

Control from the Grave

In last month's article about Dynasty Trusts, I noted that there are numerous advantages to leaving property in trust as opposed to distributing it outright to beneficiaries. Some may view this as control from the grave which has a stigma attached to it, but I would like to challenge that opinion from two directions. First, even if it is control from the grave, what's wrong with that?

Benefits of Keeping Property in Trust

There are a number of benefits of having property continue to be held in trust for the benefit of family members as opposed to making outright distributions to family members. If property is distributed outright to beneficiaries, all of the property is subject to the claims of all of the creditors of the beneficiary. If the beneficiary is immature, the beneficiary can imprudently spend the money. Think for a moment what you would have done with a large sum of money at age 18. Not many would invest it.

Even if the beneficiaries are mature, they may encounter involuntary creditors. Marriage may lead to divorce. In Massachusetts, the law is not clear that a divorcing spouse can not reach the trust property, but much more often than not, the trust property is protected. An auto accident can lead to a lawsuit. If the property were in trust for the person, the creditors could not reach the trust property.

Considering that people are living much longer, property does not pass from one generation to the next until the children on the decedent are often reaching their own retirement. They may not "need" the money but would prefer it to benefit their children, but they would be limited by the gift tax rules in the amount that they could transfer to their children. Property in trust can avoid inclusion of the estates of the beneficiaries saving substantial estate tax savings and there is no limit on the amount that could benefit the grandchildren of the decedent.

If property remains in trust there are numerous income tax planning opportunities that can save the family a great deal of tax. Because a trust can distribute income, money can be used to pay a grandchild's college tuition and the student is not likely to pay much if any income tax if this is the majority of the student's income. Alternatively, if the property were distributed to the child of the decedent, he would be taxed on the income earned on it even if the income were used for the student's tuition.

Even with all of the benefits of keeping property in trust, many people avoid these benefits for three reasons. First, there is public stigma with controlling family members from the grave. Second there is no mechanism for making good distribution. Third, there are not qualified people to make the decisions.

Trust fund babies

If you worked long and hard to earn your money, shouldn't you say who gets what and under what circumstances? The egregious examples of control from the grave get the most press. Perhaps it is morally wrong to prohibit a beneficiary from receiving

distributions so long as he does not marry a certain individual, but legally, you can do pretty much what you want with your own money.

Moderate restrictions are much more common and conditions on the receipt of property from a trust can be a motivator. For example, if a trust provides that a beneficiary can only receive an annual distribution equal to that beneficiary's earned income, the beneficiary would be motivated to work. Alternatively, a provision may permit distributions for the payment of tuition, but only so long as a certain grade point average is maintained may motivate the beneficiary to get better grades. Such rigid limitations are relatively rare.

Decision Making Mechanisms

While some creators of trusts value the control they can exert from the grave, an excellent means by which to provide for flexible control is to permit trustees to make "appropriate" distributions to beneficiaries. But, who determines what is "appropriate"? The creators of the trust should be the one to make the decision, but often they are not alive so the decision, so the trustees must decide. This leads to the obvious questions of how do trustees decide what is appropriate.

There is a disturbing distinction between how decisions should be made and how they are often made in practice. It is important to distinguish the means by which decisions are made and the decisions made. Even good procedures for making decisions will not prevent an occasional "wrong" decision, but having a good mechanism in place substantially increases the likelihood that the intent of the trust creator will be satisfied long after the trust creator is available to make the decisions.

Because the trust creator is often not available to make a decision, a written understanding of the trust creator's objectives is necessary. In my practice, I have clients attempt to define an "appropriate" distribution and, as importantly, an "inappropriate" distribution. We discuss how the definition should change based on the beneficiary and the circumstances. We certainly do not cover every situation, but I believe that we cover enough different circumstances to document the desire of the trust creator. This written understanding of the creator's intent is kept with the trust file to provide a very good mechanism for decision making for trustees.

Trustees

An additional reason for poor control from the grave is the trustees themselves. In some cases, trust creators name exclusively family members as trustees. The problem with this approach in addition to the usual unfamiliarity of the family member trustee with fiduciary laws, investment expertise and tax laws, is that they are either usually either too liberal in making distribution decisions out of love, affection or fear of the beneficiary or they are too conservative in making decisions out of a desire to perpetuate their responsibilities.

I had a case a number of years ago where a gentleman who died relatively young left his brother as the sole trustee of the trust for his widow and children. His widow had

to all but beg for distributions to satisfy her very basic needs. Is this what her late husband would have wanted? The animosity has grown to hate and, as a result of the decedent's good intentions, a family has been torn apart.

When a trust creator names solely a corporate trustee, decisions are often poorly made. Trust officers can change through bank mergers leaving the beneficiaries to request a contribution from someone who never met the trust creator and knows only the terms of the trust.

The best solution that I have come up with to date is to use a combination of a family member trustee and a professional trustee. The family member trustee provides the lifeline of information about the beneficiaries and the professional can deal with the legal, tax and investment issues competently. Additionally and of the utmost importance is for the trust creator to document his/her parameters for distributions as set forth above. Good trustees with good guidance most often make the right decisions.

Control from the grave is appropriate and beneficial. Moderate flexible distributions can be made by capable trustees based on the documented intentions of the trust creator. Before creating a trust or otherwise providing for the disposition of your property, I suggest that you consult with a estate planning attorney.

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