DRAFT (October 2018)

Distribution Challenges from the Responsible Adult Beneficiary's Perspective

Much has been written for trustees about the distribution function: how to understand various distribution standards (e.g., health, education and maintenance); how to deal with difficult or incapacitated beneficiaries; how to balance intergenerational considerations in making distributions. This note considers the distribution function from a different perspective: that of a responsible adult beneficiary. Although this may be the most seldom theorized or discussed scenario, it is also the most common. And in this least problematic of distribution cases, there remain many problematic issues.

1. How to access funds? Three obvious options--"asking", "being asked", and "waiting to receive" are all compromised.

In normal (non-trust) contexts, an adult does not "ask" for her financial resources. You don't ask a bank teller for a withdrawal or a broker for a redemption, at least not in the sense that they could deny the request. To be put in the position of having to ask can seem inherently infantilizing, regressing one back to childhood requests for an allowance or spending money. The advantage of asking is that a beneficiary may feel more proactive about and engaged with her financial fate; she may be able to meet certain needs or desires more effectively; and she may feel more mature (e.g., "I'm old enough to know what I need"). The disadvantage may be fear of being, or being perceived as, entitled (e.g., "if I ask, they'll think I'm spoiled and always asking for more"). Beyond entitlement, some inheritors may have emotional or personal barriers to accessing money in trust: the trust or trust structure may seem foreign and imposing, and interfacing with it or the money itself may arouse fears or anxieties. As already mentioned, asking may feel infantilizing.

Similarly, "being asked" whether you need, want, or could use additional moneys can be an uncomfortable or infantilizing experience. If a parent asks an adult daughter whether she needs money, it typically implies that the person cannot take care of her own financial needs and therefore needs assistance. Almost no question feels right. "Do you need funds?" seems wrong: in the context of wealthy families, real need is rarely the relevant standard. "Do you want funds?" also seems off. Basing distribution decisions on desire can feel adolescent or irresponsible.

Finally, doing nothing—a "waiting to receive" strategy—is also problematic. The advantage of a "waiting to receive" approach is never having to ask for anything. The inheritor never has to confront the possibility of being told "no," because she never asks. She never has to identify her needs or wants, because she never asks. And she never has to really take responsibility for any moneys she receives, because she didn't ask—the money was just "distributed" (such a neutral-sounding word) to her (e.g., "I didn't ask for this."). The disadvantage of "waiting to receive" is that she may never receive, or may receive in different amounts (greater or smaller) than she would prefer. In addition, she may feel disconnected from her trusts, seeing them as untouchable or "not really hers." The longer she does not ask, the

longer she does not learn to ask and she and her trustee fail to create a pattern of practice that would make asking comfortable and productive. Put differently, not asking is not neutral: she is actively avoiding asking, and this has certain long-term consequences for her and her relationship to the trust and the trustee.

In short, none of the three most obvious means to access funds from a trust—asking, being asked, or waiting to receive—is particularly attractive. To compound matters, each of these approaches suffers from a different sort of problem: because many trustees operate on a yearly distribution cycle, and because asking or being asked implies that the trustee could potentially deny one's request, an inheritor is left in a somewhat uncertain situation. It is difficult to plan one's life if one's finances are speculative year-to-year. Many decisions—such as whether to make a pledge to charity or whether to purchase a second home—demand some sense of one's financial future. If an inheritor does not know what that future may bring (e.g., whether the trustee will deny a future request for funds), such normal, adult financial planning can be impossible. This is, again, somewhat infantilizing: how to make adult financial decisions in the face of such uncertainty about one's financial future?

Some thoughts on solutions: To deal with these dynamics, inheritors have to find some way to access financial resources in trust that feels mature and differentiated: through which the inheritor feels self-assured and empowered as opposed to childish or dependent. Creating such a process may be the central challenge that inheritors and trustees face.

