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TRUSTS & ESTATES

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By **Niké Anani, Todd A. Flubacher, Kristin Keffeler,** & **Philip J. Hayes**

Letting Go of the Dead Hand

The shortcomings of traditional trust planning.

Taylor, the only child of her entrepreneurial parents, was 23 when she first found out about the trust created for her benefit. Taylor knew her parents loved her, but she jokingly commented that her parents' gold-mine of a business was like a sibling to her—maybe the favored sibling. Taylor's parents didn't come from wealthy families themselves and, while they loved the idea that they could "give their daughter the world," they were more worried about the potential negative impact their wealth could have on her life. Although Taylor was aware of, and had the legal right to information about, the trust that was created for her benefit, her parents avoided engaging in conversations that would help her learn about this resource or their intent for her use of it. Taylor struggled as the parent-child dynamic of her childhood extended into her adulthood. She was proud of what her parents had created and grateful for all they had given her. Yet, she felt stunted and confused as she tried to navigate a system that she didn't understand and seemed to have no voice in. All of the power was centered with her parents and their advisors.

This kind of struggle is real, and it's one that often leaves trust beneficiaries questioning their own abilities: "I'm grateful for all my parents have done, but I don't have a voice. How can I find my way and be fulfilled?" The desire for autonomy and the freedom to forge their unique paths is palpable. However, what often stands in the way of their aspirations is a pervasive lack of confidence. Regrettably, this confidence deficit is sometimes exacerbated by the very trust structures designed to protect their financial futures.

In another real-world example that highlights the struggle of a beneficiary in the grip of dead hand control, consider a past client who married into a multigenerational enterprising family. The family's patriarch, an immigrant who built a billion dollar business from scratch, had two children and five grandchildren. He feared that his financial success might stifle the drive and ambition of his offspring. His goal was to instill motivation, productivity and a strong sense of community service. To achieve this end, he created a trust that linked the beneficiaries' distributions to their earnings to incentivize hard work. The beneficiaries included his two children and their spouses One of the beneficiaries, however, followed a path that required hard work, but had a lower earning ceiling. She was a committed teacher and spent a significant portion of her free time volunteering. Despite her personal fulfillment and commitment to make the world a better place through those activities, within the extended family she often felt like a failure and unappreciated. Ultimately, she felt compelled to pursue a higher earning career to gain acceptance from her father-in-law. While that result wasn't likely his intention, the narrative of instilling productivity and financial success dominated the family discussion and had a detrimental impact on the daughter-in-law's confidence.

In the world of trust planning, it's crucial to recognize the perspective of the rising generation—inheritors who often find themselves growing up in the shadows of giants. As beneficiaries, they may feel voiceless and powerless. In addition, growing up in the legacy of their forebears can be an intimidating experience. They stand in awe of their parents' achievements, with a nagging sense that they may never measure up.

Personal agency is highly linked to happiness and motivation. We know from the learned helplessness literature that appropriate doses of difficulty at every developmental life stage are essential for individuals to gain a feeling of control or mastery in their lives. Too little difficulty and one never learns they're capable.

Too much and they stop trying. Whether rooted in the settlor's fear, the drive to optimize tax savings over all other goals or the desire to exert control over the life decisions of descendants, many modern day trusts are drafted in ways that deprioritize beneficiary well-being and, in fact, often perpetuate learned helplessness.

Trust Purpose

We advise clients to create trusts to take advantage of transfer tax exemptions, valuations and income tax planning. But do you know what your client's primary purpose is for creating a trust? Is it simply to save the largest amount of tax at death and pass the most money possible to descendants—whom the client will probably never meet—into perpetuity?

Planners find it's easier to speak with clients about exemptions, tax rates and valuations than to tackle mushy topics like feelings, motivations and the beneficiaries' well-being. But what really is the clients' "why"? What's their purpose for creating a trust in the first place? Isn't it to promote and support the well-being of descendants so the trust ultimately benefits their lives and enhances—rather than detracts from—their ability to lead purposeful, productive and meaningful lives?

To begin the process, each advisor should ask the client: If they were a beneficiary of the trust, how would they like to experience the financial security afforded by the trust, and how would they like the trust to benefit their life? We believe trust planning should start from there.

Traditional Trust Planning

Traditional trust planning rarely goes far enough to address beneficiary well-being, as the overwhelming focus is driven by fear that the trust will turn descendants into unproductive "trust fund babies" rather than fostering purpose and productivity. To the extent that traditional planning attempts to address these critical issues, documents focus on using distributions as a carrot or stick, placing filters or guidelines on the distributions a beneficiary may receive or through secrecy, placing restrictions on the information provided to the beneficiary.

Regardless of if it's intentional, the distribution scheme chosen by the client can have a far-reaching impact on the way beneficiaries will relate to the trust fund. Distribution schemes can be designed to allow: (1) purely discretionary distributions; (2) distributions only pursuant to a standard, like health education, maintenance and support (HEMS); (3) distributions guided by precatory language or letters of wishes; or (4) the ultimate dead hand, with specific triggers, conditions, caps or other restrictions.

