CARETAKER AND INCENTIVE TRUSTS FOR ADULT CHILDREN

Are you concerned your son may adopt a "vacation" lifestyle if he receives his inheritance all at once? Do you have a daughter who can't manage her own finances responsibly, or is too easily influenced by others? Have you worked hard to accumulate your wealth and are now concerned that an outright gift of large sums might be detrimental to your children and grandchildren? If so, you may want to consider an incentive trust as part of your estate plan.

Parents often agonize over children's lack of maturity or behaviour problems and worry that matters will only become worse once the child receives his or her inheritance. Typically "caretaker" or "protection" trusts have been created to preserve wealth and provide financial security for such family members. Funds are parked in the trust and a gatekeeper trustee, such as a trust company, is given discretion to make distributions. Fixed distributions may also be required in stages over a period of time based on the age of the beneficiary, or the number of years since the death of the parent.

Caretaker trusts protect assets from others such as creditors or an estranged spouse, and can also prevent capital from being squandered by an irresponsible beneficiary. They provide a form of security blanket funded by the inheritance. However, they do nothing to motivate or assist beneficiaries to develop character, or become mature responsible adults. They simply protect them in the event they do not. Some parents fear in fact, that the creation of such a trust can act as a disincentive for their children to become independent – since they can always fall back on the trust fund – becoming what are called "trust babies".

Incentive trusts, on the other hand, are designed to encourage or discourage certain types of behaviour and are based on the principle that children should ultimately take responsibility for their own lives. Most parents want their children to develop their own personal resources so they can become self sufficient and reach their full potential. Trusts are created in the Will to encourage behaviour consistent with a parent's particular values, or considered to be in the child's best interests. Examples of behaviour or achievements that might be rewarded under an incentive trust include:

- obtain a university or graduate degree
- maintain a certain grade level
- pursue a particular career
- maintain full time employment
- demonstrate financial responsibility
- do charitable volunteer work
- undergoing treatment for psychological problems or addiction
- enter into a pre-nuptial agreement

Some specific incentive rewards might include: matching earnings, providing seed money to start a business, allowance for a stay at home parent and continuing or increasing distributions. The most flexible approach would be to permit the beneficiary to work with the trustees to determine the specific criteria to be rewarded and the financial consequences. Involving the beneficiary may be the most effective way to motivate behaviour and achieve the parent's objectives. The children's participation in the autonomy and personal growth.

Incentive trusts have not been used extensively in Canada and may prove a challenge to design and administer. Ideally the terms of the trust should also take into consideration the results of current research in the psychology of behaviour modification. The choice of trustees is critical since success will depend on their exercise of discretionary powers to set appropriate goals, determine whether they have been attained, design financial consequences and continuously monitor the effectiveness of the incentive scheme. Life insurance can be used to secure the funding. Professional advice from a legal advisor with expertise in estate planning is essential.

Your Investment Advisor can help introduce you to a professional advisor.

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