

Discretionary Trust Distributions of Principal and Income: Avoiding Beneficiary Challenges and Adverse Tax Consequences

TUESDAY, APRIL 23, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Biographies

C. Marie Eckert is an experienced business litigator and a partner at Miller Nash Graham & Dunn, LLP. Prior to joining Miller Nash in 2002, Marie practiced at Perkins Coie from 1988 to 1994, and then at U.S. Bancorp as litigation manager and senior corporate counsel in charge of litigation for a six-state region of U.S. Bank. Marie has handled a broad range of complex trust and estate administration and litigation matters on behalf of institutional and family-member trustees, individual beneficiaries, and charitable and nonprofit organizations. Marie takes a pragmatic, solution-driven approach to resolving disputes and enjoys helping clients achieve the best outcome in the most effective and cost-efficient way possible.

June Wyrick Flores is an experienced attorney who works with families, family businesses, and closely held businesses to develop and implement succession strategies. June provides sophisticated and highly personalized estate plans to meet her clients' objectives. She is also experienced in estate and trust administration and assists both fiduciaries and beneficiaries. June helps her business clients with business formations, developing governance structures, reorganizations and dissolutions, and mergers and acquisitions to achieve beneficial tax results. She also acts as general counsel on a multitude of business transactions. June provides professional and independent guidance to the stakeholders, family members and other advisors. June's practice also focuses on charitable and nonprofit organizations. She is experienced in counseling tax-exempt and charitable organizations with formation and operations matters. In addition, June helps clients with asset protection, including domestic asset protection trusts, prenuptial agreements and domestic partnership agreements.

Both Marie and June are admitted to practice in California, Oregon, and Washington.

Sample Trust Provisions to Provide Guidance to Trustee

1.1 Application of Guidelines. The following are guidelines to Trustee as to Trustee's exercise of discretionary distributions of income and principal from a trust to, or for the benefit of, a beneficiary whose interest is held in trust pursuant to the provisions of this Trust Agreement. These are discretionary guidelines intended to provide additional guidance to Trustee regarding Trustee's discretion in making distributions to a beneficiary for his or her health, education, maintenance and support. These guidelines are not intended to supersede specific instructions given by Settlers to Trustee.

1.2 Education. It is important that a beneficiary have the opportunity to acquire an education. Trustee may make distributions for a beneficiary's or a beneficiary's dependent's

education. Trustee may condition continued support upon a beneficiary's performance in the school or program. As used herein, education includes, without limitation:

1.2.1 costs of a preparatory school or institution preceding college;

1.2.2 such advanced training as a beneficiary is qualified to attain;

1.2.3 education at a public or private college or university;

1.2.4 undergraduate studies, graduate studies, tutoring, travel expenses which are incurred as a part of undergraduate or postgraduate studies for which the beneficiary will receive credit towards the beneficiary's degree;

1.2.5 training at a trade, industrial, or vocational school, or other training designed to teach the beneficiary an employable skill or to provide career enhancement;

1.2.6 enriching educational opportunities such as symposia, short educational courses, cultural or language study, musical training, or other such opportunities that are not directly related to the beneficiary's occupation, the intent being to broaden the beneficiary's intellectual horizons and general knowledge; and

1.2.7 self-enrichment and self-improvement classes such as cooking, horseback riding, yoga, photography, writing, scuba diving, golf, and similar courses.

1.3 Education Incentive Distributions.

1.3.1 Distribution Upon Entering College. At any time after a beneficiary has commenced a course of study at an accredited college or university with the objective of obtaining a bachelor's degree in a subject which Trustee, in their discretion, deem reasonably likely to prepare the beneficiary for financial self-sufficiency, Trustee may make a single, lump-sum distribution to the beneficiary of an amount not to exceed \$_____. Trustee may also make this one time distribution to a beneficiary who does not satisfy the foregoing requirements, but who has commenced a course of study or training which Trustee, in their discretion, determine to be reasonably equivalent to the pursuit of a bachelor's degree in light of all of the facts and circumstances, including the beneficiary's abilities or disabilities and the beneficiary's career goals. The distribution described in this section may be made to the beneficiary no more than once during his or her lifetime.

