



DISTRIBUTION OF TRUST ASSETS

Division, Allocation, and Distribution

A. GENERALLY

A.1 In order to make your trust¹ more effective, it is important for us to understand how you want the assets of the trust distributed after taxes and other expenses are paid. It helps us if you provide us your instructions in writing. Hopefully, these pages will give you some food for thought. Some of the provisions of this memo will apply to revocable trusts, and some are targeted primarily for irrevocable trust. Hopefully, some of this will be helpful to you with any trust you are having us prepare.

A.2 In your instructions, you will need to tell us how and when to *allocate* your trust's assets and then tell us how, when, and on what condition to *distribute* those assets. The actual legal language used in the documents will probably be somewhat more complex, but for drafting purposes, we just need your plain-English explanation of what you have in mind.²

B. ASSET ALLOCATION

Which assets go to which beneficiaries? This can be specific or general. Many people include instructions for cash gifts and gifts of specific property. The balance of the assets — referred to as the “residue” of the estate or trust — is normally distributed in percentages or other fractions (such as “equal shares”).

B.1 Separate Shares or A Common Trust. When a share or fund is set aside for the benefit of multiple beneficiaries, such as “children”, “grandchildren” or “descendants”, the trust can be divided into separate shares for each of the beneficiaries, or the trust can remain as one common fund (sometimes referred to as a “single-pot trust” or a “pot trust”) for the benefit of the entire group. It is most common for a pot trust to be designed as a discretionary trust that allows the trustee to make equal or unequal distributions to the various members of the beneficiary group, usually based on need and circumstances. In a pot trust, the trustee should be given clear guidelines of the factors to consider in making distributions. If the common fund is to be divided into shares upon the occurrence of a triggering event, you need to tell us what that triggering event is and what is to happen to each beneficiary's share thereafter.

B.2 Cash Gifts. You might make a list of cash gifts, something like the following:

Beneficiary	Amount
Fred Smith	\$1,000
John Jones	\$25,000

¹ A trust can be either (1) a testamentary trust created after your death under the terms of a will or (2) an “inter vivos trust” (or “living trust”) that is created during your lifetime through a written “declaration of trust” or “trust agreement”.

² A sample of what you might provide can be found at <http://rlklegal.info/pdf/disp-sample.pdf>. Yours may be simpler or more complex.

Beneficiary	Amount
Each grandchild who has graduated from an accredited college or university with a bachelor's degree	\$10,000

B.3 Specific Assets. Again, a list is appropriate. These are generally put into a separate list that is mentioned in your will or trust.³

Beneficiary	Asset
John Jones	1999 Infiniti Q-45 automobile
Sarah Zulano	Toaster Oven

B.4 Formula-Based Amounts. It is common to design a trust so that the amount to be allocated to a beneficiary or to a share for one or more beneficiaries is determined by a set percentage or a formula. For example:

(a) *Ten percent of the distributable assets shall be set aside as a trust for my grandchildren.*

(b) *The "Marital Trust" shall receive assets having a value equal to the amount needed to reduce the federal estate tax to zero.*

(c) *\$200,000 or five percent of my distributable assets, whichever is less, shall be distributed to <name of charity>.*

B.5 Residue. The "residue" of your probate estate or trust estate is the balance of the assets remaining in your estate or trust after all obligations have been paid and specific distributions have been made. You need to explain to us how the balance of your estate is to be divided up. Here are some options to consider, which can be applied to all or part of your assets.

(a) *Children, By Right of Representation*. To my children in equal shares, with the share of a deceased child going to his then living children, or, if none, to the other children.⁴

(b) *Children, Per Capita*. To my then living children in equal shares, with no share being allocated to the posterity of a deceased child.

(c) *Percentages*. Percentages or other fractions are specified because it is impossible to know what the exact makeup or value of your estate will be at your death. Make a list or table, making sure that everything adds up to 100%. Here is an example:

³ Gifts of stock, cash, and other property classified by the law as "intangible personal property" cannot be made on a separate list under the terms of a will.

⁴ Under Nevada law, "by right of representation" is legally the same as the Latin phrase "*per stirpes*".