By what criteria should such a "non-ask-based" process be designed? It should maximize the inheritor's subjective experience of autonomy, adulthood and differentiation. It should allow her to plan her life at least five and possibly ten years out by minimizing the year-to-year uncertainty described above. It should be predictable and stable.

This suggests that trustees and inheritors should think in three, five, or ten year distribution cycles, not in year-to-year decisions. They should set up a distribution principle for that five or ten-year period, such as "the trust will distribute between $X and $Y, subject to variation for emergencies (e.g., a crash in the market or an emergent need by the inheritor)." This can provide predictability during that time period. All of this might eliminate or reconfigure the typical yearly ritual in which the trustee asks "what do you need?" and the beneficiary awkwardly tries to ask for a distribution amount. It both allows the beneficiary to plan her (near term) future and gives the trustee an opportunity to help her create a budget that will be life-enhancing during that period.

Finally, the trustee and inheritor should try to focus on a different question than "do you want or need funds?" Instead, the relevant question for a responsible adult beneficiary is "for what beneficial, life-enhancing purpose could you use additional financial resources?" If the inheritor has no such purpose, distributions make no sense. But if such purpose exists, both the beneficiary and the trustee should focus on how they can collaboratively achieve that purpose—beyond the trustee merely distributing financial capital. Are there people the trustee knows that can help the beneficiary achieve her purpose? Are there educational opportunities aligned with

her purpose that she may not have thought about? Are there other resources or skills the trustee can offer in support of the purpose? This is a very different conversation than "how much money do you need?"

2. Who "decides?" Beneath these issues about asking and being asked there lurks a more fundamental question: who decides on whether to distribute from the trust? At a certain level, this question is easy: inherent in the trust structure is the legal vesting in the trustee of decision-making authority over distributions. This is integral to the concept of a trust itself, and the tax treatment of trust assets requires that beneficiaries not overly influence (at least purely discretionary) distributions.

The inheritor's adulthood chafes against this structure, however. As an adult, one does not want others to decide major life issues for you—one wants to take responsibility for oneself. In all other aspects of her life, an adult inheritor (hopefully) will have grown into the ability to make good, reasoned decisions, often of great importance: about health care for herself or her family; about career; about parenting; about love and relationships; and, about finances. How, then, can interacting with a trustee not feel odd—and a bit uncomfortable—if it is the one serious context in which someone else wields decision-making power over her life?

There is no evading the legal reality: the trustee decides. But both the inheritor and the trustee should acknowledge the highly unusual and somewhat unfortunate nature of this fact. Moreover, they should consider structuring distributions and the distribution function to minimize the negatives associated with this lack of decision-making control.

Some thoughts on solutions: To do so, at the very least a trustee should treat an adult beneficiary as an adult and truly listen to her wishes and perspective on the use of trust assets. This does not imply that the trustee must obey her commands or honor every request, but instead that the trustee must avoid condescension and paternalism—"listening" without really listening. Trustees can become enamored with their decision-making power and decide that they know what's best. This will immediately repel any truly adult beneficiary, because she will recognize that the trust structure has become inherently regressive for her life and independent adulthood.

More than merely avoiding such bad outcomes, the trustee and beneficiary should consider distribution processes and structures that give the beneficiary real substantive input into distribution decisions, to the maximum extent permissible by law. The beneficiary might appoint a council of distribution advisors who know her (and her children) well and can advise the trustee on what distributions will be most beneficial. The beneficiary may herself sit on such a council, or otherwise participate in such decisions, so long as she does not have decision-making power. And a trustee might agree with the beneficiary (or her distribution council) to certain non-binding parameters or guidelines for distributions. Although such parameters might not be legally enforceable, they may have moral weight and therefore give the beneficiary some real sense that she has some control over her own financial fate.

3. When? A third question arises: when—at what age or period of life—should an inheritor begin to access funds from a family trust? Is there some age that is too young? Is there any harm in waiting—can there be some age that is "too old?" Assuming the trust document contains no age-based limitations or triggers, should beneficiaries begin to access trust funds at the age of majority?

