Help me…I’m a Trust Beneficiary!

Over the next few decades, members of the Baby Boomer generation are widely expected to have a final, lasting impact on their Gen X and Elder Millennial children – leaving a collective inheritance around $80 Trillion dollars![i] The so-called “Great Wealth Transfer” is forecast to usher in massive societal and economic impacts in the United States.

Impacts on individual inheritors may be just as astounding as we experience financial assets, homes, and Great Aunt Millie’s Victorian ceramic figurines making their way to the newest, wealthiest generation of Americans.

Since studies suggest that older, higher income Americans tend to be more likely to have an estate plan, much of this wealth may be transmitted to its recipients in trust, rather than outright[ii]. There stand to be many surprised and frankly, unwilling, trust beneficiaries who will be simultaneously glad of their new wealth and furious with its method of transfer.

If you’re a newly minted trust beneficiary, give some thought to the following before you lose all hope of enjoying your inheritance.

1. **First, Take a Deep Breath.**

   Inheritances typically come when loved ones pass away and emotions run high. Instead of feeling pressured, take some time to collect yourself, gather facts, and talk to your advisors before making any big decisions.

2. **Advisors Assemble!**

   While it’s certainly possible to generalize how a trust works, each trust has its own unique peculiarities. Owing to different drafting approaches among attorneys, interpretations among tax professionals, and bedside manner among trustees – even similarly worded trusts can result in wildly varying experiences for beneficiaries.

   As a trust beneficiary you should strongly consider having your own team of advisors helping you to make sense of your trust and how it changes your financial situation.

   - Try starting with a **financial advisor** who can help marry your personal financial and tax picture with the trust assets.

   - Your financial advisor will help you to find a great **CPA** who will properly report and plan for your trust income.

   - Finally, your financial advisor can draft in an **attorney** experienced in trust matters to help you understand the trust in detail and serve as your official representative with the trustee if needed.

It is important to remember that while your trustee owes you fiduciary duties, they must also navigate the trust instrument and in some cases weigh your beneficial interest against those of others.
These considerations can sometimes cause trustees to make decisions that you might not think are best for you. It can be invaluable to have your own advisory team to objectively advise you and work with (or argue with!) the trustee when that is necessary.

3. Just the Facts!

As humans, we all suffer from negativity bias[iii]. You might be predisposed to "feeling some type of way" about these newfound trust restrictions. One way to overcome negativity bias is to reframe the situation in a different light[iv] - perhaps by gaining a working understanding of the terms and characters involved in administering your trust.

You may start to feel better if you understand the following aspects of your trust[v].

- ***Trustee***: Is your trustee an individual family member or a professional trustee, like a bank? The trustee's identity and background can help you refine your approach and set your expectations.

- ***Copy of the Trust***: As a trust beneficiary, you likely have a legal right to know a lot about the trust and its assets. Your most basic right is to a copy of the trust which the trustee should be able to provide upon your request.

- ***Trust Inventory & Accounting***: Your trustee has a duty to gather, control, and prudently manage trust assets. Your trustee should also have the duty to provide regular financial reports to you. These reports are invaluable to assess the trustee's performance and your financial position.

- ***Show Me the Money***: Your advisors should be able to help you locate the "beneficial provisions" of the trust. These are the trust terms which guide both the trustee and, in some cases, you, when it comes to enjoying the trust assets.

  Understanding these provisions will help you to level set your expectations and guide ongoing communications with the trustee.

  - Distribution Standard: A trust's "distribution standard" is the language in the trust that tells the trustee how to expend trust assets for your benefit.

    - Shall or May: Remember that trusts are legal documents, so the very specific words used in the trust are important. In general, if a trust uses the term "shall" then the trustee might be forced to distribute assets.

      On the other hand "may" could indicate that the trustee has discretion to distribute or not. This may (no pun intended) be an important distinction if you ever need to press the trustee to make distributions.

    - Health, Education, Maintenance, Support ("HEMS"): These words (or some variation of them) are oft-used distribution standards in estate planning trusts. The first part of HEMS (health and education) is pretty broad – the trustee can distribute for just about any healthcare or educational need that may arise.

The other standards (maintenance and support) tend to be aimed at providing the necessities of life and often in the manner to which the beneficiary has become accustomed. In other words, "maintenance and support" probably means more than the "bare necessities" King Louie famously sang about in The Jungle Book, while still within the framework of your established lifestyle.

- Best Interests or Any Purpose: Trusts sometimes pair HEMS with a "Best Interests" or "Any Purpose" standard to allow the trustee to go beyond the basics for trust beneficiaries. These are broad distribution standards that rely heavily on the trustee's discretion.

  The person who created your trust may have left a "letter of wishes" for the trustee, setting out non-binding examples of trust distributions for the trustee to consider.

- Specific Purposes: Finally, trusts will sometimes include very specific reasons, sometimes mandatory sometimes not, for a trustee to make a distribution. Typical examples include distributions to beneficiaries to start businesses or buy homes.

- Mandatory Rights: A trust may also have provisions which give beneficiaries various mandatory rights to distributions.

