



The MONEY MONITOR

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703-288-0500

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Second Families Trigger Complex Planning Issues

Yours, mine, and ours. As a premise for a movie, the blended family is ripe with comedic potential.

As the basis of an estate plan, it can be fraught with emotional and financial minefields. But today, with more than half of all marriages ending in divorce, second families full of stepchildren and half-siblings are becoming the norm.

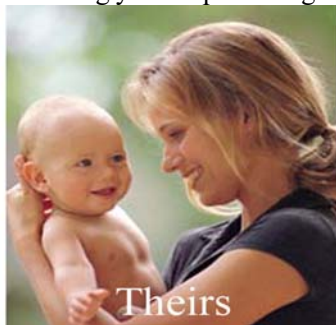
Most estate plans aren't set up to address the myriad issues of these modern family groups. Consider the increasingly

that document will take precedence over any future planning. Alimony, child support, life insurance, how assets are titled, and distribution of assets in retirement plans are typically spelled out in a divorce and need to be incorporated into planning for a second family.

After that, it helps to have an airtight prenuptial agreement signed before your second marriage. Most states that aren't community property states have strict laws preventing one spouse from disinheriting



His



Theirs



Hers

common scenario of one couple with three sets of children. Each spouse has children from previous marriages, and together they have their own children. Unless an estate plan says otherwise, when one spouse dies, the other gets everything, with complete discretion on how to divvy up the assets. The surviving spouse could favor his or her own children, leaving the other kids out of the money.

The best way to avoid such issues is to make plans to bring in the lawyers early, before expectations and emotions take over. A solid prenuptial agreement combined with a well-structured estate plan can go a long way toward maintaining the peace.

As uncomfortable as it may seem, the best time to begin planning for your second family is during the divorce from your previous spouse. Everything agreed to in

the other, and a prenup may be the only legal document that can override such statutory spousal rights. Without a prenup, a surviving spouse may be entitled to as much as half of the total estate.

If a prenuptial agreement waives those statutory rights, you will have the freedom to do what you want with your money—for example, leaving more of your estate to your children. Consider a husband who has a second wife, kids from this marriage, children from a previous marriage, and an estate worth \$10 million. A prenup could ensure that upon his death, his estate will flow into two trusts, with \$2 million going into a qualified terminal interest trust (QTIP) for his second wife and the rest into a family trust. Through the QTIP, the second wife will receive income from the trust during her lifetime, but the husband

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What We Are About

Good advice. That is what The Monitor Group is all about, and this Money Monitor is packed with good advice.

The chances are high that you or someone you know has a blended family. It is crucial for second families to plan properly so as not to unintentionally disinherit a child. There are other issues, too, discussed in our cover story.

We recommend trusts for virtually all our clients, with some rare exceptions. Choosing a trustee is sometimes a challenge, and in some cases a corporate trustee is indicated. We have relationships with corporate trustees, and are happy to recommend one where appropriate. Please read the discussion on pages 2-3.

Do you love to spoil your grandchildren? Perhaps there are some thoughtful ways you can enrich their lives with wisdom as well. There are some excellent ideas on the third page.

Many of our clients move to a new location after retirement. Reduced costs and reduced taxes are a major consideration. But there are additional items to consider—the concluding article discusses five mistakes to avoid.

We trust your spring and summer are shaping up to be enjoyable!

Cal Brown, CFP
Vice President

Shaping Your Legacy With Trusts

Like many affluent baby boomers, Paul Schervish and his wife worry about the impact of their wealth on their children. So, instead of leaving the three kids a lump-sum inheritance, they've structured a trust that will distribute its holdings "like a good parent," providing support for home buying, education, and health care.

As director of Boston College's Center on Wealth and Philanthropy, Schervish knows he's hardly alone in his concerns. As families participate in the biggest wealth transfer in history, estimated at more than \$45 trillion, "they're trying to figure out how to make inheritances productive, not destructive," Schervish says.

