

Equal or Equitable: What is Fair?

By Jeff Maurer

I know life isn't fair, but why is it never unfair in my favor?

Calvin, the irrepressible six-year-old created by cartoonist Bill Watterson, raises an important point. Distinguishing between fair and equal is one of the biggest challenges in estate planning. How do we treat our children and their families? Equally, regardless of their circumstances? Differently? Either way, how can we preserve family harmony?

For most parents, equal and equitable seem synonymous in dividing an estate. On reflection, however, the decision can be more complex. Differences in their children's means and needs, and in their relationships, can challenge many families to consider what, exactly, fair means to them.

To start with an obvious case in point, what if the elder child is established and the younger has years left in his or her education? Certainly, a provision needs to be made for the younger child, to equalize their support. That's straightforward enough, albeit occasionally complicated by questions around the duration of undergraduate or graduate study.

Later on, there may be substantial differences in wealth among children. How do we fairly treat both a CEO and a schoolteacher? In some cases, parents choose to favor the less wealthy child with financial gifts during their lifetimes and/or after their death. That approach can work if they are entirely transparent about their intentions. Secret gifts, which, if significant, will be reported in gift and estate tax returns, and unexpected discrepancies in wills can cost lasting family disharmony, and even litigation. Discussions allow parents to differentiate between money and love – they give their love equally but favor the less well-off child with their money.

Other situations are more delicate still. Parents may view their children's ability to manage their finances differently, perhaps seeing one as a spendthrift, and choose to leave their inheritance in trust. A trust may also be used if parents are concerned about a child's spouse or creditors. If, however, parents leave one child's inheritance in trust and another child's inheritance outright, hard feelings almost always ensue, particularly if expectations have not been set.



This situation can be exacerbated if one child is made the trustee of the trust and becomes the financial watchdog for the other child; an arrangement like this rarely works well. Again, in these and many other circumstances (see Karen Francois' article on blended families on page 20), a discussion about possible future transfer tax savings, professional management, protection against creditors, and the ability to distribute to grandchildren may win over the reluctant heir. Of course, treating them equally with trusts for all children can also make good sense.

A variation on the above is the situation in which one child has a physical or mental disability and will be challenged to provide for themselves. Some parents leave a limited amount in a so-called special purpose trust for that child, which permits them to qualify for government benefits and yet assures that they will have adequate resources available for their special needs. Others will leave a full share in trust, still with provisions to qualify for government benefits. In both instances, the trust residue will go to the remaining children and, if stipulated, subsequent generations.

Grandchildren, life's dividend in so many ways, can further complicate estate planning. Many grandparents create trusts for their grandchildren. These are normally designed to pay out when the grandchild reaches a certain age, generally around 30, but they can also be used for tuition, a residence, or to start a business. The trusts are funded annually with the gift tax-free annual exclusion, currently \$14,000 per person or \$28,000 for a couple. But if, as is usually the case, the oldest grandchild is many years older than the younger, there could be a discrepancy of several hundred thousand dollars in inheritance. The grandparents may choose to equalize their giving with distributions through their lifetime or at death, utilizing estate and generation-skipping tax exemptions. If they have exhausted their exemptions, they may still choose to equalize their giving to their grandchildren and pay the associated gift, estate, and generating-skipping taxes.

What if one child has, say, five children, and the other only one? What about grandchildren who may be born later? Consider the grandmother who hopes

to leave her assets in trust for each of her two children, with the grandchildren receiving the trusts when their parents die. That seems simple enough until we consider that one of the children has five children, and the other only one. Should the only child receive 50% of the ultimate estate and the other five children just 10% each? Perhaps – that seems to be the approach that most families favor. On some occasions, however, the terms of the trust will require that the trust remainders be divided by six and distributed equally to the six grandchildren.

Grandparents may choose to equalize their giving with distributions

In a similar vein, families in which some branches have children and others do not can either dole out inheritances equally among the first generation of children or place the childless child's share in trust, with the remainder divided equally between the other grandchildren or divided based on an equalization between each family branch. Careful consideration needs to be given to placing only one child's share in trust.

Equal and equitable distributions to children are, for most families, one and the same. For many, however, there may be good reasons to make other arrangements. In my 40 years of managing wealth for multigenerational families, I have come to believe that, irrespective of the situation, honest discussions and transparent planning work best.

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