Some thoughts on solutions: One possible principle is not age-based but life cycle based: a beneficiary should access trust funds once they have become self-sufficient such that they know in their heart that they do not need those funds to survive or thrive.

This principle is based on the idea that for trust distributions to be a positive force in a person's life, they should not create dependency, nor should they undermine the person's development as a mature, differentiated human being. In order for this to be true, a beneficiary should ideally know that they are self-sufficient: that they do not *need* the funds from the trust and can instead survive—and even thrive—without them. This does not require that the beneficiary make millions of dollars on their own or sacrifice their passion or calling to "prove themselves" before accessing trust funds. It does mean, however, that a beneficiary might consider delaying accessing trust funds until such time as she has established herself in life enough that she can pay for her basic needs herself (or with the help of a spouse or partner).

The obvious exceptions to this include beneficiaries with special needs that preclude such self-sufficiency and demand earlier trust support, and all beneficiaries who need trust support to pay for educational expenses that allow the beneficiary to become self sufficient. This "leg up" is obviously what many grantors intended for the trusts they leave behind, and it would be foolish to deny use of trust funds for such educational needs. But beyond that—once a beneficiary is an adult and has an educational foundation—it might be best for a beneficiary to live for some period of time (a few years?) paying their own expenses fully. This note assumes that we are dealing with a responsible, adult beneficiary. Acquiring a real sense of self-sufficiency seems a logical precondition to *being* such a beneficiary.

To reiterate, the benefit is psychological and emotional, not financial. Many inheritors fear that their inheritance or trust assets will disappear. Becoming self-sufficient can calm and assure an inheritor that they could survive even were this to happen. Moreover, there is pride in the accomplishment of self-sufficiency. Being able to cover one's expenses is an important part of emerging adulthood—one's twenties and thirties. Jumping over that stage of life will de-sync an inheritor from her peers in fundamental ways and undermine her self-worth and self-confidence.

This may feel like—and become—a futile exercise if perceived as a procedural "test" to pass or hurdle to jump. In the context of great wealth, the beneficiary knows that the trust assets exist and will ultimately be available to augment her finances. If she merely goes through the motions of becoming (or seeming) self-sufficient while internally telling herself a story that this is a stupid exercise imposed on her by the trustee or, conversely, that although self-imposed it is merely a theatrical "show" for the trustee to convince the trustee of her maturity, the

psychic benefits of self-sufficiency will not materialize. The "waiting period" will merely breed cynicism, not maturity. Trustees, beneficiaries, and families must therefore build cultural support for the principle of self-sufficiency and explain with some nuance why it matters.

4. How much? In families with great wealth and discretionary trusts, there may be little to guide the "how much?" decision.

For families or family members at the extremes of the spending spectrum, this question is not necessarily so difficult. If a family has acculturated its members to spend lavishly—on private planes, luxurious clothes, and the like—the "how much" question will be essentially answered by the necessity of paying for an expensive lifestyle. The answer, in short, will be "as much as possible." The more the better. Conversely, if a family is acculturated to being extremely frugal (or if the relevant trusts are becoming too small to sustain lavish living), the question again becomes relatively easy to answer: "as little as possible." Again, at this end of the spending spectrum the question is not particularly difficult.

This leaves us with the irony that it is those in the middle—those *not* inclined to spend extremely lavishly but also not confining themselves to no spending whatsoever—that must wrestle most with the "how much?" question. If an inheritor doesn't worry about it at all (and spends whatever she can), this question fades away. Conversely, if she worries about it so much that she is unwilling to spend at all, it likewise becomes an uninteresting question. But if she wishes to use the trust to enrich her life *without* pushing her spending into the stratosphere—which was, most likely, the original grantor's goal for the future beneficiaries of his or her gift—she must wrestle with this very difficult question.

