. Black's Law Dictionary 1549 (8th ed. 2004). This differs in comparison to a testamentary trust, which does not take effect, or essentially even exist, until the death of the settlor. BEYER, *supra* note 15, at 32.

144. See WOLVEN, *supra* note 17, at 5–6. The Welch family based their financial teaching methods around their “four young children, 8-year old twins, a 6-year old and a 4-year old.” *Id.* at 5. Though their children were young, the Welch’s used weekly allowances in exchange for chores around the house to develop responsible spending and saving habits in their children. *Id.* Weekly trips to a local store taught the young children the value of their earned dollars. *Id.* When the trips first began, the children spent their money on “impulse” buys but, after several weeks, the children began considering their options and saving their money for quality items. *Id.* The Welch’s also “match[ed] whatever money the children . . . [did not] spen[d] during the shopping trip.” *Id.* Though in elementary school, the Welch’s children learned the valuable lesson “that unspent money can lead to future money.” *Id.* The Fuller family was under different circumstances. With three children, one in high school and two in college, the Fullers made the decision to involve their children in every aspect of their monetary decisions following a “financial windfall.” *Id.* The Fullers used their financial gains and charitable nature to teach their children money management skills and charitable giving. *Id.*

planning for the future, all beneficiaries—real or potential—should learn to be prepared for life outside the protective bubble of their families.¹⁴⁵ Though these lessons are best learned over time and through the hands-on guidance of an adult, such guidance is not always available or simply does not happen.

When unforeseen circumstances such as terminal illness or premature death hit, many families are left unprepared for what the future might hold. Following the steps of effective estate planning, incentive-based trusts can be used in lieu of hands-on education when the settlor leaves behind minor beneficiaries, or beneficiaries who have yet to learn the lessons of responsible living or are left unable to care for themselves.

B. The Steps to Creating an Effective Incentive-Based Trust

The purpose of an incentive trust is to promote a family's legacy and support the beneficiaries without spoiling them; a different purpose than trusts written thirty years ago.¹⁴⁶ When sitting down to create the incentive trust, the settlor should consider what legacy he or she wants to leave behind.¹⁴⁷ The settlor must carefully draft the trust to avoid undesired behavior from the beneficiaries.¹⁴⁸ The settlor should ask a number of questions when determining how to draft incentive provisions to meet the needs of the trust and the beneficiaries.¹⁴⁹ As previously discussed, the settlor must think of the age and number of beneficiaries the trust is meant to support.¹⁵⁰

Next, the settlor should focus on the purpose of the trust he or she is creating.¹⁵¹ Does the settlor intend for the trust to support the beneficiaries throughout their lifetime?¹⁵² Or does the settlor only want to support the beneficiaries if they attempt becoming self-sufficient?¹⁵³ Settlers might even base the release of trust funds, to a beneficiary, on the amount of children the beneficiary has.¹⁵⁴ Restricted only by legal and public policy concerns, the settlor has numerous options in creating his or her incentive trust—the sky is the proverbial limit.¹⁵⁵

145. See generally *id.*; see also generally SERWER, *supra* note 23.

146. See WOLVEN, *supra* note 17; see also SERWER *supra* note 23. "Keeping money in the family is one end of the values spectrum and giving to charity is another." (See Part II.1 referencing the outdated "Better Than Me" Standard for trust creation still used by some well-meaning but misguided settlors.).

147. See ACKERMAN, *supra* note 40; see generally Part II.A see also Part III.A.

148. See ACKERMAN, *supra* note 40; see generally Part II.A; see also Part III.A.

149. See ACKERMAN, *supra* note 40; see generally Part II.A; see also Part III.A.

150. See WOLVEN *supra* note 17, at 5–6; *supra* Part V.A.; see also Ackerman, *supra* note 40. Many wealthy clients are waiting until their children are older—25, 30, and even late as 35—before allowing trusts to be disbursed. See ACKERMAN, *supra* note 41.

151. See WOLVEN, *supra* note 17, and Part V.A.; see also ACKERMAN, *supra* note 41.

152. See WOLVEN, *supra* note 17, and Part V.A.; see also ACKERMAN, *supra* note 41.

153. See WOLVEN, *supra* note 17, and Part V.A.; see also ACKERMAN, *supra* note 41.

154. STOUT, *supra* note 66, at 28.

155. *Id.* at 28–29. Common incentives are based on the educational status of the beneficiary, including the achievement of a specific GPA or graduating with a bachelor's, master's, or other professional degrees.