Residuary Beneficiary	Percentage of Residue
Fred Smith	25%
John Jones	55%
Sarah Zulano	15%
ABC Health Foundation	5%

B.6 Timing of Allocation. It is common to divide and allocate assets immediately upon your death, but it may be appropriate to defer the allocation of assets until the occurrence of an event, such as the death of a surviving spouse or when the youngest child reaches a specified age.

B.7 Alternate Allocation. For all types of gifts, specify alternate beneficiaries who will benefit if the named beneficiary does not survive you.

B.8 Excluded Persons. If you wish to exclude someone as a beneficiary of your will or trust, it is important to expressly say so, especially if that person has an expectation of being a beneficiary. It is generally unwise to explain why a person is excluded. No justification is needed.

C. DISTRIBUTION

Once each beneficiary's share has been identified, you need to describe how it is to be distributed. Not all beneficiaries — even those in the same class, such as children — need to receive their shares at the same time or even under the same criteria. Here are some options to consider:

C.1 Outright, Immediate Distribution. If a trust provides for everything to be distributed immediately upon death, the trust will terminate when all trust assets are distributed.

C.2 Irrevocable Inter Vivos Trust; Dynasty Trust. When you create an irrevocable trust during your lifetime, you are the settlor⁵ of the trust, and you will want it to exist for a specific period of time. A simple generation-skipping trust might exist during the lifetime of your children and grandchildren, and a dynasty trust can exist for 365 years under Nevada law or until the assets are fully distributed, whichever comes first.

C.3 Complete Distribution upon Triggering Event. A trust can provide for a single, complete distribution of a beneficiary's share upon the occurrence of an event, such as reaching a specified age or receiving a college degree. It is common to allow the trustee the discretion to make distributions for health care (or at least emergency health care), education, and/or support until the triggering event occurs. In a dynasty trust, the triggering event is the expiration of the 365-year period during which trusts can endure under Nevada law.

C.4 Income-Only or Unitrust Payments. You may wish to set aside a fund as a trust for someone to receive income during his or her lifetime or for a fixed number of years, preserving

⁵ The "settlor" is the creator of the trust. Equivalent terms include "trustor", "grantor", and "trust-maker".

the underlying property in the trust (referred to as the “corpus” or “principal” of the trust) for one or more other beneficiaries.

(a) As an alternative to income-only payments, the trust can provide for the payment of a “unitrust amount”, which is a fixed percentage of the value of the trust assets (such as 3%, for example) that is to be paid each year, first from income and then from the trust principal. We encourage this method because it avoids having disputes over the types of investments that are to be made (which can either favor the income beneficiary or the remainder beneficiaries), and it allows the trustee to make investments that generate the best overall return, even if part of that return would normally be classified as principal (i.e., appreciation).

(b) Once the income or unitrust beneficiary dies or another specified triggering event occurs, you will need to specify who the next income or unitrust beneficiary is, or, if there is no new income or unitrust beneficiary, how and to whom the remaining assets are to be distributed.

(c) The beneficiaries who are named to receive benefits after the income-only or unitrust payments cease are referred to as the “remainder beneficiaries”.

C.5 Periodic Payments. Installments, such as:

(a) 10% a year for 10 years.

(b) One third upon your death, one third five years later, and the final third five years after that.

(c) One third at age 30, one third at age 35, and the final third at age 40[, with the ages being reduced by five years for a beneficiary who has a bachelor’s degree from an accredited college or university].

C.6 Discretionary / Supplemental Needs. Discretionary distributions throughout the beneficiary’s lifetime to supplement their other resources, with no distributions that would disqualify the beneficiary from receiving SSI, Medicaid, or other public- or private-assistance benefits. This can be especially appropriate for disabled children and aging parents.

C.7 Salary-Matching. An annual amount equal to a percentage (50%, for example) of “earned income” that is shown on the beneficiary’s income tax return (IRS Form 1040) for the prior year.⁶ This can be paid in periodic installments to allow for budgeting by both the trustee and the beneficiary.

C.8 Incentive Payments. Early distributions or additional distributions can be made to or for beneficiaries who participate in activities you want to encourage, such as college graduation, completion of a vocational training program approved by the trustee, honorable military service, being an at-home mother, Peace Corps service, AmeriCorps service, church-service missions, or service as a volunteer for the Red Cross or other community service group.