1.3.2 Annual Award for Academic Performance. At the end of each academic year that a beneficiary is engaged in a course of study at an accredited college or university with the objective of obtaining a bachelor's degree in a subject which Trustee, in their discretion, deem reasonably likely to prepare the beneficiary for financial self-sufficiency, if such beneficiary has maintained a grade point average of at least 3.0 on a grading scale that provides a 4.0 for an "A" average (or the equivalent on a different grading system), and if such beneficiary is pursuing his or her education on a full time or substantially full time basis, Trustee may make a lump-sum distribution to the beneficiary of an amount not to exceed \$_____. In determining the amount distributed under this section, Trustee may take into consideration, for example, the quality of the educational institution, the difficulty of the

beneficiary's curriculum, and any special challenges the beneficiary may have faced during the academic year.

1.3.3 Distribution upon Receiving Bachelor's Degree. At any time after a beneficiary has received a bachelor's degree from an accredited college or university, or such other degree or certification as Trustee, in their discretion, deem reasonably equivalent to the attainment of a bachelor's degree in light of all of the facts and circumstances, including such beneficiary's abilities or disabilities and the beneficiary's career goals, and if the beneficiary has completed his or her education with a final grade point average of at least 3.0 on a grading scale that provides a 4.0 for an "A" average (or the equivalent on a different grading system) Trustee may make a single, lump-sum distribution to the beneficiary of an amount not to exceed \$_____. In determining the amount to be distributed under this section, Trustee may take into account, for example, the degree of difficulty of the beneficiary's curriculum, any academic honors received by the beneficiary, and any special challenges that may have been faced by the beneficiary. The distribution described in this section may be made to the beneficiary no more than once during his or her lifetime.

1.3.4 Distribution Upon Receiving an Advanced Degree. At any time after a beneficiary has received an advanced degree (such as a master's degree, a PhD, an MBA, or a professional degree) from an accredited university, or such other educational achievement as Trustee, in their discretion, deem reasonably equivalent thereto in light of all of the facts and circumstances, including such beneficiary's abilities or disabilities and the beneficiary's career goals, Trustee may make a single, lump-sum distribution to the beneficiary of an amount not to exceed \$_____. The distribution described in this section may be made to the beneficiary no more than once during his or her lifetime.

1.4 Health. Settlers direct that any trust created hereunder be liberally expended for any form of psychological, psychiatric, educational, other counseling or consultation that the beneficiary may require or that Trustee determines to be necessary, desirable or otherwise appropriate. Settlers specifically intend that such expenditures shall be within the discretionary standard for distribution hereunder and requests that such expenditures be given the highest priority by Trustee. It is important that a beneficiary have good health, medical and dental care. Trustee may expend trust property to provide for health care of any kind or nature. Trustee will have the right to begin and maintain a program of life, accident, disability, long term care, and health insurance for a beneficiary and the beneficiary's dependents. Trustee has the right to invest in a policy of life insurance or other death benefit plan on the life of any person who is related to a beneficiary. Trustee may discontinue any plan or program of insurance, without liability, in the event the funds are unavailable to Trustee to continue and maintain life, accident, disability, long-term care and health policies.

1.5 Support and Maintenance. In making a determination for distributions for a beneficiary's support and maintenance, Settlers intend that such terms are broadly defined. The following are examples to Trustee for distributions for a beneficiary's support and maintenance.

1.5.1 Guardian. If a guardian has been appointed for any beneficiary, Trustee is specifically authorized, in its sole discretion, to make distributions of income or principal directly to the guardian of any beneficiary of this trust for expenses incurred by the

guardian because of his or her care for such beneficiary. Such expenses are to include, by way of illustration and not limitation, the guardian's reasonable travel expenses in visiting the beneficiary, the reasonable cost of additions or improvements to the guardian's home, and the reasonable cost of additional household help or appliances in the guardian's home, providing such expenditures are necessary in the judgment of Trustee to enable the guardian to care for such beneficiary. It is Settlers' intention that such expenses be paid even though such payments may directly or indirectly benefit the guardian or the guardian's family. To the extent that such expenditures do not frustrate the primary purpose of the trust, Settlers direct Trustee to be generous in making such distributions to the guardian, and direct that whenever feasible, doubts should be resolved in favor of the guardian.