With these questions in mind, the settlor must take the first step towards creating the incentive trust and choose a trustee.¹⁵⁶ Since the trustee will be the person in charge of distributing the funds of the trust, usually long after the settlor has passed away, choosing a trustee is a tedious process.¹⁵⁷ Most attorneys recommend that the settlor choose multiple trustees to serve as co-trustees or use institutional trustees.¹⁵⁸ These recommendations are based upon the idea that non-family members or institutional trustees are *usually* less likely to be “swayed by emotional appeals” of the beneficiaries.¹⁵⁹ A handful of practitioners recommend using an advisory committee made up of representatives chosen by the settlor to deal with discretionary decisions.¹⁶⁰ However, committees of this nature generally lack the ability to make objective decisions.¹⁶¹ If a settlor chooses to use an advisory committee, any decisions made by the committee should be treated as recommendations only and not as binding on the trustee.¹⁶² Whatever type of trustee the settlor chooses, communication between the settlor, trustee, and all (living) beneficiaries is key to the success of the incentive trust.

Upon choosing a trustee, the settlor now simply has to instruct the trustee on how to make trust distributions. The trustee, and beneficiaries, should be fully informed of the settlor’s wishes so they can make effective decisions regarding trust distributions.¹⁶³ A trustee’s instructions should include detailed distribution provisions for minor children should the settlor of the trust unexpectedly pass and leave behind beneficiaries not yet old enough to attempt to meet the distribution requirements of the trust.¹⁶⁴ The instructions should also include directions regarding distribution if some of the beneficiaries left behind are of sufficient age to receive distributions, some are not, and/or some intended beneficiaries have predeceased the settlor.¹⁶⁵ A settlor must be careful because creating a trust that treats beneficiaries differently can have

Id. at 28. “Incentive trusts can also encourage moral and ethical responsibility, marriage or divorce, preferred procreation standards and productive careers.” *Id.*

156. Allchin, *supra* note 18.

157. *Id.*

158. Joshua C. Tate, *Conditional Love: Incentive Trusts and the Inflexibility Problem*, 41 REAL PROP. PROB. & TR. J. 445, 462 (2006).

159. *Id.*; Allchin, *supra* note 18.

160. Tate, *supra* note 159, at 463.

161. *Id.*

162. *Id.*

163. *Id.*

164. MICHELLE NOBLE MCCAIN, Family Incentive Trusts, <http://michellenoblemccain.com/FAMILYINCENTIVETRUSTS.html> (last visited Mar. 20, 2011). In planning for the care of minor children, many parents creating an incentive trust do not wish their children to be destitute should something unforeseen prevent the parents from caring for them before the children can inherit through the trust. Provisions instructing the trustee to use certain funds to “pay for the children’s support, health, and education” allow a trustee to support a minor child without passing off a large amount of wealth.

165. *Id.*

unexpected, even harmful, consequences.¹⁶⁶ To avoid problematic occurrences, a settlor should remember to clearly define his or her intentions in the terms of the trust, as well as give the trustee the ability to make some discretionary decisions if circumstances require.¹⁶⁷ A trustee with the ability to make discretionary changes to trust distributions based on changing circumstances has the ability to achieve the settlor's wishes without alienating an off-course beneficiary.¹⁶⁸ It is impossible for a settlor to know definitively, how or if, his or her children are going to grow up, or the unexpected curve balls life may throw at them.¹⁶⁹

The settlor may also choose to create an inter vivos trust that can be changed throughout the settlor's life.¹⁷⁰ This allows the settlor to make changes should his or her children not meet distribution standards, without relying on a trustee to figure out what is best.¹⁷¹ Settlers may also want to make sure a beneficiary is taken care of even if he or she does not meet incentive requirements. In these cases, a settlor may include provisions creating a "safety net" that will allow the trust to support a beneficiary that fails to meet the trust's standards.¹⁷² These safety net provisions allow the settlor to enforce incentive provisions without alienating beneficiaries who are unable, by choice or by circumstance, to meet incentive standards.

