Experience Shapes Successful Trusts

By Thomas E. Junkin

"In theory, theory and practice are the same. In practice, they are not." Albert Einstein

It takes experience to fully appreciate Einstein's words. After three decades of working with clients, here is what I know. First, some clients come to us having put a great deal of thought into how they think their estate plan should be structured and unfold over time. Second, good estate plans are generally the result of a coordinated team effort. The team members may change depending on your estate size and goals, the nature of your assets and the relative complexity of your family situation.

Your dream team will likely consist of an accountant, a lawyer specializing in Wills and estate planning, an investment advisor, a life insurance agent, and a professional trust officer if you plan to appoint a trust company as your executor or trustee. Each brings their specialized expertise to the table. In addition to technical knowledge, trust officers spend their professional life dealing with trusts, other trustees and trust beneficiaries. Like Einstein, we learn hard-won lessons about what works and does not work in the real world. We help clients appreciate trouble spots in an estate plan that may otherwise seem perfect. To show you what I mean, here are some adapted examples based on real life situations.

SEEING THE SITUATION FROM ALL SIDES

Bill and Mary, age 70 and 65, met and married after their first spouses died. Both have adult children and both brought money into the marriage. Bill and Mary keep their finances completely separate, and intend to leave their estates to their respective children. The couple lives in the home that Bill owned when they married.

One of Bill's estate planning priorities is that Mary be able to live in the marital home for as long as she wants. In case he dies before Mary, Bill wants to leave his home in a spousal trust. Fiduciary Trust Company of Canada, as Bill's trustee, would hold title to the house during Mary's lifetime and upon Mary's death the house would be sold and we would pay the proceeds to Bill's children.

Bill reasons that Mary should be able to afford to pay the expenses to operate the house from her money. She thinks this is fair, as she will enjoy living in the house, free of rent or mortgage payments. As a result, Bill envisions the spousal trust holding only the house, with the rest of his estate going straight to his children so they can enjoy their inheritance right away.

In discussing this plan with Bill and Mary, one of our first questions was, "Imagine that the house needs a new roof. Who should pay for that?" Bill thought Mary should be able to afford to keep the house in good repair from her resources. Mary, however, pointed out that putting a new roof on the house would be a major expense for which she might be reluctant to pay.

We highlighted to Bill that the benefits of a new roof—and its potential life expectancy of 30 to 40 years—would be enjoyed by his children, as the house would be more valuable after the repair. By paying for the roof repair, Mary would be transferring wealth from her estate and her children to Bill's children. This is not what Bill intends.

We also explained that, if Mary did not agree to pay for a major repair to the house, the value of the house to Bill's children might be depleted. Postponing the repair could lead to further damage to the home's structure.

We proposed that Bill arrange to place some money from his estate in the spousal trust as a contingency fund to pay for necessary repairs to the house during Mary's lifetime. This would postpone some of Bill's children's inheritance until after Mary dies, but it would enable Fiduciary Trust Company of Canada, as trustee, to keep the home in good repair, enhancing the ultimate value to Bill's children.

Our practical experience from administering many trusts holding real property led us to ask the correct questions to help Bill and Mary understand each other's point of view.

SEEING WHAT'S POSSIBLE

Irene, a successful businesswoman and investor, has built a substantial estate. Widowed, she has a 46-year-old son, who has had a difficult life. Martin dropped out of high school at age 16 and left home because he could not see eye-to-eye with his father. For many years Martin and Irene were alienated. After her husband's death, they reconnected and now have a fragile, but loving relationship.

When Martin left home as a teenager, he lived on the streets for many years and became addicted to alcohol. He has cycled between unemployment and seasonal, unskilled work ever since. Without financial assistance, Martin faces a grim future.

Irene wants to help Martin and she has the means to do so. Based on her own values and work ethic, she feels strongly that Martin should take more control of his life and find steady work. As long as he is working, Irene is prepared to help Martin live more comfortably, and she gives him $1,000 per month. She feels this is enough money to help, but not enough for Martin to live on. Irene believes that this strategy provides an incentive for Martin to strive to find work. She feels that Martin benefits from her tough love.

Irene plans to leave her estate in a trust for Martin, with instructions for her trustee to pay a maximum of $1,000 per month to Martin for the rest of his life. Her estate will be large enough to support much higher income payments, but Irene feels strongly that Martin should not rely on trust income as his sole support. She wants a professional trustee to continue her tough love approach and encourage Martin to work and straighten out his life.

In meeting with Irene to discuss Fiduciary Trust Company of Canada's role as trustee of this trust, experience taught us that her plan was impractical. When we carefully questioned Irene, we learned:

- Martin had continued his pattern of unemployment and there was little evidence that Irene's planned incentive to work was effective in influencing Martin's behaviour.
- At least five or six times a year, Martin would persuade Irene to give him additional money, often $2,000 or $3,000 at a time, to help meet his expenses. Irene was not consciously aware of the aggregate amount of money she was gifting to Martin annually.

Our questions helped Irene realize Martin was, in fact, financially dependent upon her and unable to support himself through employment. We explained to Irene that the fact that Martin was financially dependent upon her might give him grounds to contest her Will if she did not provide adequate support for him through her estate.

We also helped Irene realize that Martin's dependency upon her to meet his unplanned expenses probably resulted from an innate inability to handle money responsibly, or a vulnerability to exploitation by other people.

Based on our advice, Irene could see that it would be very unlikely that an impartial professional trustee would be able to succeed in incenting Martin to find steady work, when despite her best efforts as his loving mother, she had been unsuccessful in achieving that goal.

Irene accepted the situation, and instead of setting up a trust to pay a minimal amount to Martin, she researched the cost of living a comfortable, but not luxurious life in the city where she and Martin reside. She amended her Will to direct that the trustee pay this reasonable amount to Martin for his lifetime. She also gave the trustee discretionary power to make additional payments to Martin, but only for medical or health-related reasons. In doing so, Irene provided clear guidelines that precluded Martin from demanding trust money for frivolous purposes. The result is a more practical estate plan that would probably withstand a challenge by Martin based upon his financial dependency. The final plan strikes a compromise between the hard line that felt right to Irene and the reality of Martin's situation.

WORTHWHILE EXPERIENCE

Sometimes, it is a fresh perspective or an appreciation for the practical ripple effects of a seemingly small decision, or the ability to help bridge the thinking of various estate team members, or to talk about a client's underlying concerns in an unbiased fashion that helps arrive at an estate plan that will work as intended in the real world. We call it an earned wisdom that can help make challenging estate plans even better.