1.5.2 General Expenses. Trustee may make distributions of net income and principal (a) for the reasonable expense of a wedding and honeymoon; (b) for payment of child care for the beneficiary's children; (c) to provide funds to purchase or to qualify for financing of a primary automobile for personal use that is consistent with the beneficiary's age and maturity; and (d) for maintenance and support if the beneficiary has been diligently seeking but is unable to pay debts as they come due because of incapacity, disability, or severe economic downturn. Providing rent money for an able beneficiary who has been less than diligent in seeking employment and has other, albeit undesirable, alternatives to sleeping on the street (e.g., living with friends or relatives), is not consistent with Settlers' intent.

1.5.3 Personal Residence. Trustee may use the trust property that is consistent with the beneficiary's social station (e.g., to live in a comfortable home but not a home having a cost or value which substantially exceeds homes occupied by the beneficiary's peers after taking into account the age of the beneficiary and the size of the beneficiary's immediate family), to assist the beneficiary with the acquisition of a primary residence. Assistance may be provided by using any one or more of the following methods: (a) a loan of money to the beneficiary, secured or unsecured; (b) an outright distribution of trust property to the beneficiary; (c) co investment with the beneficiary; (d) a guarantee of performance, or part performance, of a loan; for a partial reduction of the unpaid principal balance of the loan or loans secured by the beneficiary's home to make monthly loan payments reasonably affordable; (e) to help the beneficiary qualify for a home equity line of credit or provide a line of credit loan secured by the beneficiary's home; and (f) to fund (as a distribution or a loan of net income) home improvements. Alternatively, in Trustee's sole discretion, Trustee may purchase a residence for the benefit of the beneficiary who may be permitted to reside in the residence on terms Trustee deems appropriate, including, but not limited to, rent free, reduced rent, or at fair market rent.

1.5.4 Tax Liability Assistance. Trustee may make distributions of net income or principal directly to the beneficiary or payments directly to the federal, state, or local tax authorities for any income tax liability arising from or associated with the trust assets which income is includible in the beneficiary's income.

1.5.5 Travel. Trustee may provide travel assistance to a beneficiary. Settlers believe strongly in the benefit of Settlers' descendants maintaining relationships with their extended families. Settlers request that Trustee use trust funds to encourage and foster such relationships. To this end, Settlers authorize Trustee to distribute trust funds for family travel to visit family members, including the family of the beneficiary's spouse,

which would include the reasonable expenses of the beneficiary and his or her spouse and children or more remote descendants (including the guardians of a minor beneficiary and such guardian's children) as well as the occasional travel by family members to visit the beneficiary and his or her family. Travel assistance may include, but is not limited to, pursuing educational, religious or charitable goals; travel to countries where the beneficiary can experience different cultures, languages, and customs. Travel assistance may include the costs of tuition, room, and board for attending cross cultural short term or residential language, personal enrichment, and cultural programs.

1.5.6 Distributions to Assist in the Purchase of an Automobile. At any time after a beneficiary has attained at least 20 years of age, and if such beneficiary has no record of moving violations for a continuous 36 month period, then upon the request of the beneficiary, Trustee may contribute to the beneficiary's maintenance and support, but is not required to do so, by making a down payment for the purchase of an appropriate automobile for the beneficiary, provided such payment shall in no event exceed \$20,000 or 50 percent of the value of the automobile, whichever is less. Prior to making any such distribution to or for the benefit of the beneficiary, Trustee, or persons selected by Trustee, shall meet or otherwise confer with the beneficiary to determine what constitutes an appropriate automobile for purposes of this section based upon the beneficiary's needs and his or her ability to pay expenses related to such automobile (including insurance, loan or lease payments, maintenance, and taxes) from resources outside of the trust. Trustee is discouraged from making a distribution authorized under this section to any beneficiary who fails to cooperate with Trustee in performing this analysis.

