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Basic Trust Designs & Provisions

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Revocable Living Trust Agreements ("Trusts") offer many additional options and benefits in comparison to other methods of wealth transfer at death. Transfers through a Last Will and Testament ("Will"), or through intestate succession (default distribution if no estate plan), provide for an immediate distribution of assets at death through the Probate Court. A properly drafted and funded Trust can: save your beneficiaries the time and expense of going through the probate process; allow you the flexibility to structure how and when you would like assets to be distributed; protect your bequests from creditors and lawsuits against your beneficiaries; and provide significant opportunities for advanced planning.

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This column will discuss basic Trust designs and provisions that are available and applicable to most Grantors (individual who executes and funds a trust is the "Grantor"). As discussed above, Trusts are very dynamic documents and can be used in a variety of complex planning situations, however, these advanced situations and Trust designs (e.g. ILITs, QPRTs, GRATs/GRUTs, IDGTs, BDITs, QDOTs, Cottage Trusts, etc.) are outside of the scope of this introductory article.

TRUST DISTRIBUTION ("PAY-OUT") DESIGNS

One of the major advantages of Trusts is that you can control how and when your assets will be distributed to your beneficiaries. Trusts typically follow one or more of the following distribution designs.

Mandatory Distributions

If you know how and when you want assets distributed to your beneficiary(ies), you can compel the Trustee to make the distributions according to these wishes. The Grantor can instruct the Trustee to give identified assets to particular beneficiaries (e.g. a house, business interest) and/or to distribute Trust assets upon a determined time table (e.g. immediately, in 10 years, 1/3 increments every five years).

This distribution design is recommended when the Grantor has responsible (often older) beneficiaries who can be trusted to manage their finances, and do not have creditor/legal obligations or special needs.

Conditional Distributions

A Grantor can condition a distribution upon the occurrence or nonoccurrence of a particular event or condition. For example, the Grantor can set aside Trust assets to be distributed to a beneficiary to incentivize an act, such as obtaining a college degree, starting a business, or getting married. Conversely, the Grantor can give the Trustee authority to take away or postpone a distribution to a beneficiary, such as in the case of drug dependency. In this case, a Trustee can require that a beneficiary undergo periodic drug/alcohol testing or counseling prior to releasing Trust assets so that assets will not be used to further such dependency.

This distribution scheme is recommended if the Grantor wants a beneficiary to accomplish a certain act, and wants to provide a financial incentive to do so, or if a beneficiary has chemical dependency problems or other destructive behavior, and the Grantor wants to discourage such behavior.

Support Trust

A Grantor can empower the Trustee to make payments to a beneficiary pursuant to an established standard, instead of at specific times. For example, Trust assets can be set aside to a beneficiary for his or her basic needs, such as: health, education, maintenance, and support. Under such a standard, the Trustee would have discretion to use Trust assets set aside for a beneficiary to further the particular support standard set by the Grantor. A properly drafted trust utilizing this design has the added benefit of protecting the funds that are not distributed according to the standard from most of the beneficiary's creditors.

This distribution scheme is recommended for young beneficiaries or beneficiaries that cannot manage their own finances, so that the Trustee can manage the assets to satisfy the beneficiary's basic needs.

Special Needs/Supplemental Needs Trust

A Grantor can decide to give the Trustee complete discretion over distributions to a beneficiary. The Trustee would have the authority to decide when, and under what conditions, a beneficiary would receive Trust assets. If properly drafted, this Trust design can protect Trust assets from all of a beneficiary's creditors.

This distribution is recommended when a beneficiary has special needs, or is receiving government assistance to address his or her basic needs. If the beneficiary is receiving other government assistance, this Trust can be structured so that any Trust assets that are held for the beneficiary will not supplant any government benefits that are being received. Instead, it would give the Trustee discretion to distribute assets on behalf of the beneficiary to purchase items not covered by the government assistance that would increase the beneficiary's overall quality of life.

