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Five Ways to Make Trusts More Flexible

Content provided by The Advisors Forum; Edited by James W. Garrett, Esq.

Trusts that continue for the benefit of a surviving spouse's lifetime, and then for the benefit of one or more generations have become the norm. Drafting trust agreements that will cover the administration, investment, and distribution of trust property over the span of multiple decades is challenging. In this issue you will learn how trust agreements can be made flexible to address changes in the lives of beneficiaries and changes in governing laws by:

1. Carefully selecting trustees.
2. Defining trust beneficiaries.
3. Including powers of appointment.
4. Allowing for trust decanting.
5. Providing for the appointment of a trust protector.

If you would like us to review any of your clients' trust agreements and make recommendations for improving their flexibility, please follow the link to our website and contact one of our attorneys at any one of our five offices serving central and eastern Virginia.

The Wrong Trustee Can Derail Your Client's Wishes

Choosing the right succession of trustees for an irrevocable trust that is intended to continue for years into the future is critical to the trust's success and longevity. Typically the client's initial thought is to name one or more family members as trustee(s) who can then appoint additional family members because they will better understand the varying needs of the beneficiaries and will keep the costs of administering the trust down. But in reality family members will not be able to fulfill all of their fiduciary obligations without hiring legal, investment, and tax advisors.

Clients ought to consider the qualifications of their trustee candidates, including personalities, financial or business experience, and time available due to their own family or career demands. Serving as trustee can take a substantial amount of time and requires a certain amount of business sense. In some situations, a client will be better off appointing an institutional trustee, such as a bank, trust company or a law firm, which will be better suited to handle all fiduciary obligations.

For this reason, our law firm established Legacy Fiduciary Services, PLC ("LFS"). LFS is a law firm dedicated to serving as trustee of trusts created and governed pursuant to the laws of Virginia. But, unlike banks and trust companies, LFS does not manage the investment of trust assets but works with the client's financial advisor to manage the client's trust assets while it administers the trust. The attorneys at LFS are dedicated to ensuring that a client's careful planning is implemented. They make it their job to stay current with changing trust laws and regulations, and they work closely with financial advisors to help ensure that both the needs of clients and the needs of their loved ones are being met.

On the other hand, forcing trust beneficiaries to be stuck with any trustee (family or institutional) without a reasonable means for removing and replacing the trustee will land the beneficiaries and trustee in court. It is crucial to build provisions into the trust agreement that allow beneficiaries or a trust protector (more on them below) to remove and replace trustees without court intervention.

Planning Tip: Selecting a trustee is one of the most important decisions a client will make when creating a long-term dynasty trust. Serious consideration should be given to naming an institutional trustee such as Legacy Fiduciary Services, PLC, either alone or as a co-trustee with a family member. Unlike a person subject to illness, retirement and death, an institutional trustee has continuity of existence. Furthermore, an institutional trustee will act as a neutral party to oversee discretionary distributions and investment strategies that benefit both current and remainder beneficiaries. To create flexibility, specific beneficiaries (such as current income beneficiaries) or a trust protector should be given the right to remove the institutional trustee and replace it with another institutional trustee.

Trust Beneficiaries Need to Be Clearly Defined

Clients need to consider who they want to include as trust beneficiaries twenty, thirty, or even fifty years into the future. Should adopted children be included (both minor and adult adoptees)? How about children born using "assisted reproductive technology"? In the past the definition of a "descendant" was straightforward, but today it can encompass much more than blood heirs.

Planning Tip: While clients cannot predict or foresee everything that will happen in the future, they should still take time to consider who they want to take care of after they are gone. Clearly defining the class of beneficiaries who will benefit from the trust will allow for a smooth transition between generations and potentially head off litigation.

Powers of Appointment Can Add or Eliminate Beneficiaries

Clients who are concerned about whether children, grandchildren, or great grandchildren will develop into responsible adults up can build flexibility into a dynasty trust by giving a surviving spouse or other beneficiary the ability to include or exclude heirs through a power of appointment. A power of appointment is also important when a trust is designed as a generation-skipping trust but one or more beneficiaries do not have children, and it can also be used to include or exclude charitable beneficiaries.

Planning Tip: Powers of appointment at each generation should be considered when designing a trust intended to last for decades into the future. The powers can be as limited or as broad as the client desires without creating any gift tax or estate tax problems.

Trust Decanting Takes Something Old and Makes It New

Trust decanting involves taking the funds from an existing trust and distributing them to a new trust that has different and more favorable terms. Decanting is authorized in Virginia and should be included as an option in the trust agreement.

Reasons for decanting a trust may include the following:

- Tweaking the trustee succession provisions.
- Converting a trust that terminates when a beneficiary reaches a certain age into a dynasty trust.
- Changing a support trust into a full discretionary trust so that a beneficiary's creditors cannot seize assets from the trust.
- Clarifying ambiguities or drafting errors in the existing trust.
- Changing the governing law or trust situs to a less taxing state.
- Modifying powers of appointment.
- Merging similar trusts into a single trust or creating separate trusts from a single trust.
- Adjusting the trust terms to provide for a special needs beneficiary.

Planning Tip: Clients may be concerned that including decanting provisions into a dynasty trust will defeat their long-term goals and intent. However, including the authority to decant a trust provides flexibility into the trust agreement from the beginning, reducing the risk that a client's beneficiaries will end up in court to fix a trust that no longer makes practical or economic sense.

Trust Protectors Can Fix Just About Any Problem

A trust protector is an individual or entity empowered to make trust changes so that the grantor's wishes can be ultimately fulfilled. Think of a trust protector as a "safety net" in the event something goes wrong long after the trustmaker has passed away. A trust protector's duties can be as limited or all-encompassing as the trustmaker chooses. In essence a trust protector can be given the power to modify the terms of a trust without necessarily having to decant it and to address unforeseeable events such as changes in tax laws or family dynamics.

Planning Tip: Of any of the options clients can include in their trust agreements to insure flexibility, a trust protector is in and of itself the most flexible. This is because a trust protector can be given the right to appoint, remove and replace trustees; include or exclude beneficiaries; adjust powers of appointment;

and decant the trust into a new one. Our firm's practice is to create the office of a trust protector, but to leave the office vacant in most instances and provide for the appointment of a trust protector by a third party or by a court should one be needed.

Are Your Clients' Trust Agreements Flexible?

Unfortunately trust agreements that are more than a few years old will most likely lack provisions for allowing the trust terms to be adjusted as the needs of the beneficiaries and governing laws change. The good news is that modern trust law contemplates these changes and can be invoked to fix an old trust that has gone sideways.

If you are interested in learning how to help your clients build flexibility into their trust agreements or how a client's existing irrevocable trust can be modified, please contact us.

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