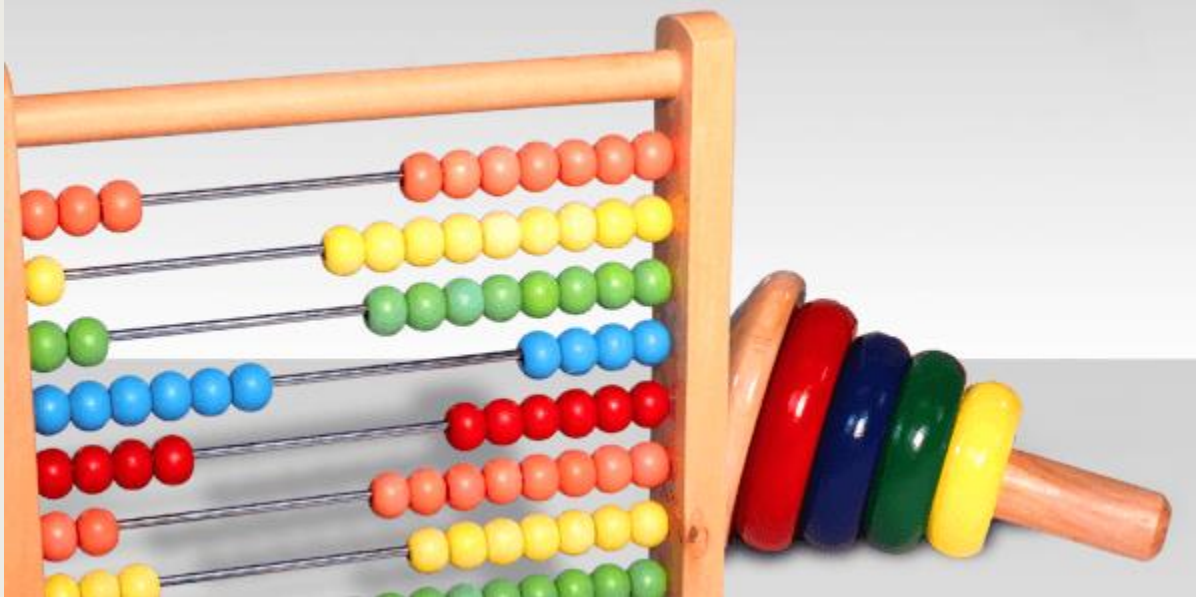


TRUSTS TO PROTECT CHILDREN

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Trusts are an excellent way to provide for the support and care of children while protecting them. Two important reasons to create a trust are to care for minor children or for a special needs child. In both circumstances, trusts can be an essential part of making plans to provide the best possible care.

HOW TRUSTS WORK

There are several people and terms that you should know about to understand how trusts work. Let's examine the different people or terms that will be useful in setting up and operating a trust for children.

Trustee: A trustee will be charged with managing the property under the terms of a trust document. The three choices for trustee are a bank or trust company, a private trustee or a charitable trustee for a trust that benefits charity.

A trustee has a particular name—a fiduciary. This means that the trustee is required under state law to provide appropriate management of the trust. Based on the trust document that you sign as the trust grantor, the trustee will do his or her best to follow your intent.

Property: The trust exists to hold and manage property. While in many states a trust is legally in existence after you sign the trust document, it doesn't actually have any purpose until it receives property. Your trustee refers to this as the "funding" of the trust. The trustee will manage the property according to the terms of your trust document.

Investments: Under state law, your trustee is required to follow the standards of a prudent investor. In most cases, the trustee will invest in a portfolio of stocks and bonds. Approximately 50% to 60% of the typical trust portfolio is invested in a diversified group of stocks, with the balance invested in bonds.

Under the prudent investor rules, the trustee is obligated to diversify. Through diversification the risk of loss will be reduced and the probability that the trust will function as you intend is greater.

Income: Income is defined under the law as either ordinary income or capital gain. The interest from bonds and mortgage notes is ordinary income. Historically, trusts have paid out their ordinary income. However, because many trustees now have more than half of the trust property invested in stocks, trusts now may pay out a portion of recognized capital gain as income.

