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When Should Inheritances Be Unequal?

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ABSTRACT

Equal treatment of children who are the beneficiaries of an estate plan may be perfectly suitable for many families, but only a point of departure for others. The character of assets, the diverse needs of beneficiaries, and the personality dynamics of family members may demand a more thoughtful solution by the estate planner.

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Let's say that you advise a married couple who has two children. Without knowing more about the family, the immediate answer to the question of ultimate division of assets after both parents die is that the children would inherit equal shares. That answer may never change for that family in the future, but it's remarkable to consider how often it might vary as circumstances change over time. I recently heard another attorney address the issue of how to provide for the children and state that an equal distribution isn't necessarily the presumption because "different children have different needs." (Children, here, means the next generation: anyone from an infant to a senior citizen, in fact.) My quick first reaction to his comment was that an equal distribution should be the general rule, not necessarily permitting unequal distributions based upon need. After all, you'd like the kids to feel that mom and dad loved them both the same. Also, you probably wouldn't advocate having achievers punished and slackers rewarded because of considerations regarding need, right?

I've given the equal shares presumption a lot of thought, and I still think that it's the best outcome in a great number of situations. Very often, while the effect of the surviving parent's ultimate distribution to their children may seem to be about money, i.e., what is received in hard dollar terms, it also leaves its imprint in feelings, the final expression of what a parent can convey to a child. And, human nature being what it is, the feelings created by the legacy may outlive the impact of the

amount received. So, let me be clear, in a great number of situations, equal treatment is best and most desirable; the final disposition shouldn't leave unanswered questions as to why some fine-tuning away from equal treatment was made. Having said that, let me go on to address a number of situations in which unequal treatment is desirable, or at least, necessary, as well as when it may occur inadvertently, with unintended consequences.

A Beneficiary with an Undeniably Greater Need

A certain number of families with two or more children have a child who will have greater needs than his or her siblings throughout adult life. Some in this category are obvious, such as special needs children whose mental and/or physical limitations are so great that they will never be self-supporting. Organizing a support system for the personal and financial needs of an impaired adult child is critical. The details of care and considerations in this regard can be an elaborate topic unto itself. Consideration must be given to government programs which can provide for a dependent adult. It is particularly important to have a trust properly designed for the lifetime care of the beneficiary, established with a corporate trustee and/or individuals acting according to a plan of succession over the beneficiary's lifetime. Sometimes an adult child may have physical or psychological needs stemming from drug or alcohol abuse. This type of condition may not result in an unequal treatment as to the division of assets. Rather, it may feature an outright distribution to other children, at, say, age 30 or 35, with a lifetime trust for a child for whom relapse is an ongoing concern. Apart from special needs or substance abuse problems, there are situations in which an adult child has some type of personal challenge or issue which warrants that funds be held in trust for them, possibly for life.

Disinheritance: Absolute and Modified

Stuff happens in families. Occasionally, we prepare a will which states that a child will receive no inheritance from parents "for reasons best known to" him or her. A breakdown in the parent-child relationship has occurred to the point where the child will be disinherited entirely. It is always important to make sure that the exclusion of the child is clearly stated in the will to forestall any claim that the omittance was all a mistake, the attorney somehow missed it, or mom and dad lost capacity, would never have done such a thing, etc. An unequal distribution short of disinheritance may be more appropriate in other situations. So, instead of 50-50, the division may be 75-25, or 30-30-30-10, or some other proportion which is designed to favor or disfavor the beneficiaries because of personal grievances or family issues of one sort or another.

Second Marriage, Second Family

How many times have you seen a man who is divorced with adult children, marry a younger woman and start a new family in which the youngest child is many years younger than the oldest child? The oldest children may be self-supporting adults, while the youngest is a toddler with major financial support needs looming in the future. Sometimes a life insurance policy held in a trust dedicated for the needs of the youngest children can be an effective solution with the remainder of the estate divided equally among all of the children. Other nonprobate assets, such as qualified plans, IRAs, or nonqualified deferred annuities, may also tilt the balance between two generations of beneficiaries. When those nonprobate assets are so employed, the attorney who prepared the will should be alert to the effect of the tax payment clause of the will. Estate or inheritance taxes may be paid from assets passing under the will, but the tax may be attributable to nonprobate assets. The disposition of assets having different tax attributes may cause an unintended benefit or cost to be realized by one beneficiary over another. The income tax character of the nonprobate asset must also be taken into account when the division of probate and nonprobate assets follows separate patterns. The nonprobate asset may be free of income tax, such as

life insurance proceeds; partially taxable, such as deferred annuities; or completely taxable, such as qualified plans and IRAs. A tax-savvy estate planner can be very valuable in enabling the client to structure a plan that gives proper weight to tax costs or benefits while fulfilling personal objectives for beneficiaries when an equal division of all assets will not be made.

Gifts of Family Business Interests

Gifts of interests in a family business may present challenges to the parents who are trying to balance business succession planning and a desire to treat children equally. When sufficient nonbusiness assets are available to avoid an imbalance, the equalization may be more readily achieved. However, if the value of the business interest owned by the parents comprises a large proportion of the value of their estate assets, other solutions may be needed. Such other solutions may include an insured buy-sell agreement between the parents and the child(ren) who is (are) active in the business, so as to create additional value ultimately available for those children who are not active. It may also be possible, in a given situation, to have the parents' commercial real estate rented by the business and held in a separate entity earmarked to pass to inactive children while the actives receive shares of the operating business. The virtue of that approach is that it permits the business to be owned only by those who are active in it; the entity which owns the real estate can collect rent from the business and distribute it to those who are inactive.

A fundamental question for those who are coordinating their business succession plan and their estate plan: should gifts of family business interests be treated as advancements? In other words, for the sake of equal distribution, should those gifts be added back to the parents' estates so that the gifts will be charged against the shares of the children who are active? In some families, gifts of business interests may favor those in the business while leaving the rest of the estate in equal shares to all of the children. The gifts of business interests may be thought to be earned in "sweat equity;" a fair and equitable division is really the overall goal, rather than precise equality between those who receive the business and those who do not. On the other hand, if the gift of the business interest is substantial in value, it may be added back to the parents' estates, with the active children's shares reduced accordingly.

Joint Assets

Sometimes a parent titles bank accounts or other financial assets in joint names with one child but not others. The titling of the account may be misconceived; it is set up as a matter of convenience, and really should have designated the child who is a joint owner as the parent's agent under a power of attorney. Very often, the child who so benefits may recognize the parent's intention and split the proceeds with siblings. However, it may also happen that the parent who established the account meant to reward a child who has done more to assist the parent as the level of care for the parent increased with age. So, once again, perfect equality of treatment may not always be desirable, particularly if a child who lives locally is saddled with a greater caregiving role than a child who lives far away from the parent. The important point for the estate planner is to understand the objectives of the parent in a given case, as well as to understand how assets are owned and whether the ownership structure reflects that parent's objectives.

Equal treatment of children who are the beneficiaries of an estate plan may be perfectly suitable for many families, but only a point of departure for others. The character of assets, the diverse needs of beneficiaries, and the personality dynamics of family members may demand a more thoughtful solution by the estate planner. ■

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