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The Beneficiary Flexible Trust

Tulsa Estate Planning Forum

November 11, 2014

Roadmap

- Situations in which a Beneficiary Flexible Trust Makes Sense
- Goals and Attributes vs. Inherent Limitations
- Beneficiary Flexible Trust Agreement (Exhibit 1)
 - Beneficiaries
 - Distributions
 - Trusteeship
 - Investments
 - Administration

Beneficiary Flexible Trust

- When Appropriate:
 - **Proposed Gift**

Beneficiary Flexible Trust

- When Appropriate:
 - Proposed Gift
 - **Potential Inheritance**

Beneficiary Flexible Trust

- When Appropriate:
 - Proposed Gift
 - Potential Inheritance
 - **Proposed Investment**

Beneficiary Flexible Trust

- When Appropriate:
 - Proposed Gift
 - Potential Inheritance
 - Proposed Investment
 - **Gift of AEA to a Spousal Trust**

Beneficiary Flexible Trust

- **Goals:**
 - Remove property from gross estates
 - Settlor and beneficiary
 - Beneficiary serves as trustee
 - Controls distributions
 - Beneficiary and others
 - Lifetime and at death
 - Controls investments
 - Protection from creditor claims
 - Protection from spousal claims
 - Minimize administrative and fiduciary duties

Beneficiary Flexible Trust

- **Attributes:**

- Beneficiary – Family Trustee
 - All powers not reserved to Independent Trustee
 - Distributions limited to HEMS standard
- Third party – Independent Trustee
 - Limited powers: Distributions to primary beneficiary beyond HEMS standard; tax sensitive powers
- Beneficiary – 5/5 power
- Beneficiary – lifetime and testamentary SPAs
- Administrative and fiduciary provisions minimize beneficiary/trustee's obligations

Beneficiary Flexible Trust

- **Constraints**
 - Settlor's wishes
 - Common and statutory trust law
 - Tax Law
 - Marital property law
 - Creditor's rights law

Beneficiary Flexible Trust

- **Limitations compared to outright ownership**
 - Less control and flexibility
 - Greater formalities
 - Segregation of assets
 - Fiduciary duties
 - Additional income tax returns?

Beneficiary Flexible Trust

- **Federal Law Considerations**
 - Transfer tax
 - Income tax
- **State Law Considerations**
 - Creditor's rights
 - Marital property issues
 - Trust law
 - Which state law governs?
 - Change of situs of trust
 - Change of residence of beneficiaries

Beneficiary Flexible Trust

- **Discussion Topics**
 - Beneficiaries
 - Distributions
 - Trusteeship
 - Investments
 - Administration

Beneficiary Flexible Trust

- **Beneficiaries**
 - Completed gift by settlor
 - No power to alter beneficiaries
 - Definition that adjusts for changed circumstances (“spouse,” “children,” “descendants,” etc.)
 - Ability to distribute to other beneficiaries is an aspect of control
 - Lifetime and testamentary non-general power of appointments
 - Include other persons as permissible beneficiaries

Beneficiary Flexible Trust

- **Distributions – Mandatory**
 - All income or a fixed amount
 - Forces assets out of trust
 - Increase sensitivity to allocation between principal and income
 - Heightened fiduciary concerns re investments
 - Failure to make required distributions

Beneficiary Flexible Trust

- **Distributions – Discretionary**
 - Beneficiary serving as Trustee
 - Limit distribution powers to HEMS standard
 - Prohibit distributions to satisfy Trustee’s support obligations
 - Added flexibility:
 - “may” vs. “shall” distribute
 - “may” consider other resources available to beneficiary
 - Factors for Trustee to consider

Beneficiary Flexible Trust

- **Distributions – Discretionary**
 - Independent Trustee
 - Distributions to primary beneficiary beyond HEMS standard
 - Other tax-sensitive powers
 - Mitigate risk of inappropriate action
 - Independent Trustee does not sign agreement currently
 - Beneficiary has power to remove and appoint successor Trustee (watch out for revolving door power)

Beneficiary Flexible Trust

- **Distributions – Spendthrift Clause**
 - Provides protection from creditor claims
 - Can facilitate exclusion from beneficiary’s estate
 - In most states, self-settled trusts not protected
 - Some states permit claims for child support or governmental agencies who have provided support

Beneficiary Flexible Trust

- **Distributions – 5 & 5 Withdrawal Power**
 - Greater access to trust assets
 - Failure to withdraw not a gift
 - Held at death causes estate tax inclusion
 - Limit time period of withdrawal right
 - Deemed settlor of amounts not withdrawn?

Beneficiary Flexible Trust

- **Distributions – Powers of Appointment**
 - Non-fiduciary power to direct distributions
 - Lifetime or testamentary
 - General or Non-general
 - Permissible appointees

Beneficiary Flexible Trust

- **Trustee – Generally**
 - Beneficiary is Family Trustee
 - Third party is Independent Trustee
 - Limited powers
 - Directed Trust alternative
 - Beneficiary has power to remove and appoint successor trustees
 - Successor Independent Trustee must not be related or subordinate

Beneficiary Flexible Trust

- **Trustee – Resignation, removal and appointment**
 - Trust instrument should include provisions for:
 - Trustee resignation
 - Trustee removal
 - Trustee appointment
 - Qualifications for successor trustees
 - Procedures for Appointment

Beneficiary Flexible Trust

- **Trustee – Exculpation Clause**
 - Trust instrument can modify or eliminate trustee's duties
 - Exceptions
 - Reduces potential for litigation
 - Apply to only certain trustees?

Beneficiary Flexible Trust

- **Trustee – Compensation**
 - Trustee entitled to reasonable compensation
 - Trust instrument can provide otherwise
 - Should beneficiary serving as trustee receive compensation?
 - Income tax
 - Gift tax

Beneficiary Flexible Trust

- **Investments**
 - Grant Broad authority
 - Insurance on beneficiary's life
 - S Corporation stock

Beneficiary Flexible Trust

- **Administration**

- Power to lend

- Self-dealing

- Power to decant & modification of trust

Beneficiary Flexible Trust

- **Administration**
 - Situs
 - Merger of Trusts
 - Division into Separate Trusts

Beneficiary Flexible Trust

- **Administration**
 - Savings Clauses
 - Controlling who is taxed on trust income

Beneficiary Flexible Trust

- **Administration**
 - Accountings to Successor Trustees
 - Accountings to beneficiaries

Beneficiary Flexible Trust

- **Administration**
 - No-Contest Clauses
 - Dispute Resolution Provisions

Conclusion

- As Advisors, We Should Strive to Strike the Right Balance Between Flexibility and Constraint
 - The Art of Estate Planning
 - Add Value to Client Relationships



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