  - Mandatory Income: Many trusts direct the trustee to distribute the "net income" of the trust to the beneficiary at least annually. The inclusion of a mandatory income right means you should receive trust distributions each year. Your advisors can be very helpful to you both in understanding "income" and perhaps interfacing with the trustee on how to maximize it each year.

  - Age-Based Withdrawal Rights or Mandatory Distributions: Depending on how the trust is drafted, it may not be designed to last forever. As a result, many trusts will have built-in age-based distributions or even termination provisions. Your advisors can help you be aware of these provisions so you're not caught by surprise when the time comes.

- The Power to (Dis)Appoint: As a trust beneficiary you'll undoubtedly learn some new things. The term "power of appointment" is probably one of them (and a great addition to your Scrabble word bank)! A power of appointment ("PoA") gives you, the trust beneficiary, the right to turn the tables on the trustee and start giving the orders!

  - Lifetime Power of Appointment: A "lifetime PoA" is one that allows you to direct the trustee to distribute trust assets during your lifetime. For example, the trust may give you the right to direct trust assets to your own children, spouse, charities, or potentially others.

  - Testamentary Power of Appointment: A "testamentary PoA" is one that can only be exercised at your death – usually by including a special provision in your Will (or some other writing). With a testamentary PoA you might be given the right to redirect the trust in greater or lesser shares to your children or skip them altogether in favor of another beneficiary. This is also why a "power of appointment" is sometimes called the "power to disappoint!"

4. Trustees are people too.

Your trust may have an individual trustee or a corporate trustee (like a bank). Either way, until ChatGPT or Skynet takes over, the decisions made about your trust funds will be controlled by humans.

Corporate trustees will often assign one or more “trust officers” to be your official contact points. They may also have committees which determine when and how much to distribute to you from the trust. A few tips might help you to navigate these waters.

- ***Communication is Key***: Don’t be afraid to open a dialog with your trust officer. Respectful communication should be the expectation on both sides. Of course, your advisors can help you to determine how much to share depending on the situation.

- ***Appeal to Discretion***: If your trustee has “discretionary distribution authority” (the right to determine how much you get), remember it is their job to make informed and justified decisions. You can help your trustee get closer to your desired outcome by providing reliable information and documentation. Also realize that these things take time in a responsible organization – so try to be patient. This is another area where good advisors can really help in making your case to the trustee.

- ***Speak Softly and carry a Big Stick***: Sometimes it just happens that trust beneficiaries and trustees can’t get along. In many cases, trustees willingly step down in situations where they know that they are at odds with beneficiaries. Most trusts will also have some express method of removing and replacing a trustee. Before demanding a change or becoming adversarial with your trustee, you should understand what the trust says about removing and replacing trustees. Do you have this right? Do you need to convince others to do this? If so, who? Again, having solid advisors by your side in this scenario can be invaluable.

5. Don’t forget – trusts have many important benefits you may come to appreciate.

It’s easy to get nervous about being a trust beneficiary. As you fear the potential negatives, also consider the positives of a trust arrangement.

- ***It’s Not You, It’s Me!***: It’s natural as a trust beneficiary to think that your loved one didn’t trust you with the trust assets or that there was some nefarious plan to control the assets from the grave. But trusts may be even more impactful for “responsible” beneficiaries:

    - <u>Asset Protection</u>: A properly drafted “spendthrift” trust may insulate the trust assets from nearly all potential risks and creditors of the beneficiaries. This could make it nearly impossible for trust assets to be taken away by divorcing spouses (even without a prenup), upset business partners, malpractice lawsuits, plaintiff’s attorneys, and others. You might rest easier knowing that the trust funds are highly protected for you and your descendants.

    - <u>Tax Benefits</u>: For very wealthy families, trusts can be drafted to avoid further “transfer taxes” (estate, gift, generation skipping tax) which might be levied on trust assets at the death of a trust beneficiary. These are called “perpetual” or “dynastic” trusts and the wealthiest families in America have relied on these types of structures for generations to protect family wealth while making assets available to family members. The compounding effects of time and avoiding transfer taxes could make your trust a generational source of economic security for generations of your family to come.

- Estate Planning Efficiency: A trust can often make your own estate planning decisions easier by providing a pre-set roadmap for how assets should pass after your own death.

- ***Your Loved One's Peace of Mind***: Consider too that your loved one may have derived a significant amount of peace knowing that their wealth would benefit you and be protected with the trust structure.

Hopefully these considerations will help you navigate your newfound wealth and the limitations placed upon it through your trust. If you're interested in exploring how a financial advisor can help you navigate these waters, reach out to a Choreo advisor!

[i] https://www.kiplinger.com/retirement/great-wealth-transfer-gen-x-should-prepare#:~:text=The%20Great%20Wealth%20Transfer%20refers%20to%20the%20massive,decades%20and%20will%20significantly%20impact%20the%20financial%20landscape.

[ii] https://news.gallup.com/poll/351500/how-many-americans-have-will.aspx

[iii] https://www.psycom.net/negativity-bias

[iv] https://www.verywellmind.com/negative-bias-4589618#What%20The%20Research%20Says

[v] It's important to note that trust law varies among the states. The default rights of beneficiaries to information and reporting is based on these state laws and the trust instrument. This is an area where having a knowledgeable trust attorney can be very helpful.