For that sort of inheritor, how to think about the "how much?" question? Various answers present themselves:

- Enrich just a bit. One answer is "enough to enrich my life, but not enough to fundamentally change it." This offers some comfort (e.g., "sure I take a few extra vacations or send my child to private school that I couldn't otherwise afford, but my life is still recognizably *mine*"). If the inheritor (or their spouse) has sufficient income to support most of their lifestyle needs, this "enrich just a bit" strategy may be quite comfortable.

  "Enrich just a bit" is an imperfect answer, of course. It is not self-defining, which means that an inheritor may fool themselves in either direction (e.g., buying a multi-million dollar house while telling themselves they are only marginally enriching their life, or, conversely, denying themselves opportunities that are eminently reasonable but feel overly indulgent). Sometimes inheritors, trustees, or grantors may try to overcome this through formulae: "I will use my trust to add 50% to my salary, but no more." But this also has drawbacks: one's salary may be morally or otherwise unmoored from one's social contribution or hard work (e.g., a teacher who is paid

poorly but works extremely hard), and therefore tying one's use of a trust too closely to the financial rewards society has chosen to bestow may be arbitrary (e.g., "my brother runs a hedge fund and gets paid a lot; if he uses his trust to supplement his salary by 50% he'll spend a fortune, whereas as a kindergarten teacher I'll still be living very frugally").

- Category-by-category. Another strategy is to limit distributions to certain categories of use, such as education (e.g., paying for college or graduate school), entrepreneurship (e.g., for starting a business), housing (e.g., one's first home), or health care (e.g., helping with a disabled child or an ill parent or relative). Again, a trust document can so limit distributions, but assuming it does not it may still feel comfortable to either the inheritor or their trustee to focus distributions on particular purposes. This category-by-category approach has advantages. These "big ticket" items may feel more justified or justifiable than an extra pair of shoes. It may be easier for an inheritor to internalize using trust funds for such large and important expenditures, whereas it might not be easy for that same person to feel good about spending trust dollars on general living expenses. In addition, the category-by-category approach is to some extent self-limiting: there is only so much one is likely to spend on education, a first home, health care, or even entrepreneurship. Although one could push these categories, in most instances they will likely limit total spending from a trust (as opposed to using trust funds for any type of expenses).

  There are disadvantages as well. The category-by-category approach may imply that the inheritor does not really feel fully entitled to the funds in trust, and is limiting herself to using them only for "special occasions." Although this could be healthy, it could also be a sign that the inheritor feels illegitimate in some way. In addition, it can lead to a somewhat "lumpy" financial picture for the inheritor. She may finance an expensive education debt-free, but then find herself falling off a subjectively-severe financial cliff as she begins to live only on her income; she may then get a financial boost by using funds to purchase a home, only to struggle to furnish or repair it. And so on.

  Moreover, the category-by-category approach may warp the inheritor's incentives or behavior. Staying in school for an additional year or getting an additional graduate degree may seem like a more attractive option than it would otherwise be, if such educational endeavors can be paid for with trust moneys but supplementing her regular income cannot.

- Enough to be independent. In trust contexts with great resources, the trustee and inheritor face a basic question: should the inheritor build up her estate independent from the trust structure from which she benefits, or should she leave all assets inside that trust structure to minimize threats to those assets?

Each approach has advantages and disadvantages. Building enough wealth in one's estate to be truly independent risks those assets coming under attack from divorce, creditors, and taxes. Conversely, building up no independent estate and depending entirely on a trust structure for yearly support may leave a beneficiary feeling insecure or uncertain about her financial future.

This dilemma echoes the dynamics of all the struggles for independence and differentiation that mark the transition from adolescence to adulthood. If not yet differentiated in a stable and mature way, a beneficiary may "need" more independence than is actually in her best interests—playing out the remnants of her adolescence, she may seek to build up an estate that is unwisely large, merely to "prove" her independence. Conversely, if not yet striving enough to differentiate, she may enjoy the safety and dependence of leaving all her assets in trust and relying on her trustee to care for her.