That often means employing one or more trusts. Though frequently touted for their tax benefits, trusts can also help preserve and protect wealth and enable parents to exert control over children's lifestyles. The irrevocable nature of most trusts can provide substantial protection from divorcing spouses, medical malpractice judgments, and other claims by creditors.

Trusts are almost infinitely flexible. "You can write just about any trust provision you want, and

some people set very specific requirements that have to be met before payouts are made—that a child attend a particular college, say, and receive a set grade point average," says Jeffrey Condon, co-author with his father Gerald Condon of *Beyond the Grave: The Right Way and the Wrong Way of Leaving Money to Your Children (and Others)*.

Trusts can protect assets from creditors and ensure that your wishes are carried out

Getting that specific is usually a mistake, says Condon, though he does encourage clients to consider establishing solid criteria for how beneficiaries—a spouse, children, grandchildren, or even those in succeeding generations—gain access to trust assets. Condon believes such restrictions are preferable to the common practice of simply staggering payouts—for

example, giving beneficiaries a third of their share at age 30, another at 35, and the rest at 40. "Heirs can blow those installments just like any other windfall," he says.

To help protect a "problem" child, who may have a drug or alcohol habit, a trust could put a great deal of control in the hands of a professional trustee, such as a bank or trust company, that will not only oversee trust investments but also cut the checks for all beneficiary expenses. Sometimes, trust provisions also call for a third party, a family friend or relative, to help assess an heir's needs and keep the professional trustee informed.

But Condon warns against a "carrot and stick" approach that imposes too many conditions. "No matter how well such trusts are drafted, everyone may wind up in court, with the kid saying he or she has met the conditions and the trustee saying the heir hasn't." A better solution, in such cases, Condon says, is simply to limit the payout. "That way, the heir knows this is all that's coming. Sometimes, the best you can do is hope your children's lives will be happy. Trusts can do many things, but they can't force your children to live the way you want when you're no longer around." ●

Selecting A Corporate Trustee Certainly Has Its Drawbacks

Does the idea of putting control over trust assets in the hands of a virtual stranger give you the shivers? Or maybe you've heard that corporate trustees are pricey, take longer to make decisions, and—due to personnel changes—may mean your beneficiaries will have to deal with a series of point people rather than one individual.

All are potential drawbacks. But before you opt for a friend or family member as trustee, consider the pros of choosing a corporate trustee.

● **Staying power.** The role of trustee can be demanding, and may span a long period. An individual could find that responsibility overwhelming, and if that

person dies or becomes mentally incapacitated, it could create problems for the trust and its beneficiaries. A corporate trustee, however, can administer the trust for as long as it endures.

● **Objectivity.** Friends and family members are likely to have emotional connections to beneficiaries, could cave in to unreasonable requests, and may not be able to balance the needs of current and future beneficiaries. A corporate trustee will follow the grantor's wishes to the letter.

● **Expertise and commitment.** The role of a trustee is complicated and time consuming. Trustees must not only collect, value, and safeguard assets, but

also invest and distribute them, as well as keep accurate records and follow complex accounting, legal, and tax regulations. And flubbing a filing or omitting a tax payment can have serious ramifications, and could leave the trustee liable to charges of fiduciary malpractice.

● **Conflict resolution.** An independent corporate trustee can serve as a buffer when conflicts arise and may be better equipped to resolve disagreements or make unbiased decisions.

Of course, it's essential to choose corporate trustees with care. Plan to talk to several candidates. Consider factors such as how long the trust department has been in business, the number and the

Five Financial Ideas For Grandparents

Spoiling your grandchildren with extravagant gifts may be fun, but you're not really doing them—or yourself—any favors. Instead, it may be wise to look for ways that help grandchildren but that also make financial sense for all of you.

Your long experience handling money matters is one invaluable gift you can pass along. Sharing your savvy not only helps grandkids develop healthy financial habits but also to understand family and cultural values. So tell them about your first job, how you started a business, and financial goofs you've made, such as spending too much or getting suckered into bad investments. "There's a big legacy gap," says Nathan Dungan, author of *Prodigal Sons and Material Girls: How Not to Be Your Child's ATM*. "Grandparents aren't having these conversations with the grandkids."

