What All Trust Beneficiaries Should Know

Typically, the beneficiaries of a trust are not involved in actually setting up the trust, so they may not be aware of two very important concepts: (1) how the trust functions; and (2) how they can use the trust to best support their own needs and goals.

Yes, the trust document contains most everything beneficiaries would need to know. However, most people are not going to read it closely. And if they did, they may not fully understand how it might affect them and their finances.

Below are the key questions that all beneficiaries should ask and get answered.

#1. Who is the trustee/co-trustee and what can I expect from them?

The trustee(s), named in the trust document, is critical to how well the trust functions on all levels. All trustees/co-trustees are fiduciaries, meaning they are legally obligated to protect the interests of the beneficiaries and to carry out the specific terms and intent of the trust document.

Another important duty of the trustee (either person, a company like LNW, or both) is to inform each beneficiary about the trust and its operations in a way that can be easily understood. You, as the beneficiary, should definitely not experience impatience or the feeling that you are asking dumb questions. You deserve the patience, knowledge and guidance required for you to understand how the trust can work for you.

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#2. How can I access income from the trust?

The distribution terms in the trust document can range from a required amount annually, to payouts at pre-determined milestone dates, to fully discretionary. It's important to know what type of terms your trust requires and what you need to do, if anything. Below are some examples of different types of distribution structures:

- **Fixed percentage via a "unitrust."** A unitrust requires the trustee to distribute a stated percentage of the trust's assets at least annually to the beneficiaries. The amount varies since it is based on the market value of the assets in the trust, and payments can be made monthly, quarterly or once a year.
- **Age-based distributions.** The trust document would specify at what age distributions happen. For example, at age 30 a beneficiary might receive one-third of trust assets, one-half of the remaining assets at age 40 and the balance at age 50.
- **HEMS discretionary.** Here, beneficiaries can ask for distributions that fit into some or all of these categories: Health, Education, Maintenance or Support (HEMS). HEMS is not limited to basic needs; the trust document can define HEMS narrowly or in broad terms.

  Typically, "Maintenance and Support" is about the beneficiary's standard of living (housing, transportation and living expenses, for example). Other examples of discretionary requests that a trust can allow include travel expenses, purchasing a home, funding a business or paying for a wedding.

  Note that there are legal definitions for what qualifies as HEMS based on IRS and state regulations where the trust is based. To prove compliance, the trustee would need to show documentation from the beneficiary.

If HEMS is referenced in the trust document, find out the conditions. Before making any distributions, for example, the trustee might be required to:

- Consider the needs of the other beneficiaries
- Give preferential treatment to a primary beneficiary
- Assess what other resources the beneficiary has available

- **Totally discretionary.** "Pot trusts" have an open-ended distribution structure, meaning assets in the trusts are not allocated for specific beneficiaries or for a specific purpose.

  Typically, each beneficiary would document what they are asking for from the trust, along with a budget. If LNW is the trustee, we would then do a sustainability report to show how the distribution or ongoing distributions would impact the longevity of the trust along with reviewing the assets in the trust.

How does the trustee make a decision on my discretionary request?

At the LNW trust companies, most discretionary requests from beneficiaries are reviewed and subject to approval by our Trust Administration Committee (TAC). The Committee is comprised of senior members of LNW's trust services team with many years of trust administration experience.

When contemplating a beneficiary's discretionary request, TAC reviews the request, the terms of the trust and the assets in the trust. The trust document plays a vital role in informing TAC on whether the beneficiary is required to provide information on their outside resources or if the needs of secondary beneficiaries must be considered.

What assets are in my trust and how are they invested?

Assets in trusts can be virtually anything of value -- from financial (stocks, bonds, etc.) to real estate, limited liability companies, limited partnerships or private capital investments. Trust assets are owned by the trust. How the assets are managed and distributed plays a critical role in how long the trust funds will last.

The trustee has a duty to invest prudently and in line with the trust's objectives. At LNW, each trust has an Investment Policy Statement (IPS) that outlines how trust assets will be invested and serves to guide investment management of the trust.

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How will I be notified of my trust's investments and financials?

The trustee is required to communicate regularly about trust asset performance, including answering questions about specific investments, asset allocations and strategies.