This note, again, assumes a responsible, adult beneficiary. This means a beneficiary that has differentiated enough from her parents and/or family and/or trusts that she can recognize the inherent dilemma in taking either "too much" or "too little" from her trusts. If an inheritor has attained this level of maturity, she can then make decisions to balance these competing needs. A distribution history that does not strike such a balance suggests either a beneficiary or a trustee—or both—that have failed to understand what a mature relationship to trust assets looks like.

Some thoughts on solutions: There are no easy answers to the "how much" question. Ideally one would tie these decisions to the beneficiary's ongoing development as an adult—to their maturation, not to age or other arbitrary triggers. As an inheritor (hopefully) progresses from adolescence through young adulthood and into more mature adulthood, her ability to relate to trusts and a trustee in the ways described should evolve. Differentiation from parents and from the emotional content embedded in the trust relationship itself does not happen at eighteen or twenty-five, necessarily. It is a process that unfolds as the individual grows into maturity.

Tying distributions to maturity level is complex, because it requires that the trustee actually have attained a level of adult development *beyond that* of the typical beneficiary—that the trustee be fully differentiated in her own life and be capable of modulating the relationship with the inheritor over time by recognizing how and whether that inheritor is ready for access to additional resources. Done poorly, this can be the worst form of paternalism, if a trustee just dresses up condescending views of the inheritor with psychological terminology and justifications. Done well, however, a beneficiary and trustee can align trust distributions with the beneficiary's development over time—ensuring that the trust helps the beneficiary to continue to grow as a human being.

This approach complicates the original premise of this note—that we are focused upon a responsible "adult" beneficiary—by admitting something that in modernity we often ignore:

childhood and adulthood are not binary states, but instead on a spectrum of development that takes decades to unfold. Some fifty year olds are developmentally stuck where most twenty-somethings reside psychologically; some twenty-somethings have achieved levels of psychological maturity beyond their years. There is no one, simple "adult." Ideally, a distribution function would recognize this ongoing process and tailor access to trust resources in ways that maximize the likelihood that the inheritor will continue to mature and develop.

Short of that ideal, of course, both a trustee and a beneficiary should at least have some common understanding of what "reasonable adult" means to them. If, as this note has argued, a responsible adult beneficiary should be included in the decision-making about distributions, should influence those decisions, and should be heard, how will one recognize that one has attained that level of adulthood? At the very least, trustees and beneficiaries should discuss this fundamental issue.

5. A note on terminology. Throughout these thoughts, I have used both the term "beneficiary" and the term "inheritor." There is, obviously, a fundamental difference. A beneficiary is in a trust relationship; an inheritor (generally) receives her funds or inheritance directly and is thereafter the owner in fee simple of those assets.

To some extent, the challenge of the distribution function in a trust structure is to replicate, as much as possible, the benefits that an inheritor has over a beneficiary. These are primarily emotional and psychological. Outright inheritance has various advantages. The inheritor knows that the assets are hers and can integrate them into her psyche, self-perception, life, and planning. The inheritor also knows that she was entrusted with the use of those assets; there are no strings. Finally, the inheritor may benefit from the one-time nature of the inheritance. At the death that triggers the inheritance, the inheritor will receive the gift left to her and can then move on, incorporating that gift into her life.

The beneficiary, conversely, does not necessarily perceive the assets in trust as "hers." She is not their owner. She does not have unfettered control over their destiny or use. This makes real integration into her self-image difficult. She may wonder why assets were left in trust as opposed to outright—did her parents not believe in her? And she will have to engage in an ongoing series of discussions with her trustee. She has entered a relationship (perhaps against her will), rather than experienced a one-time inheritance event.

Thinking about beneficiaries *as* inheritors changes the frame on their relationship to the trust and its trustee. The terminology is thus not neutral: it is worth considering whether beneficiaries do (and can) feel like inheritors, and whether there is some advantage in using that terminology.