

The following article was originally published in the fall edition of the *West Virginia Lawyer*. For information on the publication, go to: [www.wvlawyer.org](http://www.wvlawyer.org).

### Incentive Trusts: A Potential Tool for Every Estate Plan

By Bruce L. Stout, Partner, Huddleston Bolen LLP

All parents face the dilemma of getting their children to do what they want. Parents often express concerns about their child's lack of drive to work and succeed and his or her naiveté when it comes to the use of money. We try to punish, we try to reward—but with mixed success—we are always are looking for ways to improve our techniques.

Regardless of these day-to-day struggles, when a testamentary trust is drafted for a child, the proceeds of the trust are generally distributed at one or more times based upon the child's age. A common approach is to distribute one-third of the proceeds at age 25, one-half at age 30, and the remainder at age 35. The inlaid assumption is that at this age, children become mature, competent money managers.

While this approach has history on its side, it simply does not make sense. If parents want to impose conditions (sometimes called “strings”) to payments made to their children during their lifetime, why should this stop at death? Is there any reason to suggest that children magically mature at the death of a parent or at a certain age? My experience with my clients' children and my own provides none.

There are a number of clauses that have been used in the past to create an “incentive” for a beneficiary to act in a certain manner. Many incentive trusts focus on promoting education by restricting payment of the trust. Some grantors consider the distribution of trust funds based upon a child's graduation from high school, college, professional, or graduate

school. Distributions can also be contingent upon maintaining a specified GPA. Other stipulations might include graduating with a certain major, from a certain school, or within a certain time period.

Incentive trusts can also encourage moral and ethical responsibility, marriage or divorce, preferred procreation standards, and productive careers. Many trusts restrict the distribution of funds if the beneficiary uses or abuses drugs, alcohol, or tobacco. Grantors may even wish to consider the promotion of social responsibility by requiring the beneficiary to be free of criminal convictions, gambling addictions, traffic violations, or DUI citations. Incentive trusts can often obligate a beneficiary to marry at a certain age, marry a person of a certain religion or ethnicity, or stay married for a certain length of time. While most incentive trust provisions dealing with marriage typically discourage divorce and cohabitation, another goal is to influence procreation; many incentive trusts provide distributions to beneficiaries based on the number of children they have.

Encouraging divorce in a trust is against public policy. *Wills: Validity of Condition of Gift Depending on Divorce or Separation*, 14 ARL 3d 1219. Nonetheless, testators are constantly seeking a way around this rule. In *Brizendine v. American Trust & Savings Bank*, 101 So. 618 (Al. 1924), the Alabama Supreme Court held that when a testatrix left her real estate to her son, conditioned on his having nothing to do with his current wife, the clause was void against public policy. Instead of outwardly encouraging beneficiaries to divorce, testators can include a constraint to base beneficiaries' distributions on their current resources. For example, if a beneficiary's assets decrease by 25 percent in a certain year, the beneficiary becomes eligible to receive the trust assets. Another stipulation could serve to increase the benefits given to a beneficiary if he or she is a single parent. Adding these provisions to the trust will help obtain the testator's desired result without specifically requiring a beneficiary to divorce.

While promoting divorce in a trust is against public policy, a person does have the right to impose their religious views on the beneficiary of a trust. This allows the grantor to restrict funds from a child who has married someone of an unacceptable faith. In *United States National Bank of Portland v. Snodgrass*, 275 P.2d 860 (Or. 1954), the testator's daughter could only

receive her portion of the trust if she did not embrace the faith of her husband. The court ruled the clause was valid based on freedom of speech.

Furthermore, a grantor may want a beneficiary to establish a productive career and engage in charitable activities. Many grantors choose to pay distributions to beneficiaries based on the amount of income they earn. This approach is often referred to as “earn a dollar, get a dollar.” I like to think of it as allowing others to participate in the “joy of work.” Other incentive trusts may choose to give rewards to beneficiaries who enter the family business. Lastly, there are incentive trusts that set up what is called the “Family Nobel Prize,” where the beneficiary who is deemed to have made the most significant contribution to a charitable field receives a cash award at the end of the year.

After choosing the desired terms of the trust, the grantor must ensure proper administration of these conditions. One possibility is to have three co-trustees, one of whom is not a family member. Another option is to select an institutional trustee to ensure proper administration of the trust. It is important for grantors to be concerned with the potential inflexibility issues that result from an incentive trust. For instance, what if a child is unable to attend college because of a learning disability? What if a beneficiary has an accident and is unable to work, or loses his or her job for an unforeseen reason? If the beneficiary is unable to have children, are there provisions that provide for adoption? What if the beneficiary cannot find a spouse who meets all of the trust’s specifications? Appointing a trust protector with the power to modify the trust in light of these circumstances could help prevent such inflexibility issues.

While the grantor of an incentive trust cannot possibly foresee all of the troubles a beneficiary may encounter, a reasonable grantor should have the trust drafted in a way to account for the possibility of changing circumstances. A common approach is to establish a means by which the trustee or the beneficiaries have the capacity to amend the trust. While traditional rules cannot allow courts to order a modification of the trust, settlers can direct the terms of the trust to allow for modifications due to a change in circumstances.

In light of parents’ growing concerns of leaving their children with too much money and too little direction, an incentive trust proves to be a useful tool for every estate plan. Limiting

trust distributions in a way that fosters positive behavior provides each grantor a better chance of obtaining what he or she wants to achieve. While nothing is ever guaranteed, estate planners should consider using incentive trusts as another arrow in their quiver—especially in the world we live in—where trusts are lasting for generations and not all children are born in Lake Wobegon.

**About the author:**

Bruce Stout heads the firm's Trust and Estate Department. He was recently named a 2010 Lawyer of the Year for Trust and Estates Law by *Best Lawyers*. For more information on Mr. Stout, visit his biography at: <http://www.huddlestonbolen.com/attorneys.php?a=34>.

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