Dynasty Trusts

Dynasty provisions allow a Grantor to pass wealth to future generations, beyond just children and grandchildren. Typically, the Trustee is granted the power to disburse trust income or principal to the primary beneficiaries (typically children or lineal descendants) under certain conditions or a selected distribution standard (e.g. health, education, maintenance, support, welfare, etc.). Once a primary beneficiary dies, the remaining assets in the Trust will be used to benefit another beneficiary (typically grandchildren) and so on, potentially in perpetuity.

This distribution is recommended when a Grantor has significant assets and, opposed to an out-right distribution, desires to build a long-lasting legacy that will provide for specific family goals going far into the future.

CREDITOR PROTECTION / "SPENDTHRIFT" TRUSTS

A "Spendthrift" provision is commonly used in Trusts to prevent a beneficiary from voluntarily, or involuntarily, transferring his or her interest in the Trust. Typically, this means that a beneficiary cannot sell their future interest in a Trust prior to when the Trust document says he or she should receive it. This provision also has the added benefit that the majority of a beneficiary's creditors will be unable to reach the beneficiary's interest in the Trust assets.

A Spendthrift provision is a generally applicable provision and is recommended in most Trusts, regardless of the distribution design. Most beneficiaries benefit from the creditor protections offered by this provision, and it prevents a beneficiary from thwarting the distribution design of the Grantor by prematurely selling their interest in a Trust.

QUALIFIED TERMINABLE INTEREST PROPERTY ("QTIP") TRUSTS

QTIP Trusts provide a method where a Grantor can leave Trust assets for the lifetime benefit of a spouse, but ensure that Trust assets will be available for other selected beneficiaries after the death of the spouse.

Typically, these Trusts are structured to provide a Grantor's spouse with the income produced by the Trust assets, limited withdrawals of principle, and gives the Trustee discretion to use Trust assets to address the spouse's other needs.
After the death of the surviving spouse, the Trust would distribute assets to the identified remainder beneficiaries.

QTIP Trusts are recommended when a Grantor wants to provide for a spouse's lifetime support, but wants to ensure that there are assets remaining for his or her children (or other beneficiary). These Trusts are particularly useful if the Grantor has children that were not with the current spouse, second marriages, other blended families, or where a spouse may not otherwise wish provide Trust assets to the same beneficiaries.

RETIREMENT ASSETS

Increasingly, retirement assets (401(k), 403(b), etc.) make up a larger portion of a Grantor's Trust assets. A properly drafted Trust will be able to ensure that retirement assets are distributed properly, and receive preferential tax treatment.

Conduit vs. Accumulation

Conduit Trust provisions provide that a Trustee is required to distribute retirement assets payable to the Trust directly to the Trust beneficiaries. Accumulation Trusts allow a Trustee to accumulate retirement assets within the Trust. Conduit Trusts provide for immediate distributions and will likely reduce the total taxes due on these amou-nts (since individual beneficiaries are generally taxed more favorably than Trusts). Accumulation Trusts allow for the retirement benefits to be held and distributed according to the distribution design identified in the Trust.

Designated Beneficiary

Different distributions of retirement assets may be available for your beneficiaries, including: immediate distributions, payments over five years; and payments over the life expectancy of a beneficiary. Generally the longer the distribution for retirement assets the more favorable the tax consequences over the course of the entire distribution. However, in order to qualify for the longer distribution terms, great care must be taken to ensure that the Trust qualifies as a "Designated Beneficiary" of retirement benefits.

Again, the discussed designs and provisions are just some of the basic options available when using Trusts as part of a comprehensive estate plan. If these or other Trust planning options are of interest to you, I recommend that you discuss your particular situation with an experienced estate planning and elder law attorney to ensure that your Trust is individually crafted to address your needs. Additionally, an individual's financial assets and goals, and the law governing Trusts, may change over time. Even if you currently have a Trust in place, it should be reviewed on a regular basis to ensure that it continues to comport with your current goals.

For more info, or to schedule an appointment, please contact the Morello Law Group at 734-281-6464 or visit morellolawgroup.com