# Avoiding “Trust Fund Babies”

*Incentive Provisions You Can Build into Your Trust*

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## 01 Why Consider Incentive Provisions

Many parents and grandparents want their wealth to help their children and grandchildren, not hold them back. A common worry is that a guaranteed inheritance can dull the drive to finish school, build a career, or manage money responsibly. Incentive provisions built into your trust address that worry by tying distributions to the values and behavior you want to encourage, such as education, work, service, and sobriety, while still giving a real safety net to a beneficiary who needs one.

Texas law gives you broad freedom to set the terms on which your beneficiaries receive trust property. The challenge is not whether you can include incentive provisions but how to write them so that they work decades from now, in circumstances no one can predict, and so that a trustee can actually carry them out. This article walks through the most common approaches, shows sample language, and gives our view of each. Most families use only a few of these provisions, combined with ordinary trust terms, rather than all of them.

AT A GLANCE

- Incentives work best as **carrots rather than sticks**: rewarding effort and achievement generally works better, and invites fewer disputes, than punishing behavior.
- Every incentive clause needs a **safety valve** for disability, illness, caregiving, and circumstances you cannot foresee.
- The trustee becomes the judge of your beneficiary’s conduct, so **who you choose as trustee** matters as much as the clause language.

## 02 Three Questions to Answer First

1. **Carrot or stick?** Will the trust reward achievements such as graduation, employment, or earnings, or will it reduce support when a beneficiary falls short? Reward-based provisions are easier to administer and less likely to damage family relationships.
2. **Bright line or discretion?** Objective tests, like a minimum GPA, 35 hours of work a week, or a set dollar match, are predictable but can produce harsh or odd results. Broad discretion adapts to real life but depends entirely on the trustee’s judgment. Most successful plans combine a clear statement of your goals with discretion to apply them.

3 **Who decides?** Someone has to decide whether a beneficiary is "productive," whether a career in the arts counts, or whether a substance problem exists. Family trustees may find those calls personally painful, and a corporate trustee may be too distant from the family to make them well. We often recommend a professional or independent trustee working with a family advisor or distribution committee.

## 03 Your Options at a Glance

The table below summarizes the approaches discussed in this article. Our views are general recommendations; the right choice depends on your family, your assets, and your goals.

| APPROACH | HOW IT WORKS | OUR VIEW |
|---|---|---|
| Education support | Pays tuition, living costs, and other education expenses while the beneficiary makes a good-faith effort in school | RECOMMENDED |
| Earned-income matching | Distributes an amount tied to what the beneficiary earns from work | USE WITH CARE |
| Earned-income cap | Limits distributions to no more than the beneficiary's earned income, with exceptions | RECOMMENDED |
| Self-sufficiency guidance | States your wish that the trust support productive lives and not replace them | RECOMMENDED |
| Milestone-based access | Opens staged withdrawal rights at set ages once the beneficiary has met productivity criteria | RECOMMENDED |
| Substance-abuse safeguards | Lets the trustee pause support payments and pay for treatment | RECOMMENDED |
| Marital-property protection | Requires marital agreements that keep trust assets separate | USE WITH CARE |
| Character and family-relations clauses | Rewards or penalizes values, behavior, or relationships | USE WITH CARE |
| Lifestyle, religion, and association penalties | Cuts off beneficiaries for a career choice, a relationship, or the people they spend time with | NOT RECOMMENDED |

## 04 The Options in Detail

### A. Promoting Education

RECOMMENDED

Education provisions are the most widely used incentive clauses and, in our experience, the most appropriate. The trust pays tuition, books, fees, room and board, and a reasonable living allowance while the beneficiary is actively pursuing an education in good faith. Some families add a cash reward or a trip on graduation or other academic milestones.

> SAMPLE LANGUAGE
> *"...the trustee [shall] provide financial assistance to a beneficiary... in amounts reasonably required to assist in achieving such objective. Such assistance should include tuition and direct costs, and also a reasonable living allowance."*

POINTS TO CONSIDER

- **Define the standard.** "High performance" is vague. Decide whether you mean a minimum GPA, good standing at the school, or a good-faith effort, and say so.
- **Define education broadly.** Include trade and vocational programs, online study, apprenticeships, travel with an educational purpose, and equipment such as computers. Education may look very different for your grandchildren.
- **Keep rewards in proportion.** If a graduation gift is "selected by the beneficiary," a sports car may seem appropriate to a new graduate. Set a dollar limit or leave the choice to the trustee.
- **Coordinate with other resources.** Let the trustee consider scholarships, financial aid, and what parents can contribute, and treat older and younger grandchildren fairly when there is one shared education fund.
- **Avoid penalizing good reasons for leaving school.** A beneficiary who leaves in good standing for a job, military service, or family obligations should not be treated as a failure.

## B. Matching Earned Income

USE WITH CARE

A matching provision distributes an amount tied to what the beneficiary earns from work, for example dollar for dollar, or a fraction of any increase over the prior year. It sends a clear message that the trust supplements work and does not replace it.