1.5.7 Distributions to Assist in Starting a Business. At any time after a beneficiary has attained at least 18 years of age, [OR] Upon the earlier of a beneficiary attaining (a) 22 years of age and a bachelor's degree or (b) 27 years of age, upon the request of the beneficiary, Trustee may contribute to the beneficiary's maintenance and support, but are not required to do so, by assisting the beneficiary to commence a business or profession in which the beneficiary will be employed on a full-time or a substantially full-time basis, alone or with others. Such assistance may be in the form of a loan (with or without interest or security), an outright distribution, an investment by Trustee in the proposed endeavor, or any combination thereof. Prior to making a distribution to or for the benefit of the beneficiary, Trustee, or persons selected by Trustee, shall meet or otherwise confer with the beneficiary to establish a realistic business plan in order to determine the likelihood that the beneficiary will become financially self-supporting through the proposed endeavor, the timing and amounts of distributions from the beneficiary's trust that would be required to insure the success of the proposed endeavor, and whether such amounts would be reasonable in light of the risk of failure of the proposed endeavor, the remaining assets of the trust, and any other factors which Trustee deem reasonable under the circumstances. Trustee are discouraged from making a distribution under this section to or for the benefit of any beneficiary who fails to cooperate with Trustee in establishing a realistic business plan for the proposed endeavor.

1.6 Inflation Adjustment. Whenever reference is made in this Trust Agreement to the adjustment of a specific dollar amount for the effects of inflation pursuant to this section, such amount shall be increased by the same percentage as the percentage of increase, if any, shown by the All Items Consumer Price Index for Urban Wage Earners and Clerical Workers published by the U.S. Department of Labor, Bureau of Labor Statistics, for the Portland

Metropolitan Area for the first second half of [year], as compared with the most recently published Index on the first date that such adjustment is made. If such index is no longer published, Trustee shall select an appropriate substitute index for the purpose of adjusting such amounts for the effect of inflation since [month], [year]. Notwithstanding the foregoing, no adjustment need be made:

1.6.1 as to an amount that is six figures or less (that is, under \$1,000,000) until the cumulative effect of the adjustment over time exceeds \$10,000 from the original amount or the last prior adjustment, and then shall be adjusted in increments of \$10,000, rounded down; or

1.6.2 as to an amount that is more than six figures (that is, at least \$1,000,000) until the cumulative effect of the adjustment over time exceeds \$100,000 from the original amount or the last prior adjustment, and then shall be adjusted in increments of \$100,000, rounded down.

1.7 Withholding Distributions. Notwithstanding any provision of this Trust Agreement to the contrary, Trustee may withhold any distributions of income or principal to, or for the benefit of, any beneficiary which are authorized or otherwise required under the terms of this Trust Agreement, if Trustee determines such beneficiary is not being productive, is otherwise engaged in inadvisable or self-destructive activities, or is under the influence or control of others who do not have the beneficiary's best interests in mind.

1.7.1 In reaching such a determination, Trustee may consider, for example:

(a) whether the beneficiary is seriously pursuing an education which will enable the beneficiary to obtain gainful employment commensurate with his or her abilities, which is productive behavior;

(b) whether the beneficiary is working to support himself or herself in a manner commensurate with his or her abilities (even if such beneficiary's chosen career does not produce substantial income but makes a productive contribution to the community), which is productive behavior;

(c) whether the beneficiary is working in the home as a parent in the care of such beneficiary's children or other dependent family members, which is productive behavior;

(d) if the circumstances warrant, whether the beneficiary is involved in activities which promote the welfare of others or of the community as a whole, which is productive behavior;

(e) whether the beneficiary is capable of managing money in a responsible manner as demonstrated by past conduct, including his or her use and application of previous trust distributions, which is productive behavior;

(f) whether the beneficiary is engaged in substance abuse or other negative addictive behavior, which is unproductive, self-destructive behavior;

(g) whether the beneficiary is subject to the undue influence of others who do not have the beneficiary's best interests in mind and who seek to control the beneficiary or the beneficiary's financial resources to their undeserved advantage; and

(h) whether distribution to the beneficiary would serve to benefit such beneficiary's creditors, including estranged or former spouses, rather than the beneficiary.