⁶ It is common to require that the income tax return be provided with an affidavit from an accountant or other tax-return preparing certifying that the return was actually filed with the IRS.

C.9 Other Incentives. A beneficiary can be rewarded in different ways.

(a) A beneficiary might be rewarded by becoming the trustee, co-trustee, or investment advisor for his or her own share of the trust or at least a part of it. This could be triggered by having accumulated investments outside the trust having a certain value or by attaining a specified age.

(b) A beneficiary can be rewarded by being given the power to designate the successor beneficiaries of his or her share and can even be given the power to change how distributions are to be made for successor beneficiaries. (A dynasty trust can be frustrated if a beneficiary has the power to take the assets out of the trust, so any power to direct allocations or distributions might require that the trust continue.)

(c) A beneficiary can be rewarded by having some funds of the trust available for investments in a beneficiary-owned business. This usually will require guidelines that require such a business to be viable. (Allowing investments in start-up companies is very risky and rarely successful.)

(d) Bonus distributions can be provided for when certain specified goals are reached or when the beneficiary takes certain actions. For example, a beneficiary could receive a bonus for philanthropic work within guidelines that you specify.

C.10 Conditional Distributions. You may wish to require or prohibit distributions under certain conditions.

(a) If a beneficiary has a spouse or significant other, you might make distributions dependent on a property agreement in which the spouse or significant other agrees never to assert a claim on trust income or trust assets.

(b) If a beneficiary has issues with substance abuse or gambling, you may wish to allow the trustee to pay for rehabilitation and to pay for support without requiring cash distributions to the beneficiary.

(c) You may not want to have a beneficiary who is a convicted felon receive distributions.

(d) You may want to make some distributions dependent on the approval of someone in addition to the trustee, such as a “trust protector” or other trust advisor.

(e) You may want to make distributions to a beneficiary contingent on the beneficiary’s giving the trustee a copy of each year’s federal individual income tax return or some other CPA-prepared or audited report.

C.11 Powers of Appointment. A beneficiary can be given the right to designate subsequent beneficiaries for the beneficiary’s share, and that right is called a “power of appointment”. If you want a beneficiary to have some level of control over the disposition of the beneficiary’s share after the beneficiary dies, granting a power of appointment can be appropriate.

(a) A power of appointment can be unrestricted, which is called a “general power of appointment”, or the power can be limited so that it can only be exercised in favor of a specified group of potential beneficiaries. For example, a child might be given a power of appointment that allows the child to designate as beneficiaries one or more descendants of the settlor or one or more qualified charities.

(b) In a generation-skipping trust, including a dynasty trust, beneficiaries cannot have the power to designate themselves, their creditors, their estates, or the creditors of their estates as beneficiaries without potentially triggering unintended tax consequences.

(c) A well-written trust will specify how a power of appointment is to be exercised (such as in a Will or a notarized document), who are permissive beneficiaries, and whether the “appointed” assets must remain in the trust.

D. MULTIPLE OPTIONS

D.1 Multiple Subtrusts. You do not have to treat your entire trust the same way. For example, some clients who have income-producing assets such as operating businesses or companies that hold income-producing real estate segregate those assets into a subtrust⁷ from which the principal is never distributed. This can benefit multiple generations. Frequently, some of the income from such a subtrust is accumulated and some of the income is distributed. The balance of trust assets could be placed in a second subtrust that provides for distributions of income and principle using some of the methods discussed previously. When multiple subtrusts are involved, each can have its own provisions relating to the designation of trustees, the criteria for making distributions, and provisions relating to powers of appointment.

D.2 Beneficiary-Specific Distributions. You may wish to have one beneficiary’s share handled one way while handling other beneficiaries’ shares differently.

E. CONCLUSION

It is up to you to decide what is best for each beneficiary, both in terms of the distribution or distributions the beneficiary will receive and the timing or conditions of those distributions.

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⁷ A “subtrust” is a separate trust that is part of an overall trust. There are many tax and non-tax planning reasons to divide a trust into two or more subtrusts.