

Trust Distribution Guidelines and Policies

A. Understand the Terms of the Trust Agreement

A trustee *must* fully understand the terms of the trust agreement in respect to distributions to beneficiaries. The trustee must read the trust agreement before accepting the appointment plus annually review of the trust terms and distribution issues. Along with this initial and annual review of distribution terms, the trustee must also examine the entire trust agreement for statements and clauses giving the grantor's intent for distribution standards and any priority or preference given to beneficiaries.

B. Guidelines for Discretionary Distributions

Often the most difficult job a trustee has to do is to make discretionary distributions to trust beneficiaries. Inexperienced trustees can be surprised to learn that terms in trust agreements such as "absolute" or "uncontrolled" rarely permit total and unqualified trustee discretion. However, a trustee that has acted in good faith, with proper motives, within the boundaries of reasonable judgment and in line with terms of the trust agreement generally should not find themselves on the losing side of a court case.

Usually where the trustee is given the power to make discretionary distributions, the trust agreement will give a distribution purpose standard such as "for the health, support, maintenance and education" of the beneficiary. Often a trustee will have a meeting with a beneficiary and establish a mutually agreed monthly or quarterly stipend for the beneficiary based on their budget, taxes and resources outside of the trust. Additionally, a trustee should reasonably calculate whether the trust portfolio can provide the beneficiary's needed level of support as long as the trust requires (e.g., for the beneficiary's life), which may or may not require invasion of principal which over time will reduce the trust's capacity to provide for the beneficiary in the future. The trustee should document the facts and circumstances serving as their basis for making beneficiary distributions at a specific level. As noted briefly above, sometimes a trust agreement will require that the trustee consider the beneficiary's needs in light of his or her accustomed standard of living. In this case, the distribution budget may include items that are reasonable for that individual in light of that lifestyle (such as expensive vacations, clothing or club dues). In this case, the trustee should maintain records that indicate that these expenses are similar to those previously incurred by the beneficiary and retain all beneficiary requests for disbursements, including the amount requested. Income tax returns, proof of expenses and budgets submitted by the beneficiary should also be retained. At least annually the trustee should review distributions and confirm the actual expenses of the beneficiary over time. Further, the trustee should maintain and update distribution information in their file.

In addition to recurring allowances, beneficiaries will periodically request discretionary distributions for specific purposes. A trustee should require that these requests be in writing and explain the need for the distribution. As noted above, this written request should be retained in the file of the trustee. Also, if a beneficiary has a verbal request for an emergency distribution, and if the emergency distribution is made by the trustee, the trustee should obtain written confirmation of the request from the beneficiary as soon as possible. Generally and to the extent reasonably possible, it is a good practice to keep records of all face to face and telephone conversations with beneficiaries when verbal requests are made.

Beneficiaries are generally very happy when they receive all of the funds from the trust they request. However, this is generally not possible, especially where there are multiple beneficiaries. Also, it is not good when a trustee makes distributions over time that depletes the trust or does not leave assets for remainder beneficiaries. This could result in legal liability to the trustee. It is often the case where a trustee may be required to reject one or more distribution requests from beneficiaries. Due to this, it is always a good practice for a trustee to clearly communicate with beneficiaries on a regular basis to avoid conflicts over these matters. From the very beginning, a trustee should explain the purposes of the trust, the terms of the trust agreement, and disclose the amount of funds available to the beneficiaries. This explanation can increase the likelihood of the beneficiary accepting and understanding why certain distributions cannot be made. Further, unless the beneficiary is a minor, they deserve to be treated as an adult. (Even if the beneficiary is a minor, their parent or guardian should be given the same information and courtesies. The trustee should always present trust information in a professional unbiased manner. Beneficiaries who are given complete information and recognize that the trustee's are not arbitrary are more likely to make more reasonable requests and to react more rationally when their requests may be denied.

C. Weighing the Interests of Multiple Beneficiaries

The trustee serving under a trust agreement with multiple beneficiaries must consider the differing interests of the various beneficiaries. This includes beneficiaries who are current or remainder beneficiaries. If a trust grantor provided that one beneficiary has priority (such as a surviving spouse) over all other beneficiaries, this request must be honored and all beneficiaries should be informed of this preference. In other trust agreements where the grantor established one or more classes of beneficiaries (e.g., current income beneficiaries or remainder principal beneficiaries) the trustee is charged with understanding the ability of the trust assets to provide for the necessary financial needs of the various beneficiaries. Consequently, the trustee must consider each request under the terms of the trust agreement defining the beneficiaries' various interests. The trustee should document the reasons for making or denying distribution requests. If a trustee has well documented files, the Courts generally will not substitute their judgment for the judgment of a trustee on questions of discretionary distributions. However, without good documentation or if there is a record reflecting poor or harsh communications by a trustee with the beneficiary, Courts are more inclined to substitute their judgment for a trustee's which could result in personal liability imposed on a trustee.

D. Loans from a Trust to Beneficiaries of the Trust

Unless a trust agreement prohibits loans, rather than making a distribution, a trustee may normally loan trust funds to a beneficiary for certain purposes. When it comes to a trust involving multiple beneficiaries, loans can be a way to satisfy a beneficiary's financial needs without giving them "too much" of the trust during its term. For trusts that will divide into separate shares for each beneficiary on a triggering event (e.g., death of a surviving spouse, or a beneficiary attaining a certain age) a loan may be offset against the beneficiary's ultimate share. Of course a trustee should be cautious about making loans because the loan will become an asset of the trust and can be scrutinized by the beneficiaries for proper portfolio management as well as the IRS for proper income tax treatment. Before making a loan, make certain the trust agreement permits loans. Then, if permitted, the trustee must make certain there is sufficient collateral for the loan and the beneficiary has the ability to timely repay a loan. All loans should be "arms length transactions" regardless of the identity of the borrower. All loans must be supported by a promissory note and any appropriate collateral security agreement. The decision to loan funds to a beneficiary is tantamount to making a trust distribution to a beneficiary, since many cannot or will not repay. If the terms of the loan are not proper and clearly spelled out, if timely payments are not made, interest rates are not adequate or collateral is not sufficient, there could be legal liability to the trustee and adverse federal income tax consequences to the beneficiary and/or the trust. Consequently, a trustee should not enter into beneficiary loans lightly and must be prepared to deal with default, should it occur.

IMPORTANT: This publication is designed to provide general information about planning ideas and strategies. Always consult with your legal, tax, investment, and insurance advisors about your unique circumstances before changing or implementing any financial, tax, or estate planning strategy.

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