Purely discretionary distributions maximize flexibility and allow the trustee to distribute all of the trust to one beneficiary or completely cut off distributions, whereas a HEMS standard could create a "support trust" and provide a safety net that beneficiaries can count on for support, health care and education expenses. This addition can make a big difference, and the practitioner should discuss different realities from the beneficiary perspective with the client. Additionally, a provision as simple as the requirement (or not) that the trustee consider other resources, may result in the beneficiaries needing to disclose tax returns and financial statements and show receipts or financial need to the trustee to obtain distributions. A document might include detailed distribution parameters, like outright bequests or withdrawal rights at certain ages, caps on annual distributions, lifestyle incentives or disincentives like salary matching and distributions to pay for weddings or the purchase of a home, to name just a few.

All of these parameters can be compelled in the document, or alternatively, the trustee could be given discretion, with these factors set forth as precatory language, or in a letter of wishes, as guidance. A trustee could be required to deliver a letter from the settlor to beneficiaries prior to making distributions that describes the settlor's values and the family legacy. Creating a directed trust and naming an individual who's close to the family as a "distribution advisor" can help ensure that personalized distribution decisions are made or facilitate more "risky" decisions, like cutting off beneficiaries, when a corporate trustee wouldn't be willing to do it.

Granting beneficiaries lifetime or testamentary powers of appointment (POA) can give the beneficiary agency over the disposition of the funds. Including charitable organizations under a POA can foster philanthropy. Trustees can be granted powers that support beneficiary pursuits, such as enabling the trustee to purchase a home in the trust, make interest-free loans to beneficiaries or encourage entrepreneurial investments, like empowering the trustee to invest in, or loan to, entrepreneurial businesses of the beneficiary or make distributions to the beneficiary to invest in businesses.

Too frequently, planners steer clients toward a so-called "silent trust" to try and address the settlor's fear of leaving

too much wealth for descendants. The term "silent trust" refers to a trust that limits or eliminates the beneficiaries' rights to receive information about the trust for a period of time, such as on attaining a certain age or for an individual's lifetime. Silent trusts have many pitfalls that can result in administrative dilemmas and harmful effects on beneficiaries, but that's a topic for a succeeding article.

Often, traditional attempts at addressing beneficiary well-being stall when the rubber meets the road. By trying to exert control over beneficiaries through distributions or restricting information flow, good intentions run head-on into the reality of modern day trust administration. These tools, ultimately, can't fulfill their purpose when trustees are concerned about fiduciary liability associated with the discretionary decisions or the amount of resources it will take to minister to beneficiaries.

Traditional Trust Administration

Corporate trustees have a business to run; it's no secret that they strive to minimize risk and manage the resources dedicated to each trust administration. In carrying out their duties, trustees must follow the terms of the trust agreement, however drafted. Unfortunately, with many traditional trusts, in the absence of guidance from the settlor, the terms addressing beneficiary distributions must be followed regardless of whether they're in the best interest of the beneficiary.

As discussed above, attorneys often use an ascertainable (HEMS) standard to protect an individual from inadvertent estate tax inclusion. Corporate trustees too often see the HEMS standard included out of habit, not for any estate tax savings protection. A HEMS standard, standing alone, can be subjective and therefore risky for the trustee, could expose the trust to creditor claims and is often unnecessary to achieve transfer tax savings. Trustees know that HEMS is in the eye of the beholder. To a current beneficiary (say, a surviving second spouse or a pot trust beneficiary), a spa treatment is obviously "support" (or "health"?). To the remainder beneficiaries (children by first marriage, or pot trust co-beneficiaries) a spa treatment (or cosmetic surgery) is clearly beyond what the settlor intended by "support" or "health." Without further guidance in the form of a statement of intent or letter of wishes, HEMS is an overbroad standard. Corporate trustees will interpret HEMS conservatively, which may not be consistent with the settlor's intent.

Likewise, rigid incentive clauses potentially set up an adversarial relationship between the trustee and beneficiary. Individuals don't like to feel they're being manipulated and will push back on the trustee scrutinizing their lifestyle choices and behavior. In addition to the negative effect they have on trust beneficiaries, incentive trusts are difficult to draft and even more difficult to administer: To monitor objective criteria, the trustee must obtain and analyze income tax returns, medical reports and economic circumstances and will need broad power to investigate the beneficiary's circumstances and obtain objective proof that the beneficiaries are meeting the requirements. A trustee who accepts this responsibility will charge a higher fee and require additional liability protection.

Trustees will also resist incentive trust provisions that place the trustee in the middle of an issue that pre-dates their involvement with the family. The trustee can't be expected to solve issues the settlor wasn't capable of managing. In these circumstances, the better method is to authorize the trustee to expend funds to hire trained professionals to enhance beneficiary well-being.

Instead of rigid incentive clauses and overbroad HEMS standards, trustees prefer wide discretion and flexible distribution standards in concert with thoughtful guidance from the settlor. Whatever standards the client imposes shouldn't be a surprise to the beneficiary or in stark contrast to the way the settlor raised them. The overarching truth is that trustees and lawyers can't fix a dysfunctional family. The advisor's drafting challenge is to respectfully and thoughtfully avoid indulging the client's worst impulse to control from the grave.

A Shift in Approach

It's imperative that we shift our approach to prioritize well-being of beneficiaries rather than control. As advisors to enterprising families, we must recognize the voices of the rising generation and their yearning for autonomy and agency. By fostering meaningful conversations with our clients when designing their trusts, we can reimagine traditional trust structures to better help beneficiaries find their own paths, promote their well-being and ensure the successful fruition of the clients' goals to create trusts that serve as catalysts for purposeful, productive and meaningful lives. Trust planning should start from the perspective of those who stand to benefit the most—the rising generation.

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