But don't leave your own children out of the loop. Make sure your advice and giving strategies don't conflict with their plans or guidance for your grandchildren. Here are several ways you might help:

Leverage your gifts. A grandparent can now give as much as \$12,000 a year tax-free to each child and grandchild. If you have a large family and make such gifts for several years, you could substantially reduce your taxable estate.

But rather than simply putting cash in the grandchildren's pockets, consider creative alternatives. For example, you might open a custodial savings account for a grandson and match what he saves. Or you could establish a brokerage account and use your contributions to help your granddaughter learn about investing. But stick to broad mutual funds rather than individual stocks. Choosing the wrong stock could lead to deep losses and discourage your would-be Warren Buffett.

Take care of college. Setting up a state-sponsored 529 college savings plan for your grandchild brings benefits for both of you. Start early and kick in the annual gift-tax-free maximum, and your grandson or granddaughter should be in fine shape when tuition comes due. Money in 529 plans grow tax free and withdrawals for qualified college expenses aren't taxed, either. And, if you want to accelerate giving, you can make five years' gifts—a maximum of \$60,000—all at once. Moreover, because you control the plan, you don't have to worry about a spendthrift scion squandering the money. And, what if you didn't get around to starting a 529? Consider sending a tuition check directly to your grandchild's college. It won't count against your \$12,000 annual gift-tax exemption.

Put a roof over their heads. First-time homebuyers often earn enough to

qualify for a mortgage but lack cash for a down payment and closing costs. Your gift could make up the shortfall. But there are other options, too. You could make a low-interest or interest-free loan, though that may raise complicated tax issues. Or, if qualifying for a home loan is a problem for your grandchildren, you could co-sign a mortgage. Some financial companies offer programs allowing grandparents to pledge securities as collateral for a grandchild's mortgage, so you can lend a helping hand without the expense and taxes of liquidating personal holdings.

Guide with your gifts. One alternative to direct giving is to fund one or more types of trusts, which can be customized to fit many financial and personal situations. An incentive trust, for example, could be instructed to distribute funds to your grandchildren in installments, at specified points in their lives, and may tie payouts to your grandchild's accomplishments—reaching a certain income level, for example, or getting a college or graduate degree. But tread carefully, warns Dungan. "You need to help a grandchild develop healthy financial habits before trust distributions start," he says. And be careful about the kinds of hurdles you set up. "You want your grandchildren to be connected to their life passions, not yours, so don't strive for too much control," he suggests.

Encourage philanthropy. There are several options for helping your grandchildren learn the value of charitable giving, and many of these vehicles also offer estate tax advantages. For example, you could transfer assets from your estate into your own family foundation, though to be effective, a family foundation needs an initial commitment of as much as \$1 million. Your grandkids could get involved by helping screen grant applications or serving on the foundation's board. A less expensive alternative is a donor-advised fund, which also lets grandparents and grandchildren confer about what charities to support. "This is like having your own foundation to support causes you believe in, but without the hassles and paperwork that go along with operating one," Dungan says. ●

But It Can Also Give You Peace Of Mind

average size of the trusts it manages, and the experience level of its employees. Because you're looking for someone you'll be comfortable talking to about your personal relationships, you'll probably want to meet with your top choices in person.

Delve into the financials by comparing investment returns, fees—including when the last increase took place and how much of a bump it was—and services. Ask for samples of trust statements or reports to see whether they're written in language a layperson could understand. Find out what restrictions, if any, limit the corporate trustee's investment options; some

conservative firms provide only internal investment options, which significantly reduces a trust's investment opportunities.