The settlor must also instruct the trustee as to the date or circumstances of trust termination. The settlor can choose a period for the trust to run before it terminates, or can choose some inevitable circumstance that will signal

166. Tate, *supra* note 153, at 463. It is nearly impossible to create a trust that covers the infinite "what ifs" of life's circumstances. Allchin, *supra* note 18. The success of an incentive trust relies on the settlor's clear explanation of his or her instructions for trust enforcement and expectations to both the trustee and beneficiaries. Nancy G. Henderson, *Managing "Carrot and Stick" Provisions: Selected Fiduciary Issues in Drafting and Administering Trusts with "Incentive" Provisions*, ALI-ABA COURSE OF STUDY, 1, July 17–18, 2008.

167. See Part IV.B; see also Allchin, *supra* note 18; see generally Tate, *supra* note 153.

168. Henderson, *supra* note 62, at 1; Tate, *supra* note 153, at 464–65. What happens if the beneficiary is diagnosed with a learning disability or suffers an unforeseen accident after trust creation affecting his or her ability to excel academically and, therefore, is unable to meet educational standards laid out in the trust by the settlor? It is unlikely the settlor intended this type of change in circumstance to affect the beneficiary's ability to inherit, but without the ability to make discretionary distributions, a trustee would be bound to the exact terms of the trust.

169. Henderson, *supra* note 62, at 1; see also Allchin, *supra* note 18. Ralph M. Engel, an estate-planning attorney in New York, says of his three children that "the one whom he thought would need financial help the most is now 'doing extremely well,'" proving his theory that an incentive trust must be flexible enough to allow the trustee to make disbursements fitting to the beneficiaries' current circumstances.

170. Henderson, *supra* note 62, at 1. Another recommendation is to use "the incentive approach only when children are young, then [completely] revising plans later." *Id.* An inter vivos trust is more easily altered than a testamentary trust because it takes effect immediately upon creation, allowing a trustee to go towards the (hopefully) still living settlor with any questions regarding changes to the trust, whereas a testamentary trust does not take effect until the settlor has passed and can no longer offer any help in determining what his wishes would have been in a certain circumstance.

171. *Id.* Unused trust funds are usually left to older children or charities.

172. *Using Your Estate to Motivate with an Incentive Trust*, Feeley & Driscoll, P.C., <http://www.fdcpa.com/Tax/0708TaxNews-UseYourEstate.htm> (last visited Mar. 19, 2011); Allchin, *supra* note 18.

termination of the trust.¹⁷³ In states such as Texas that still enforce RAP, a trust should also include a provision stating where remaining trust property should go in the event a court finds that the trust does not vest within the time required under the RAP test.¹⁷⁴ Whether the settlor designates that the trust shall run until all living beneficiaries are thirty-five years of age or until the youngest beneficiary of the trust has graduated from an accredited university, the settlor must include instructions regarding what happens to any remaining trust property upon termination of the trust.¹⁷⁵ Most incentive trusts instruct the trustee to distribute the remaining balance of the trust equally, or based on percentages, to the beneficiaries.¹⁷⁶ A settlor is not bound by what the majorities of other settlors choose to do and, therefore, may choose to distribute the remainder of the trust to a charity of his or her choice or to another beneficiary who never received income distributions from the trust.¹⁷⁷ Once the settlor ensures the trust outlines the trust's purposes, distribution methods, the powers of the trustee, when the trust will terminate and where the trust property will go upon termination, the incentive trust can go into effect.

VI. CONCLUSION

The key component in creating an effective and successful incentive trust is communication.¹⁷⁸ The clarity of the settlor's communication with the attorney that creates the trust, the trustee chosen to administer the trust, and all beneficiaries under the trust is essential to ensuring that the purposes of the trust are fulfilled.¹⁷⁹ The settlor should and his children should have an open communication line regarding morals, values, and money management skills to avoid resentment from beneficiaries who are surprised by their parents trust distribution restrictions.¹⁸⁰ The settlor should also communicate his or her goals for the incentive trust, as well as any fears surrounding trust creation, with estate-planning attorney he has chosen to draft the trust. Clear and open communication with the drafter of the trust ensures that the trustee will be

173. Beyer, *supra* note 15, at 105. In Texas, only a charitable trust is safe from following RAP requirements. A trust's interest must vest within twenty-one years of the end of a life in being at the time of trust creation. If it does not, the trust can potentially fail; however, Texas courts will rarely allow a trust to fail for violation of the Rule Against Perpetuities.

