CHAPTER 54

Revocable Living Trusts – Timing Distributions After the Second Death

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How you choose to distribute trust assets after your death and the death of your spouse is one of the pillars of your revocable living trust, the effects of which reach far into the future. For this reason, there are many factors to consider when determining the timing of distributions from your trust. The methods and techniques are almost limitless and depend on your specific objectives and the needs of your beneficiaries. Your decisions regarding the timing of such distributions should be made only after you have discussed your objectives with your counseling attorney and after you fully understand the possible outcomes.

As a preliminary matter, you need to decide whether your assets will be distributed to your beneficiaries outright or in trust. An outright distribution is the simplest way to distribute property. It immediately gives the beneficiary full access to the money or assets at the time of distribution with "no strings attached." Outright distributions are simple, immediate, and easy to understand. One disadvantage is that you lose control over the way your beneficiaries use the assets they receive. Further, you will have missed the opportunity to provide protection for the assets you intend to distribute — or ensuring they go to your beneficiaries, and not to their "creditors or predators."

If, on the other hand, you decide to control your assets by leaving them in trust, you have two main options for handling distributions, each of which can be broken down to further meet the needs of your beneficiaries. The first option is to allow distributions of income and principal only, at the Trustee's discretion. The second option is to require the Trustee to make distributions of income and principal pursuant to a set plan or schedule.

If you decide to have your Trustee exercise discretion in making distributions, you will want to define the criteria your Trustee will use when exercising this discretion. You may require that your trustee use the same criteria for distributions to all beneficiaries, or you may choose to implement different distribution instructions for different beneficiaries.

However, most people choose that their trust assets — specifically the income of the trust — be distributed according to a fixed schedule. One reason for this is that undistributed income triggers relatively unfavorable income tax consequences for your trust; the income tax consequences are generally worse at the trust level than at the level of an individual beneficiary. It is important to note, however, that there are circumstances where, after considering all factors, your beneficiaries are better off with the Trustee exercising discretion to retain income in your trust and paying relatively higher taxes on your trust's income.

After choosing a method of distribution for your trust's income, you have many options for distributing trust principal. First, you can choose to set an age when your beneficiaries have a "demand right," which is simply the ability of a beneficiary to demand principal at any time and for any reason.

It is important to realize that once a beneficiary has the right to demand principal from the trust, the beneficiary loses valuable protection over those assets. For this reason, the best demand right age often varies from beneficiary to beneficiary, and depends on all the facts and circumstances. For some, a younger age, such as 30, may be appropriate. Other beneficiaries may have a greater long-term need for asset protection, and age 50 will be more appropriate. Other beneficiaries may never be ready for a demand right, and a trust that does not allow for any demand right during the beneficiaries' lifetime may be best. Common risk factors you might consider when making your demand right decision include the risk of divorce, fear of lawsuits, and fear of business failure.

Certain beneficiaries may be best served by having a series of demand rights that are triggered by the occurrence of various events. Many people use the attainment of specific ages as triggers for demand rights. For example, you might decide your beneficiary should have a demand right over one-third of his or her trust principal at age 30, one-half of the remaining trust principal at age 40, and the balance at age 50. Such a tiered distribution could consist of equal or unequal distributions. Other examples include creating demand rights at specific time intervals (i.e., at five years after your death, ten years after your death, etc.) or upon the occurrence of one or more specific events such as upon a beneficiary's marriage, the birth of a grandchild, or when a child or grandchild begins college.

Another option is to distribute trust principal when the beneficiary successfully completes certain tasks. You may specify that "Kimberly shall receive $10,000 upon completion of a four-year degree from an accredited college or university." This type of distribution plan might be referred to as a "motivational" distribution plan.

The timing of principal distributions can also be affected by the character of the assets. For example, $250,000 in cash and the family cabin that Grandfather built may have equal monetary value, but their relative "emotional" values are very different, and therefore, necessitate a different distribution plan. You might distribute the cash right away or in one of the ways described above; Grandfather's cabin, however, might never be distributed.

The unique characteristics of your beneficiaries will also affect the timing of distributions from your trust. The age of the beneficiary could be a major factor in your decision. Any beneficiary who is a minor should receive income and principal distributions only when the Trustee exercises discretion to do so. The same is true for any incapacitated beneficiary. Careful drafting in cases of minor or incapacitated beneficiaries will minimize or eliminate Court involvement in the beneficiaries' affairs. Court involvement can add unnecessary time, expense, and frustration for all parties involved. A well-qualified counseling attorney should advise you of your options.

Finally, if you have several children and one or more of them are minors, you might choose to establish a "common pot" trust. A "common pot" trust is used to hold all your assets together to ensure each of your children can use family assets to support them through their minority. If your estate is divided into shares for your children before the younger ones reach adulthood, your younger children may end up paying their medical and educational expenses from their own "shares" of the trust estate while your older children will have received their shares "net" of the expenses you already spent to raise them to adulthood.

There are many options for the distribution of your trust assets after both you and your spouse have passed away. What we have shared here gives you a good idea of the timing and distribution options available to you. Remember to consult your estate planning attorney to design trust distribution and timing provisions best suited to your specific needs and the needs of your beneficiaries.

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