Capital Gain: Capital gain is the other type of earnings of a trust. While a portion of the capital gain represents principal and will be retained in the trust to benefit the remainder recipient, part of the gain under modern investment strategies is typically allocated to income. The trustee will look at the trust document to determine who will receive the income. Normally, the trustee will pay out on a quarterly basis the ordinary income and part of the recognized capital gains.

Remainder: Under the trust document, the trust will pay income for a period of time, such as a life of a person or a term of years. After all of the income payments have been completed, the trust principal or remainder is usually transferred to the beneficiaries.

For example, a trust was funded with \$300,000 and paid income to children Billy, Susie and Linda until they were age 30. At that time, the trust remainder value of \$300,000 was divided between the three children. Because each received one-third of the remainder, the inheritance amount for each child was \$100,000.

TRUSTS FOR MINOR CHILDREN

Parents correctly understand that a minor child is not ready to receive a substantial inheritance. Therefore, it is very common for parents to create in their will or living trust a plan to set up a trust for minor children.

The trust for minor children frequently permits the trustee broad latitude to pay income and principal to the children or spend it for their healthcare or other needs. Because of this flexibility, the trustee of the trust for minor children is frequently a family member or professional advisor for the family. After all of the children reach a particular age, the trust is then usually distributed in equal shares to the then-living children.

TRUST FOR CHILDREN BILLY AND MARY

Bill and Clara Jones are 36 and 34. They have two children—Billy (age four) and Mary (age one).

After visiting with their attorney, Bill and Clara signed their first will. If one of them should pass away, estate property and guardianship of the children will pass to the survivor. However, if they both pass away, then they have selected Clara's brother, Harold, and his wife as the guardians for the children. They also have selected Bill's sister, Susan, who is a CPA, as the trustee of their family trust for Billy and Mary.

CPA Susan has discretion under the trust instrument to make distributions of income or principal to Billy and Mary or to pay providers for their support or medical care. In order to provide maximum protection for Mary, the entire trust principal is retained until Mary is age 30. By that time, Bill and Clara believe that Mary will have completed her education and be well established in life. Even though Billy will be 33 and Mary will be 30, the trust principal will be divided equally between the two of them at that time.

With a family trust for minor children, the assets of the family are typically not large. Most trusts for

minor children are funded primarily by term life insurance on the lives of Bill and Clara. Therefore, it is very common for the trust to continue in existence until the youngest child reaches the desired age. While this means that older children may have to wait longer for their inheritance, that is a secondary goal to making sure that the youngest children are all taken care of until they reach the selected age.

SPECIAL NEEDS TRUST

A child with a disability or special need will require both a caregiver and financial resources.

During the lives of the parents, they are often able to provide the required care for a special needs child. However, after they pass away, there may need to be a more structured option that involves a special facility for that child.

To plan for the case when both parents pass away, arrangements for the care facility and financial requirements of a special needs child should be made in advance. A special needs child often has no major assets and therefore is qualified for the Social Security SSI Program or for Medicaid.

However, if the parents were to give the child an inheritance outright or a vested income stream, then those funds will all be expended before the child could receive federal benefits. As a result, the special needs trust was designed to allow parents to provide help for children, even though the child may be receiving federal or state benefits.

The key to the special needs trust is that the trustee has complete discretion over principal and income. He or she may add the income back to the trust corpus, or may make distributions to the child or for the benefit of the child.

Because the special needs trust depends on federal and state laws that regularly change, an attorney who specializes in these trusts is often used to draft the specific provisions. However, there generally are several items the trustee can provide the special needs child and still maintain his or her qualification for federal and state benefits. These include a vehicle, a home, home furnishings, property for self-support, medical care and educational expenses.

The special needs trust also should have an intention to preserve the trust for a remainder beneficiary. Even though the special needs child may receive income and principal that actually does exhaust the trust, the hope that another entity or person would benefit from the remainder is quite helpful.