

Second Generation Wills
(for Unmarried Persons)

What Is a Second Generation Will?

A "Second Generation Will" is a Will that utilizes so-called "second generation planning" for your children and other descendants. If you are unmarried and you have children, grandchildren, etc., for whom you wish to provide benefits after your death, a second generation Will may be appropriate for you. Many individuals who have no children or other descendants, but who wish to provide for nieces, nephews or other loved ones (relatives or otherwise) also use second generation Wills.

The main benefits of second generation planning are (i) creditor protection and divorce protection for your children and other descendants for their lifetimes, and (ii) estate tax savings for your children and other descendants upon their deaths. (Note that second generation planning does not directly save estate taxes upon your death; in order to reduce your own estate taxes you should use any one or more of the other available estate planning vehicles, such as Irrevocable Life Insurance Trusts, Family Limited Partnerships, etc.)

What Are Child's or Descendant's Trusts?

Most Wills, other than simple Wills, provide for "Descendant's Trusts" for children and other descendants. Some Wills include "Child's Trusts" for children only. Others include Child's Trusts for children only and Descendant's Trusts for grandchildren and other descendants. In any case, each child or descendant is the named beneficiary of his or her own separate trust. The beneficiary's own children and descendants are often included as additional (secondary) beneficiaries of the beneficiary's trust.

In Wills *without* second generation planning, each trust will terminate when the beneficiary reaches age 25 (or some other specified age) but it is also common to have multiple staged terminations (e.g., 1/3 at age 25, 1/2 of the rest at age 30, and the balance at age 35). If the beneficiary dies prematurely, the remaining property of his or her trust passes to his or her children and other descendants, if any. Until the time that the Child's Trust and Descendant's Trust terminates, the trust protects the beneficiary, from both himself and from others. However, when a Child's Trust or Descendant's Trust terminates, all of these protections are lost.

What is Second Generation Planning?

In Second Generation Wills, the Child's Trusts and Descendant's Trusts are lifetime trusts. Because each beneficiary's trust lasts for his or her life, the protections that the trust provides also last for the beneficiary's life.

What Are the Terms of the Typical Second Generation Trust?

Child's Trusts and Descendant's Trusts with second generation planning (a/k/a "second generation trusts") are very flexible. The typical trust has the following terms:

- Each beneficiary (each child or other descendant) is the named primary beneficiary of his or her own separate lifetime trust.
- The beneficiary's children and/or other descendants are usually secondary beneficiaries.

- Distributions of income and/or principal to all the beneficiaries to provide for their health, support and maintenance are typical, but customized distribution provisions are permissible.
- A relative, a bank or trust company, or any other qualified person or entity is usually the initial trustee; however, the beneficiary is usually given the right to become a co-trustee at one age (usually age 25 or 30) and the right to become the sole trustee at a subsequent age (usually 5 years subsequent to the co-trustee age).
- The beneficiary usually has a testamentary "power of appointment" (described below) over his or her trust.

What Are the Non-Tax Benefits of the Typical Second Generation Trust?

There are significant non-tax benefits to the typical Child's or Descendant's Trust with second generation planning:

- *Creditor protection.* The trust assets will not be subject to claims of the beneficiary's creditors, so that a large judgment in a lawsuit will not result in the beneficiary losing the benefits of these assets.
- *Divorce protection.* If the beneficiary is married, assets retained in the trust will be trust property, not marital property. Therefore, the Trust is generally beyond the reach of Texas divorce courts.
- *Control.* If there are concerns that a particular beneficiary might disinherit his or her own children, that beneficiary's trust can be drafted without a testamentary power of appointment, or the power of appointment can be limited in scope, thus ensuring that, upon the beneficiary's death, the beneficiary's trust will pass to his or her children and descendants.
- *Management assistance.* If a particular beneficiary is not sufficiently skilled (or inclined) to manage his or her trust, that beneficiary's trust can be drafted without giving the beneficiary the power to be his or her own trustee, thus ensuring that the trust will be managed by a professional trustee.
- *Guardianship avoidance.* If a beneficiary becomes incapacitated, the successor trustee of the beneficiary's Trust can manage the trust and provide for the beneficiary's needs. Additionally, the assets of the beneficiary's Trust would not be subject to a guardianship of the beneficiary's estate.

