



Revocable Living Trusts – Trustee Distribution Powers

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Imagine someone gave you \$500,000 and said you could invest the money and use the income, but only the income it produced, for any purpose you chose. Assuming you could invest the \$500,000 in a manner that would produce an 8% return each year, you would have \$40,000 a year to enjoy. That is a pretty nice gift. However, now imagine the next day, you were in a car accident and needed medical care that cost roughly \$6,000 a month. Suddenly, that \$40,000 a year would not be sufficient to take care of your needs. Wouldn't it have been better if the person who gave you the \$500,000 had given you a little more flexibility about how you could use the money?



It is important that people weigh the benefits of flexibility given to the Trustee, against the possibility of misuse by the Trustee, when creating their Revocable Living Trust (“Trust”). Many people are uncomfortable with the idea of allowing someone else to decide to simply give their hard-earned money away for any reason. However, if you become incapacitated and are unable to make your own decisions, it is important you have someone you trust who is able to manage your assets and effectively care for you and your beneficiaries.

There are several options to consider that can make your Trust flexible enough to ensure that you and your beneficiaries will be taken care of no matter what happens while still allowing you to feel comfortable that your Trustee is not able to make ill-advised decisions.

OPTION 1: SPECIFICALLY AUTHORIZE CERTAIN TYPES OF DISTRIBUTIONS

Many Trusts include language authorizing a Trustee to distribute assets from the principal of the trust to beneficiaries for specific reasons. Three common reasons are to continue a pattern of gifting you may have established during your lifetime to charities, organizations or people, to pay medical expenses for your beneficiaries, and to prepay tuition costs for your beneficiaries. These are all sound reasons for

allowing your Trustee to distribute assets from your Trust, but they may not offer your Trustee enough flexibility to manage your Trust.

OPTION 2: DISTRIBUTIONS LIMITED TO THE FEDERAL ANNUAL GIFT TAX EXCLUSION AMOUNT

Often, Trusts contain the following language authorizing the Trustee to make gifts from the Trust to your beneficiaries:

My Trustee may make gifts on my behalf, limited in amount to the federal annual gift tax exclusion amount, to or for the benefit of any remainder or contingent beneficiary named in this agreement for purposes my Trustee considers to be in my best interest or in the best interest of the beneficiary, including, without limitation, the minimization of income, estate, inheritance or gift taxes.

While it is wise to include such language, this will only authorize your Trustee to distribute a limited amount (\$12,000 in 2008, \$13,000 in 2009) to a beneficiary once a year. That \$12,000 may not be enough to sufficiently take care of one of your beneficiaries or to lower your tax burden.

OPTION 3: DISTRIBUTIONS IN EXCESS OF THE ANNUAL EXCLUSION AMOUNT

Alternatively, you could insert language into your Trust that allows your Trustee to make gifts in excess of the annual federal gift tax exclusion. The authority to make larger gifts provides your Trustee with a significant power and you may be concerned about this idea. However, if you use the following language, you can give your Trustee this power while minimizing the risks involved:

If our Trustee determines that gifts in amounts in excess of the annual federal gift tax exclusion are in the best interests of both the incapacitated Grantor and our beneficiaries, our Trustee, by unanimous vote if more than one Trustee is serving, shall appoint an Independent Special Trustee unrelated by blood or marriage to any Trustee to review the facts and circumstances and to decide whether the gifts should be made.

By requiring your Trustee to appoint an independent special trustee to authorize gifts in excess of the federal gift tax exclusion amount, you can be assured that these gifts will not be made unless it is in the best interests of both you and your beneficiaries.

While the thought of someone else making such significant gifts of your assets may be troubling, you should remember that it may be necessary. A common scenario more and more people face is the possibility of having to live in a nursing home for significant periods of times. If your Trustee cannot make larger gifts from your Trust, he or she may not be able to get you qualified for governmental or veterans assistance. If your Trustee cannot get you qualified for these pro-

grams then you risk a significant amount, if not all, of your assets going to pay for your nursing home care instead of being preserved for the well-being of your beneficiaries. Similarly, given the present uncertainty regarding estate and income taxes, there may be a good financial reason why significant amount of your assets should be gifted in a particular year. This type of power provides your Trustee with flexibility to adapt to changing circumstances.

OPTION 4: GIVE YOUR TRUSTEE DISTRIBUTION GUIDELINES

If you are concerned that if you became incapacitated, your Trustee may give away your assets to other people with little regard for your well-being, then you should consider putting distribution guidelines during your incapacity into your Trust.

You can instruct your Trustee to distribute assets out of your Trust for your benefit first and only if you are provided for, then for the benefit of others, or for your benefit and your spouse's benefit, and then for the benefit of others (including your children, beneficiaries, etc.), or you can instruct your Trustee to distribute assets from your Trust for the benefit of you and others equally. Instructing your Trustee to distribute your assets for your benefit first and only then for the needs of others may be the selection that gives you the most peace of mind that your assets will not be given away. But if you have minor children or beneficiaries who are dependent on you, you may want to consider the more flexible option.

OPTION 5: DISTRIBUTIONS ONLY FOR ASCERTAINABLE STANDARDS

If you are leery of authorizing your Trustee to distribute assets from your Trust for any reason while you are incapacitated, then you can limit distributions to your beneficiaries to an ascertainable standard. You can instruct your Trustee only to make distributions to your beneficiaries for their health, education, maintenance, or support. You can further restrict the standard by authorizing your Trustee to only make distributions for health and education. This offers flexibility while also providing your Trustee with important guidelines.

OPTION 6: BALANCE FLEXIBILITY WITH RESTRICTIONS

If you are concerned about giving your Trustee so much authority, you do have some alternatives.

- You can appoint joint Co-Trustees and require all of them to agree before making any distributions.
- You can authorize your Trustee to make distributions to your Agent under your Durable Power of Attorney, who will make distributions according to the terms of that document.
- You can appoint an independent person or professional fiduciary to serve as a Distribution Trustee. That person reviews any distributions and

determines whether they are in your and your beneficiaries' best interests before the distributions are made.

What you should do: When deciding how much flexibility to provide your Trustee to make distributions from your Trust, you should balance your concerns of giving your Trustee too much power with the understanding that you want to enable your Trustee to take care of you and your beneficiaries no matter what happens in the future. You and your attorney should discuss your concerns and consider the options outlined above to ensure your Trust will protect your assets as much as possible for you and your beneficiaries for the rest of your lives.

For the past 15 years, this firm has helped clients in the Hampton Roads region of Virginia with elder law, estate planning, estate administration, and special needs planning.