174. *Id.* Direct instructions to the court outlining the settlor's wishes are always better than allowing the court to simply guess as to what they think the settlor may have wanted.

175. *Id.*

176. MCCAIN, *supra* note 164.

177. BEYER, *supra* note 15, at 81. Beneficiaries receiving income distributions from the trust are those receiving payments during the life of the trust. *Id.* Beneficiaries who receive a principal distribution do not receive any distributions from the trust until the trust terminates, upon which time the beneficiaries receive a percentage, or all, of the principal amount left in the trust. *Id.*

178. *See* Part V.B.

179. *Id.*

180. Allchin, *supra* note 18. Children can feel resentment if "they feel that their parents did not trust them. *Id.* "Open communication between settlors and beneficiaries is key in keeping beneficiaries "happy," to an extent, with the circumstances of the trust. *Id.*

sufficiently instructed regarding all foreseeable issues and problems that may arise with the trust, as well as make sure the trustee's duties and discretionary distribution powers are clearly outlined.¹⁸¹ Open communication may almost guarantee that none of the incentive provisions violates any law or accepted public policy.¹⁸² This effective communication, coupled with a clear writing style, is the stepping-stone to drafting a successful incentive trust.

Incentive provisions should be unambiguous and clear-cut.¹⁸³ They should be restrictive enough to get across the settlor's values, morals, and goals of the trust while remaining sufficiently flexible to allow the beneficiaries to grow and live their own lives.¹⁸⁴ Rigid, immobile restrictions hinder the beneficiary's ability to walk his own path through life; but vague restrictions might allow a lazy or unmotivated beneficiary to receive trust distributions without fulfilling the settlor's goals at all.¹⁸⁵ The settlor must also be careful to include any definitions of his or her purposes, desires, or intent for the trust should any ambiguities arise that might require the interpretation of the trustee or a judge.¹⁸⁶

Warren Buffett's philanthropic children are perfect example of how meticulous estate planning, values-based financial education, and effective, long-lasting communication create productive future heirs.¹⁸⁷ Howard, Susie, and Peter Buffett learned of their father's distaste for inherited wealth early in life.¹⁸⁸ Raised in a "normal situation," the three children, now all in their fifties, were always aware they would not inherit a large amount of wealth.¹⁸⁹ However, they bear no resentment to their frugal and charitable father.¹⁹⁰ Through open communication, Buffett has ensured that his children are not resentful of their lack of inheritance and follow his example.¹⁹¹ Each child runs his or her own charitable foundation, to which Buffett donated \$1 billion at the same time he announced he was leaving the majority of his estate to the Bill and Melinda Gates Foundation.¹⁹² Growing up, none of the children even realized their father was a multi-millionaire, and certainly never saw any of those millions.¹⁹³ Though you might expect the children to harbor at least some

181. See Part V.B.

182. See Part IV.A. So long as no type of legal malpractice has been committed on the part of the drafting attorney.

183. See Part IV.B.

184. See Part IV.B.

185. See Part IV.B.

186. See Part IV.B; see also Part V.B.

187. Jeff Bailey, *Buffett Children Emerge as a Force in Charity*, NY TIMES, July 2, 2006 <http://www.nytimes.com/2006/07/02/business/02buffetkids.html> (last visited Mar. 21, 2011).

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Growing Up Buffett*, CNBC.COM, May 7, 2007 http://www.cnbc.com/id/18467661/Growing_Up_Buffett (last visited Mar. 21, 2011).

bitterness towards their father for not letting them in on an inherited life of luxury, Susie, Howard, and Peter are actually beaming with pride.¹⁹⁴ Buffett may not have used an incentive trust to teach his children excellent values and the importance of hard work, but his children are a perfect example of how all the elements necessary to create an effective incentive trust—effective communication, lessons in financial planning, and allowing children to have some freedom over their life decisions—work together to create productive future heirs.¹⁹⁵

by Mikela Bryant

194. *Id.*

195. *Id.*