When you've settled on a corporate trustee, consider when to introduce the trust officer to your family. Often, trustees are designated to take charge after the grantor's death—a time of great stress and instability for the family. A better bet may be to bring in a corporate trustee now and hold regular family meetings, giving the trustee and beneficiaries the chance to build a working relationship. And designate one or more persons to have the power to remove and appoint a corporate trustee if it becomes necessary. ●

Retirement Relocation: Five Mistakes

In his introduction to the fifth edition of *Retirement Places Rated*, a 300-page guide to the nation's best (and worst) golden-years destinations, author David Savageau makes a startling suggestion: maybe you should just stay put. Retiring where you've spent your working life will give you more power, independence, and practical knowledge than you're likely to have anywhere else, Savageau says, and it gives you the one thing you can't take with you when you go: a deep sense of place.

But leaving the old hometown isn't the only mistake retirees make, according to Savageau. For those determined to leave, he offers five missteps to avoid.

Not forming a psychic connection with your destination. Finding an ideal retirement spot can take years of vacations, followed perhaps by buying a second home and spending time there in different seasons until you develop a sense of belonging that appreciates a place's benefits and forgives its liabilities. Many older adults don't take the time for this and either return home

after a disappointing stint in Vegas or Florida or move on to another "promising" destination.

Obsessing too much about taxes. If you consider only states that don't tax personal income at all, you're limiting your search to just Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. But if you look at states that either don't tax retirement income (Hawaii, for example) or that treat it favorably (Colorado and Georgia, among others), suddenly your quest for low-tax retirement will take in more than half the country.

Focusing only on resorts. Sure, Myrtle Beach, Hilton Head, and Palm Springs have their attractions, but their economies are defined almost exclusively by recreation. This can mean several things: higher prices for consumer goods and services; low-wage jobs, and unemployment in the off-season; and higher property-crime rates at the height of the season. Instead, consider locations that balance a recreation economy with an education economy (such college towns as Durango, Colorado, or Las

Cruces, New Mexico) or a government economy (state capitals such as Austin, Texas, or Olympia, Washington).

Playing the pioneer. There's nothing wrong with searching for the next Aspen or Santa Fe, but don't expect it to be a little-known haven only you have found. Often, the reason a place is undiscovered is that it isn't a haven at all. Stick with locations that already have a population of newly arrived retired people. They're there for good reasons, and you'll never have to be the new kid on the block.

Avoiding urban areas. Most of us live in cities, and surveys show that most of us want out. Still, there is a small but growing trend toward retiring downtown. Developers are adapting warehouses, hotels, and office buildings into posh condominiums and apartments, and their biggest markets are young singles and older adults. Both groups are there for the culture and excitement. Redevelopment of handsome old masonry buildings is happening in places as diverse as Knoxville, Denver, Houston, Birmingham, Boston, and Chicago. ●

Second Families

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has control over who is named as the trust's final beneficiaries.

Granted, this scenario may not be the most efficient option from a tax-planning perspective. In a more traditional family situation, the grantor would probably fund the family trust for the children with his \$2 million estate tax exemption and leave the bulk of the assets to the spouse, who can inherit an unlimited amount tax-free. But if your goal is family harmony, tax issues usually go on the back burner.

Pre-nups can also be critical when a family business is involved. The husband may want to take care of his surviving spouse but not want to give her any ownership control of the operation. With a

pre-nup, the spouse can relinquish her claim on the family business in exchange for other considerations, such as a life insurance policy or a guaranteed share of business profits.

Often, one of the most emotional second-family issues involves the family home. You could put your house in a trust and allow your spouse to live in the house for as long as he or she lives, and for your children to inherit the house after both you and your spouse have died. The value of the house would be subject to estate tax, but placing the house in a trust assures your spouse that he or she will always have a place to live while assuring your children they will get the house after you're gone. Gift tax consequences must be considered because the gift of your house to your children could reduce your lifetime gift-tax exclusion.

Life insurance can also play an important role in the equitable distribution of assets. Suppose you want to leave your spouse all of your personal and marital assets, but still want to take care of your children. You could set up a trust naming your children as beneficiaries and fund it with a life insurance policy. To save on gift tax, you could use your annual gift-tax-free exclusion—\$12,000 per beneficiary—to pay the premiums.

Whatever your family situation and your long-term goals, a little planning can go a long way in ensuring every branch of a complicated family tree is accounted for. ●

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