Incentive Trusts | Responsible or Controlling?

A Conversation with Myra Salzer and Barbara Blouin

How do we pass our wealth on in a way that is respectful, responsible, and in accordance with our values? Some advisors advocate "incentive trusts" as a partial answer to this sticky problem. We asked two experts on inheritance to discuss the pros and cons of these specialized trusts. This brief excerpt from their discussion is meant to stimulate thought and conversation.

Myra Salzer is founder of The Wealth Conservancy (**www.thewealthconservancy.com**), a financial coaching firm for people with substantial inheritances. Since 1989, Salzer has led *Inherited Wealth and You*, an annual four-day retreat where inheritors explore the effects of wealth on their lives.

Barbara Blouin is an inheritor and co-founder of The Inheritance Project (**www.inheritance-project.com**), which publishes books, essays, and articles on the emotional and social impact of inherited wealth. Blouin is author of *The Legacy of Inherited Wealth: Interviews with Heirs* and *For Love and/or Money: The Impact of Inherited Wealth on Relationships.*

MYRA SALZER: Let me begin by saying that I hate the name “incentive trusts” because it makes them sound like a bribe, rather than trusts that encourage the beneficiary to do things that are aligned to the donor’s values. Some donors base disbursement on attaining a degree, or on marriage; some match earned income, or what the beneficiary raises to start his or her own business; some enable the beneficiary to not have to earn money while raising children. The incentives really can be whatever the grantor wants.

People set up incentive trusts because they want to be responsible in the way they give. They don’t want to take away from their heirs a sense of purpose or accomplishment, or even just a reason to get out of bed in the morning.

Reprinted from Issue #26, Effective Giving

BARBARA BLOUIN: Let me point out that although I have interviewed many inheritors, I have never interviewed anyone with an incentive trust. But I have been working for three months on an article subtitled, *How to Prepare Your Children for an Inheritance*. The conclusion I've come to is that I don't think people *should* give their children a lot of money. As Myra said, if they inherit a lot of money, what reason *do* they have to get out of bed? I also have concerns about parents who set up incentive trusts to encourage their children to behave according to the parents' values. I believe that if parents raise children well and model the values they believe in, their children will internalize them.

M.S.: I agree. That's why the incentive trusts I've been involved with are testamentary trusts (that is, trusts that are formed as a result of the donor's death). If the parents won't be around to teach the values they believe in, they feel incentive trusts will help to replace the financial guidance that they won't be able to give themselves.

Of course, it's not easy to anticipate what circumstances will arise down the road, so it can be very difficult to draft incentive trusts well. I always recommend that donors make sure the trusts stay relevant in a wide variety of circumstances, such as whether or not the beneficiary has their own children, and that they consider a wide variety of values—philanthropy, education, entrepreneurship, and so on. A good trust has to give the beneficiary choices.

B.B.: Still, I believe that children should be free to develop their own values. Growing up, my money was very heavily controlled, and so that view comes partly from my own experience. At some point, a person has to be master of his or her own destiny; parents who pass money along should be prepared for the possibility that their kids won't make good use of it. That's my bias.

I'm struggling with this with one of my own children. He's 24 and is supporting himself because any time I give him money, he blows it. If I died next week, my will says he would have a trust with my husband as trustee. My son could get the money only under certain circumstances. But when he reaches 35, he's getting the money.

A potential problem I can see is that if you create a trust that leaves it up to the trustees to determine whether the beneficiary is doing something that is deserving of distribution, it really puts the beneficiary in a powerless position. I prefer trusts where distribution is made no matter what happens, such as "trickle trusts." These make distributions at a series of ages, say five years apart. So at 21, the beneficiary receives $10,000, at 25 they get more, at 30 more, and at 35, they get the rest. At that point, there is no more trust and no further conditions.

M.S.: But in the real world, people don't generally get money just because they reach the age of 21. When people act and receive a reward as a result, they feel ownership for their money; if it's given, whether from a lottery or a lawsuit or an inheritance, there's a disassociation between them and their money. They're not integrated with it.

B.B.: That's a good point. However, in the case of incentive trusts, even though the money is "worked" for, it comes from the parents, not an employer. The trust can still be perceived as Daddy making me do what he wants me to do. Of course, if there is a more positive relationship between donor and beneficiary, it may not be experienced that way at all.

M.S.: That's why finding good trustees, who really understand the grantors' values and intentions, can make or break the trust. I recently helped draft a trust that made my clients' children trustees for the grandchildren. That way my clients won't be denying their children the ability to parent, but the money will still skip a generation, as planned. The grandchildren's parents will be co-trustees who together decide on distributions for tuition, philanthropy, or the family foundation.

B.B.: Yet, each child is unique and different, and if grandparents are the grantors, there's often no way to know what the beneficiary's money habits will be like. If two kids are ages eight and twelve and it's already obvious that they relate to money very differently, should the terms of the trust be the same for each, or different?

M.S.: That's the beauty of incentive trusts: options. Someone can choose to do distributions for one child related to anthropological work in Africa, and distributions for the other to encourage entrepreneurship. If one's a dancer, let that one dance! Then the distributions will be more meaningful and appreciated, because they will enable the beneficiary to pursue his or her passion. That's what a trust should do, rather than deny the beneficiary a desire to have a passion.

B.B.: In theory, it sounds good. In practice, we're not going to know how well they work until we actually see a number of people who grow up and inherit incentive trusts. We really haven't seen the results yet. They may work very well, or there may be problems we can't foresee.

M.S.: There's a responsibility that comes with wealth: how to steward it properly, how to pass it on properly, and how to have it be a tool to support your purpose, rather than a burden that keeps you from accomplishing your purpose. That's what we're really talking about. ■

—*Conversation facilitated by Eli Pariser*