> SAMPLE LANGUAGE
> *"Trust distributions equal to the amount of the beneficiary's earned income from employment... shall then be distributed each year to the beneficiary; provided that such matching distributions... shall be no greater than 1% of such beneficiary's then remaining trust estate..."*

POINTS TO CONSIDER

- **It creates mandatory distributions.** The most productive beneficiary, who needs the money least, empties his or her trust fastest. Once assets leave the trust, they lose its protection from creditors, divorce, and estate tax.
- **Cap it.** Without a percentage or dollar ceiling, a highly paid beneficiary could drain the trust quickly.
- **Define "earned income" carefully.** Say whether it includes self-employment and business income, whether a spouse's earnings count, and how income is verified. Avoid pointing to a specific line on an IRS form, because the forms change and some lines would count the trust's own prior distributions.

- **Remember those who cannot earn.** Stay-at-home parents, caregivers, people in lower-paying service careers, and beneficiaries with disabilities need a separate path to support.

## C. Capping Distributions at Earned Income

RECOMMENDED

This is the reverse of a match. Instead of requiring a distribution equal to earnings, the trust limits discretionary distributions to no more than what the beneficiary (and spouse) earned the prior year, with stated exceptions. It rewards industry without forcing money out of the trust, and a well-written statement of purpose gives the trustee solid footing when it declines a request.

> SAMPLE LANGUAGE
> *"...the Trustee shall not distribute to any child, grandchild, or more remote descendant... in any calendar year... amounts in excess of the earned income... of the beneficiary and the beneficiary's spouse for the prior year..."*

POINTS TO CONSIDER

- Build in exceptions for beneficiaries under a stated age, full-time students (including graduate and professional programs), beneficiaries with disabilities, and parents or caregivers raising children.
- Some forms say a trustee's decision "may not be challenged." **In Texas, that language has limited effect:** the Trust Code does not allow a trust to waive the trustee's duty to act in good faith and in line with the trust's purposes. The trustee should still document its reasoning.

## D. Encouraging Productivity and Self-Sufficiency

RECOMMENDED

Rather than applying a formula, these provisions state your wish that the trust support a productive life without replacing one, and direct the trustee to weigh that goal in every distribution decision. We generally favor this approach because it is supportive rather than judgmental and adapts to each beneficiary's circumstances.

> SAMPLE LANGUAGE
> *"I do not want the support provided by a trust to cause a beneficiary to become so dependent on the trust that he or she loses an incentive to become financially self-sufficient."*

POINTS TO CONSIDER

- Make clear that a modest-income career pursued in earnest, such as teaching, ministry, the arts, or public service, counts as self-sufficient.
- Recognize volunteer work, homemaking, and full-time care of children or aging family members, without arbitrary age cutoffs (for example, care of children only under age 8).
- Avoid provisions that cut support to a beneficiary who earns a degree and then does not work "in the field"; careers change, and the trustee should look at the whole picture.

## E. Milestone-Based Access to Principal

RECOMMENDED

A comprehensive approach combines several incentives into one structure. While the beneficiary qualifies in at least one category, such as full-time student, full-time employment, a socially productive career like art or music, caregiving, charitable or scientific work, or disability, the trustee may make distributions freely. After the beneficiary has qualified for a set number of years and reached a stated age, he or she gains the right to withdraw a growing share of the trust: for example, one-fourth at 40, one-third at 45, and the balance at 50. A medical emergency exception keeps a safety net in place at all times.

> SAMPLE LANGUAGE
> *"...the child is employed full time... or the child is pursuing a career, which is socially productive on a full time basis, such as a career as an artist or a musician, to be determined solely by the Trustee..."*

### POINTS TO CONSIDER

- Consider whether outright withdrawal rights are wise at all. Leaving property in a protected lifetime trust, with the beneficiary gaining more control over time, often protects better against creditors and divorce than handing over the assets.
- Specify what happens if the beneficiary is making a good-faith effort but has not yet qualified, and what happens if he or she never qualifies.
- Tie the age thresholds and percentages to your own family, not to a form.

## F. Deterring Substance Abuse

RECOMMENDED

These provisions let the trustee stop paying for day-to-day support when a beneficiary has a substance abuse problem, while continuing to pay for treatment and rehabilitation. The trustee may consult physicians or counselors and may ask the beneficiary to submit to testing; refusing a reasonable request can suspend eligibility.

> SAMPLE LANGUAGE
> *"...Trustee is authorized to withhold trust distributions for support of a beneficiary who is suffering from a substance abuse problem... (except for trust distributions necessary for suitable medical care and other rehabilitative purpose)."*

### POINTS TO CONSIDER

- Do not presume every beneficiary is at risk. Testing should be triggered by the trustee's reasonable concern, not required across the board.
- Give the trustee authority to pay providers directly and to require the medical and privacy authorizations it needs.
- Plan a path back: describe how a beneficiary regains eligibility after treatment and a period of sobriety.