As trustee, LNW provides monthly statements that include trust assets held, performance, as well as dividends, interest and all expenses and distributions during the month. Beneficiaries can view all this information online via a secure client portal. We also meet with beneficiaries periodically to go over trust finances, as well as their needs and goals.

How will I be taxed on trust distributions?

That depends on a combination of variables: the beneficiary's tax status, income for the year, state of primary residence, and how the specific trust payout is categorized (income or principal). At the end of the year, beneficiaries receive a Form K-1 if they have received any income distribution from a trust, and they need to include this information on their personal income tax return.

Let's say a trust pays out $50,000 to a beneficiary this year, and $25,000 of that is classified as income (the rest would have been classified as principal, possibly derived from long-term capital gains taxed to the trust). The beneficiary would owe taxes only on the $25,000 in income. When LNW is the trustee, we try as much as possible to keep taxes for the trust and the beneficiaries as low as possible. See our paper "How Trusts Are Taxed."

What changes with my trust if I get married or divorced?

The short answer is most likely nothing. Your status as a trust beneficiary does not change upon marriage or divorce. Trust distributions are generally considered your separate income even if you live in one of the nine community property states (AZ, CA, ID, LA, NM, NV, TX, WI, WA).

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NOTE: If you are a beneficiary to a trust, you must disclose that information if you enter into a pre-nuptial agreement.

Do I have power of appointment?

This means that you, as a current trust beneficiary, can appoint someone else as beneficiary for some or all the assets in the trust upon your passing. The trust document may or may not contain such language. If it does contain this language and you do not "exercise your right to appoint," then the trust document will stipulate who receives the trust upon your passing.

Long-term Guidance & Support

As you can see from the questions and answers above, the trustee plays a critical role in how well the trust works for the beneficiaries. When LNW is trustee, we focus on developing supportive, long-term relationships with each beneficiary, at their comfort level, once they are notified of the trust. Since beneficiaries can vary greatly by age, by life circumstances, interests and abilities (and might be nonprofit organizations), it is up to us as the trustee to inform and advise them in a way that works best for each.

We routinely advise not only on the trust terms but also on personal budgeting, saving/investing, tax-efficiency and long-term wealth planning. We meet with beneficiaries periodically and upon request. And we encourage them to gain an understanding of the trust and how it is managed.

A trust document may allow a beneficiary upon becoming an adult to serve as co-trustee with LNW. This is a good way for young people to learn about the trust as well as investing and financial management. When trust distributions eventually begin, beneficiaries are then well-prepared to make the most of their good fortune.

You Have a Trust!

In many U.S. states, trustees are required to notify the beneficiaries of the existence of a trust when they turn either 18 or 21 (the "age of majority") and from then on send them regular communications. That is the case in Washington State. Other states do not have notification requirements. Trusts based in South Dakota, for example, allow the grantor (the person establishing the trust) to decide if/when to inform the beneficiaries.

Of course, the grantor can let the beneficiaries know the trust exists prior to the legal notification. As the trustee, LNW can then engage with the beneficiaries about how the trust works and the assets it holds as their interest and abilities allow.

ABOUT THE AUTHOR

Lee-Norah Sanzo has more than 30 years of experience in wealth management and private banking, with most of her career focused on trusts and estate planning. At LNW, Lee-Norah is responsible for advising clients on trust strategies as well as managing trusts, working to ensure trust longevity and adherence to changing tax laws and regulations. She brings to her work extensive expertise in wealth planning, taxation, market analysis and private banking, allowing her to make the most of trust strategies in multigenerational wealth planning. She often works with multiple generations within families, educating and advising trust beneficiaries especially during times of change and transition.

ABOUT LNW

Laird Norton Wetherby (LNW) serves exceptional families and individuals seeking to activate the full potential of their wealth. To help turn lifelong ambitions and multigenerational aspirations into reality, LNW brings to each client relationship a high level of care combined with deep expertise in wealth and legacy planning, investments, and trust and estate services.

Offering both RIA (Registered Investment Advisor) and trust services, LNW is committed to providing clients with unbiased, independent guidance and solutions. LNW has offices in Seattle, San Francisco, New York, Los Angeles and Philadelphia, as well as an affiliated trust company in South Dakota, empowering clients across the U.S. and around the world.

LNW is owned by employees and majority owned by Laird Norton Company, one of the longest-sustained family enterprises in the United States. To learn more, please visit LNWAdvisors.com

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