

**Second Generation Planning
(a/k/a GST planning)**

What Is a Second Generation Will?

A "Second Generation Will" (or Trust) is a Will (or Trust) that utilizes so-called "second generation planning" for your children and other descendants. If 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 (or Trusts).

The main benefits of second generation planning are (i) creditor protection and divorce protection for your children and other descendants for their entire 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, "Gift Trusts," etc.)

What Are Child's or Descendant's Trusts?

Most Wills, other than simple Wills, provide for "Descendant's Trusts" for children, grandchildren and other descendants. Some Wills include "Child's Trusts" for children only. Others include Child's Trusts for children and Descendant's Trusts for grandchildren and other descendants. Both trusts for children and trusts for grandchildren and other descendants can be called, "Descendant's Trusts." In any case, each child or descendant is the named beneficiary of his/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, "Contingent Trusts" are used. Contingent Trusts terminate when the beneficiary reaches the specified age (such as age 25), but it is also common for a Contingent Trust to have multiple staged terminations (e.g., $\frac{1}{3}$ at age 25, $\frac{1}{2}$ of the balance at age 30, and the balance at age 35). If the beneficiary dies prematurely, the remaining assets in his/her Contingent Trust will be distributed to his/her children, if any, otherwise to his/her siblings. Until the time that the Contingent Trust terminates, the trust protects the beneficiary, just like a Descendant's Trust. However, when a Contingent Trust terminates, all of these protections are lost.

What is Second Generation Planning?

In Wills (or Trusts) Containing Second Generation Planning, the Child's Trusts and Descendant's Trusts are lifetime trusts. Because each beneficiary's trust lasts for his/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/her own separate lifetime trust.

- The beneficiary's children and/or other descendants are usually secondary beneficiaries of the beneficiary's trust while the beneficiary is living.
- Distributions of income and principal can be made to any of the trust beneficiaries to provide for their health, education, support, and maintenance. In some cases, customized distribution provisions are permissible.
- A relative, a bank or a private trust company, or any other qualified person or entity, is usually appointed as the initial trustee of the beneficiary's trust; 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/her trust.
- There will be more income tax options with respect to trust income because there is more than one potential income taxpayer.

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

There are significant non-tax benefits to the typical Child's Trust 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 obtained in a lawsuit against the beneficiary will not result in the beneficiary losing the benefits of the inherited assets (to the extent they are still held in the trust).
- *Divorce protection.* If the beneficiary is married, assets retained in the trust will be trust property, not marital property. Therefore, the trust assets are generally beyond the reach of Texas divorce courts.
- *Control.* If there are concerns that a particular beneficiary might disinherit his/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/her children.
- *Management assistance.* If a particular beneficiary is not sufficiently skilled (or inclined) to manage his/her trust, that beneficiary's trust can be drafted without giving the beneficiary the power to become the trustee of his/her own trust, thus ensuring that the trust will be managed by a professional (or otherwise qualified) 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 held in the beneficiary's trust would not be subject to a court-supervised guardianship of the beneficiary's estate.

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

Without second generation planning, if you leave assets outright to your children and they preserve those assets during their lives, there may be an estate tax on those assets upon their deaths. Your estate may already have paid estate taxes on those same assets when you died. Under current law, with second generation planning you can shelter an aggregate amount of up to \$11,700,000 (2021 amount) as of your date of death (or the date when you make a lifetime transfer to your children's Descendant's Trusts) 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."

This estate tax avoidance extends to the initial \$11,700,000 (2021 amount) *plus whatever that amount grows to during the lives of your children*. Upon a child's death, assuming proper allocation of your GST exemption, the full amount remaining in the child's trust passes estate tax free to new Descendant's Trusts for the child's children. This preserves the GST exemption so that, on each grandchild's death, the trust assets pass estate tax free to great-grandchildren. Thus, with second generation planning, each generation has use of the trust assets during life and, usually, control over the disposition of the trust assets at death (through exercise of the power of appointment), yet those assets are protected from creditors claims and spouses suing for a divorce, and pass estate tax free to the next generation (subject to the above limits).

What Are Contingent Trusts?

Virtually all Wills (and Trusts) provide for "Contingent Trusts" for beneficiaries who need a trust but are not covered by any other trusts created in the Will (or Trust). It would practically be considered legal malpractice for a Will or Trust not to have a Contingent Trust, at least. In "simple" Wills, Contingent Trusts typically apply to children, grandchildren, and other persons who might inherit any assets and who are either "too young" to receive their share outright or mentally incapacitated. In Wills (or Trusts) with Second Generation Planning, Contingent Trusts usually apply to persons *other than* children, grandchildren and other descendants. Pursuant to a simple Will (or Trust), whenever assets would otherwise be distributed to a covered person who is either incapacitated or too young to manage the assets prudently, those assets are retained in a separate Contingent Trust. The trustee makes distributions from the Contingent Trust for the beneficiary's health, support, maintenance and education. A Contingent Trust usually terminates at a specified age (or ages). Thus, all trust benefits expire at that time.

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 when the trust terminates. A "testamentary" power of appointment means that the power may be exercised only in the beneficiary's Will and the power only becomes effective on the beneficiary's death. 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 assets to his/her estate, and thereby, to anyone named in his/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 handling the "post-death process," which involves collecting and preserving your assets, filing all required tax returns (for you and for your estate), winding up your affairs, and fulfilling the provisions of your Will (i.e., establishing

and funding the trusts created in your Will, re-titling and 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 funds that are placed in 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 the guardian of the minor's 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.