

THE WALL STREET JOURNAL.

MAY 11, 2005

(Copyright © 2005, Dow Jones & Company, Inc.)

Wealth Manager: How to Ask (Nicely) for Your Inheritance

Boomers Create Empty Trusts, Invite Parents to Fill Them; An Awkward Talk With Dad

By Rachel Emma Silverman

AS A WAVE of baby boomers prepares to receive inheritances from their aging parents, the estate-planning industry is pitching a new twist on an old technique.

The new approach is called an "inheritor's trust," and it is part of a growing range of services, seminars and estate-planning strategies designed to capture what is expected to be the largest intergenerational transfer of wealth in history -- while reducing the tax hit.

Traditionally, parents planning a bequest to their children or grandchildren might set up a trust themselves for their heirs' benefit. In an inheritor's trust, people who expect to receive an inheritance take matters into their own hands by designing trusts to collect the windfall. It is essentially an empty bucket to hold whatever money is left to them.

The idea is to protect inheritances from creditors, divorcing spouses, and estate and generation-skipping taxes. If set up properly as a "dynasty trust," which are established in states that allow trusts to last forever or for hundreds of years, the trusts can offer these benefits for many generations.

The topic of planning for an inheritance is being discussed at wealth-management conferences and in trade journal articles with titles like "The Art of Properly Inheriting Property." Estate planners, who of course stand to collect fees from these trusts, are increasingly discussing the idea with their clients. Last year, a trio of estate lawyers trademarked the name "Inheritor's Trust."

Like many strategies designed to help reduce taxes or to shield assets from future creditors, inheritor's trusts could be subject to Internal Revenue Service audits or court challenges. Proponents of the trusts say they should pass muster, if drafted and funded in accordance with tax codes and other laws.

Still, many inheritor's trusts are

structured as dynasty trusts, which could face hurdles if Congress decides to curtail them. This year, the Joint Committee on Taxation staff, in a 435-page report on options to improve tax compliance and shut tax loopholes, described a way to crack down on dynasty trusts by limiting the perpetual tax breaks associated with them. However, there has been no legislation introduced in Congress on the matter this year.

The increasing popularity of these vehicles reflects a different kind of thinking about estate planning: looking up a generation instead of down, which indicates a new determination on the part of inheritors to take the lead on estate issues. But the trusts can be expensive to set up and can mean awkward conversations with relatives about whether they are planning to leave you anything, and if so, how.

Inheritors don't need to know exactly how much they will receive. But in order for the trusts to work, they will have to ask their parents to amend their wills or estate plans to leave any inheritance to the new trust, rather than to the inheritor outright. Creating a trust involves transferring assets to a person or institution, the trustee, who minds them for intended beneficiaries.

Trusts of all kinds are growing in popularity these days. One reason: They often are designed to be more flexible than in the past, making it easier, for example, for beneficiaries to switch trustees. Trusts that can shield assets from future creditors also have become attractive vehicles for doctors, business executives and other professionals concerned with liability.

Overall, bank-held personal trust assets increased to \$1.01 trillion at the end of last year, from \$966.8 billion at the end of 2003 and \$878.8 billion in 2002, according to preliminary estimates from Spectrem Group, a Chicago research firm that tracks the wealth-management industry.

Many private banks and trust companies also have been organizing special intergenerational retreats to help

spark conversations and ease tensions related to estate planning. Last month, Smith Barney, a unit of Citigroup Inc., even hosted a seminar titled "Family Dynamics and the Challenges to Intergenerational Wealth Transfer," featuring Warren Buffett's son, Peter, who talked about his family's approach to philanthropy.

Financial-services companies are also pushing other wealth-transfer strategies, such as "stretch IRAs," which extend the tax benefits of a traditional IRA to younger generations.

The cost of creating an inheritor's trust varies, depending on its complexity, but typically runs from \$7,500 to \$15,000 in legal fees, in addition to annual trustee fees, which can swallow roughly 1% of trust assets. Parents who simply fund the trust might incur much smaller legal fees -- sometimes just a few hundred dollars -- to amend their wills or trusts to direct the inheritance into the trust.

Inheritor's trusts can be set up in a variety of ways, but generally are designed to provide beneficiaries with lots of flexibility so the trusts can be adjusted as tax laws and family situations change. To realize the maximum asset protection and tax benefits, the trust has to be set up before you actually receive the inheritance. Because the trust, rather than the heir, legally holds the inheritance, the windfall can be hard for creditors or divorcing spouses to reach, even under the terms of the new federal bankruptcy law, according to estate lawyers.

In most cases, inheritor's trusts are used for inheritances or gifts from parents, but they also can be funded by other people, such as grandparents or close friends. Parents also can start funding the trust while they are still alive, rather than at their death.

Bringing up the topic of inheritances with parents often is the toughest part of the process. "It's hard for clients to go back to their parents and meddle into their affairs," says New York lawyer Gideon Rothschild. Alexis Neely, a Redondo Beach, Calif., lawyer, sometimes

has her clients role-play the conversation, with Ms. Neely playing the part of the parents and the client bringing up the topic.

Peter Haspel of Carriere, Miss., set up an inheritor's trust several years ago. The hardest part, Mr. Haspel says, was convincing his elderly mother to go along with the plan. "It was hard to get her to try to understand that it would not impinge on her life in any way, but it would make a substantial difference to her children and her grandchildren," Mr. Haspel says. "It took quite a while for her to be willing to say okay."

Inheritor's trusts generally are set up to give the beneficiary a good deal of control and options. Often, they are set up with co-trustees. One trustee typically is an independent trustee -- such as a trust company, a close friend or financial adviser -- who has discretion over when and how trust assets are distributed to the beneficiary. The beneficiary would be the other co-trustee and can have investment control over the assets in the trust and even the power to choose and change the independent co-trustee, in accordance with tax rules.

Inheritor's trusts are typically designed as dynasty trusts. As long as assets are held by the trust -- and if the trust is funded and structured properly -- the trust can pass from generation to generation without additional estate or generation-skipping taxes, allowing trust assets to multiply over time. This year, the amount that a parent can leave at death free of estate or generation-skipping taxes is \$1.5 million.

The trusts don't have to be used for big windfalls, but can even be used to receive small inheritances. Some lawyers, for instance, recommend that entrepreneurs start new businesses from an inheritor's trust; the trust invests in the businesses -- rather than the inheritor outright -- helping to shield the business from creditors. If set up properly, "the assets owned in a trust can be protected from creditors, divorce and the IRS for transfer-tax purposes," says Las Vegas lawyer Richard Oshins, one of the three who trademarked the term "Inheritor's Trust" last year.

Yet Congress is considering repealing federal estate taxes permanently. The House has already passed full repeal, and the measure has been sent over to the Senate, where speculation is widespread about a possible compromise. Total repeal would eliminate one motive for setting up the trusts: saving taxes as money passes from generation to generation. But because inheritor's trusts have nontax benefits as

well -- such as protecting trust assets from creditors -- they might well remain viable even if Congress repeals those taxes.

Creating an Inheritor's Trust

Some people are designing special trusts to help collect their future inheritances. Here are some features of these so-called inheritor's trusts: -- They help protect an inheritance from creditors, divorcing spouses and estate and generation-skipping taxes. -- They can be expensive to set up, and can lead to awkward conversations with parents about one's inheritance. -- They have to be set up before you receive the inheritance, and you cannot fund it yourself for your own benefit.