What Are the Tax Benefits of the Typical Second Generation Trust?

Without second generation planning, if you leave property to your children and they preserve that property during their lives, there may be an estate tax on that property upon their deaths. Under current law, with second generation planning you can shelter an aggregate amount of up to \$5,000,000 as of your death (if in 2011 or 2012) from all future estate taxes that would otherwise be due upon the deaths of your children and grandchildren. This amount is called the "GST exemption." The GST exemption amount was originally \$1,000,000, and was adjusted annually for inflation from 1998 through 2003. From 2003 through 2009, the GST exemption was increased significantly per the 2001 Tax Act. Unless Congress enacts further legislation, this

amount is set at \$5,000,000 for 2011 and 2012, but then drops back to approximately \$1,060,000 (adjusted for inflation) for 2013 and thereafter.

This estate tax protection extends to the initial \$5,000,000 *plus* whatever it grows to during the lives of your children. Upon a child's death, his or her exempt amount passes estate tax free to Descendant's Trusts for his or her children; this preserves the exemption so that, on each grandchild's death, the property passes estate tax free to great-grandchildren. Thus, with second generation planning, each generation has use of his or her trust property during life and control over the disposition of his or her trust property at death, yet that property is protected from creditors and ex-spouses, and passes estate tax free to the next generation (subject to the above limits).

***What Are
Contingent Trusts?***

Virtually all Wills provide for "Contingent Trusts" for beneficiaries who need a trust but are not covered by any other trust in the Will. In simple Wills, Contingent Trusts typically apply to children, descendants, and all other persons who might inherit any property (such as nieces and nephews, who might receive in the unlikely event of a disaster in which an entire family is killed). In Second Generation Wills, Contingent Trusts apply to persons *other than* children and descendants. Whenever property would otherwise pass to a covered person who is incapacitated or too young to manage the property prudently, that property is retained in a separate Contingent Trust. The trustee makes distributions for the person's health, support, maintenance and education. A Contingent Trust usually terminates at a single specified age.

***What Is a Power of
Appointment?***

A "power of appointment" enables the beneficiary of a trust to decide to whom the trust's assets will pass. A "testamentary" power of appointment means that the power may be exercised only in the beneficiary's Will. Powers of appointment may be "limited" so that the group of people to whom the property may be given is restricted, or "general" so that the beneficiary may give the trust property to his or her estate, and thereby, to anyone named in his or her Will.

***What Is a
Fiduciary?***

"Fiduciary" is the generic term applied to anyone acting on behalf of another to manage assets that have been entrusted to the Fiduciary. Most Wills appoint two types of fiduciaries: An "Executor" and a "Trustee". The Executor is the person generally responsible for collecting your assets, filing any required tax returns, winding up your affairs, and fulfilling the provisions of your Will (i.e., creating trusts, distributing assets to the proper recipients, etc.). The Trustee is the person responsible for the more long term job of administering the trusts you create (i.e., managing investments, making distributions to the beneficiaries of the trust, etc.). The same person can be both a Fiduciary and a beneficiary, and the same person can be both an Executor and a Trustee. Different trusts can have different Trustees.

***What is a
Guardian
Declaration?***

A "Guardian" is the person who is charged with caring for minor children. In Texas, children are minors until they reach age 18. Guardians may be named in the Will, or in a separate instrument entitled "Declaration of Guardian for Minor Children." A "guardian of the person" is responsible for making parental decisions regarding the minor's upbringing, education and welfare. A "guardian of the estate" manages funds that belong to the minor (but not for funds that are placed into trust for the minor, which are managed by the trustee of the trust). The same person may be both the guardian of the minor's person and estate. This person may, but need not, be the same

person who serves as trustee of any trust created for the minor's benefit. Co-Guardians of a minor's person may be named, but only if they are married to each other.