## G. Protecting Trust Assets in Marriage

USE WITH CARE

Texas is a community property state, and income from separate property is generally community property. Depending on the trust's terms, that can include not only trust income *distributed* to a married beneficiary but, in some circumstances, *undistributed* income as well, such as income the beneficiary has a present right to receive.

Once community income is mixed with the beneficiary's separate property, in a bank account, an investment account, or a home, the two can become difficult or impossible to tell apart over time. Texas law presumes that property held during marriage is community property, and a spouse who claims otherwise must prove it by clear and convincing evidence. Commingled funds that cannot be traced may be treated as community property and divided in a divorce.

Some families address this by requiring a married beneficiary, as a condition of receiving distributions, to sign a premarital or postmarital (partition) agreement confirming that trust interests and trust income remain the beneficiary's separate property.

> SAMPLE LANGUAGE
> *"...all interests in any trust in which [beneficiary] has an interest, including but not limited to all corpus of those trusts, as well as all distributed and undistributed income from those trusts... [shall constitute separate property]."*

POINTS TO CONSIDER

- A narrow agreement that covers **only the trust property** is far less intrusive than one that must satisfy the trustee on every aspect of the couple's finances. How spouses handle their other assets should be their decision.
- Keeping assets inside a discretionary spendthrift trust, rather than distributing them, is often the simplest protection.
- Consider having the trust reimburse the beneficiary's reasonable legal fees for preparing the agreement.
- Clauses that penalize a beneficiary for living with a partner, or require a "palimony agreement," tend to breed resentment and are difficult to administer. We generally advise against them.

## H. Character, Values, and Family Relationships

USE WITH CARE

Some clients want to reward ethical conduct, charitable giving, or close family relationships. Framed as a reward, for instance by directing the trustee to provide generously for a beneficiary who gives back to the community, these provisions can express your values effectively. Framed as a penalty, they are among the hardest clauses to administer: a trustee must judge another person's morals or relationships, often with incomplete information, and the resulting disputes can be long and expensive.

> SAMPLE LANGUAGE
> *"...the Trustee shall seek to reward a beneficiary exhibiting the desired types of behavior by providing liberally for the beneficiary's support needs..."*

POINTS TO CONSIDER

- A statement of your values, or a separate non-binding letter of wishes to the trustee, often accomplishes more than a legal test.
- If there is a specific family member you do not want to benefit, say so directly; a targeted exclusion is clearer and more enforceable than a general "good relations" standard.

### I. Provisions We Generally Do Not Recommend

NOT RECOMMENDED

Some clauses found in older forms are likely to cause more harm than good:

- **Religious or occupational disinheritance,** such as cutting off a child who becomes a member of the clergy or enters a particular profession. These invite challenges as contrary to public policy and are rarely consistent with what parents want for their children in the long run.
- **"Guilt by association" clauses** that withhold support because of the people a beneficiary spends time with. The trustee would have to prove a negative, and the standards are subjective.
- **Trustee-approved marriages or relationships.** Conditioning support on whom a beneficiary marries, or on the trustee's approval of a partner, is intrusive and likely to damage family relationships.
- **Rigid penalties without exceptions.** Any provision that reduces support should excuse illness, disability, caregiving duties, and other circumstances beyond the beneficiary's control.

## 05 Practical Considerations

- **Choosing the trustee.** Incentive provisions turn the trustee into a judge of your beneficiary's life. Consider a professional or independent trustee, a family distribution committee, or a combination, and give the trustee authority to hire advisors and pay for them from the trust.
- **A letter of wishes.** A non-binding letter explaining what you hope for, and why, gives the trustee context that formal clause language cannot.
- **Flexibility for the future.** A trust protector with power to adjust administrative terms, together with Texas decanting and modification statutes, lets the plan adapt as your family and the law change.
- **Beneficiaries with special needs.** A beneficiary who receives or may need government benefits requires a different kind of trust. Incentive provisions should not interfere with that planning.

- **Taxes and asset protection.** Mandatory distributions carry taxable income out to the beneficiary and remove assets from the trust's spendthrift and estate tax protection. Discretionary provisions generally preserve those advantages.
- **Fairness among beneficiaries.** Consider how each provision will treat children with different abilities, careers, and family situations, and whether it could be seen as favoring one over another.

## 06 Next Steps

If you are considering incentive provisions, it helps to think through the following questions before meeting with your estate planning attorney. There are no wrong answers; the goal is a trust that reflects your values.

**QUESTIONS TO CONSIDER**

- ☐ What do you most hope your inheritance will do for your children and grandchildren?
- ☐ What are you most concerned it might do to them?
- ☐ Which of the approaches above appeal to you, and which feel too controlling?
- ☐ Who do you trust to make judgment calls about your beneficiaries' education, work, and conduct?
- ☐ Are there family circumstances, such as a disability, addiction, or a difficult marriage, that call for special provisions?

**PLANNING FOR THE NEXT GENERATION?**

Call for an appointment: 214-281-8000

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