1.7.2 Trustee's determination as to whether distributions should be withheld as to a particular beneficiary pursuant to the provisions of this section shall be final and binding upon all persons interested in the trust estate. Trustee shall not be liable to the beneficiary or to anyone else for Trustee's decision to make or withhold any distribution to a beneficiary under this section, it being Settlor's goal to provide Trustee the flexibility to react to circumstances that were not anticipated by Settlor when Settlor created this Trust Agreement in a manner that serves the best interests of Settlor's descendants.

1.8 Distributions to Substance Abusers. In making distributions to or for the benefit of any beneficiary whom Trustee believes may have substance abuse problems, Settlor request that Trustee limit distributions to such beneficiary to those which Trustee deems necessary to insure that such beneficiary's basic living requirements are met. In making distributions for the basic health and maintenance needs of a beneficiary with substance abuse problems, Trustee is requested, to the extent practicable, to make payments directly to persons or organizations who are furnishing housing, utilities, health care (including health care insurance), and other basic goods and services to the beneficiary, rather than make distributions directly to the beneficiary.

1.9 Testing for Chemical Dependency.

1.9.1 Definition of Chemical Dependency. For purposes of this section, a beneficiary will be deemed to suffer from chemical dependency if such beneficiary: (a) routinely or frequently uses or consumes any illegal drugs or other illegal chemical substance so as to be physically or psychologically dependent upon that drug or substance, or (b) is clinically dependent upon the use or consumption of alcohol or any other legal drug or chemical substance that is not prescribed by a board certified medical doctor or psychiatrist in a current program of treatment supervised by such doctor or psychiatrist, and if as a result of such use or consumption, the beneficiary is incapable of caring for himself or herself or is likely to dissipate his or her financial resources.

1.9.2 Testing for Chemical Dependency. If a Trustee reasonably suspects that a beneficiary is suffering from chemical dependency, then Trustee shall request the beneficiary to submit to one or more examinations (including laboratory tests of bodily fluids, lineal descendants, genes, gene products, chromosomes, drugs, deoxyribonucleic acid (DNA) determined to be appropriate by a qualified health care provider, by a board-certified medical doctor, by a psychiatrist or psychologist, or by another licensed health care professional selected by Trustee. Trustee may request the beneficiary to consent to full disclosure by the examining doctor, laboratory, or facility to Trustee of the results of all such examinations. Trustee may also ask the beneficiary to provide to Trustee such information held by a State agency, local health authority, insurance company, health maintenance organization, or employer as Trustee may

request if such information is reasonably likely to assist Trustee in determining whether the beneficiary is chemically dependent. Trustee shall maintain strict confidentiality of these results and shall not disclose these results to any person other than the beneficiary without the prior written permission of the beneficiary.

1.9.3 Treatment. If, in the opinion of the examining doctor or psychiatrist, the examination indicates current or recent use of a drug or substance as described above, the beneficiary shall consult with the examining doctor or psychiatrist to determine an appropriate method of treatment for the beneficiary (for example, counseling, or treatment on an inpatient basis in a rehabilitation facility). If the beneficiary consents to the treatment, Trustee shall pay the costs of treatment directly to the provider of those services from the income or principal otherwise authorized or required to be distributed to that beneficiary.

1.9.4 Discretionary Distributions. If the examination described in Section ____ above indicates current or recent use of a drug or substance as described above, or if a beneficiary, or the parent or legal guardian of a minor beneficiary, refuses to consent to such examination or other disclosure requested by Trustee under Section ____, then all distributions and all withdrawal rights of income or principal with respect to the beneficiary (including distributions upon termination of the trust) will be suspended until, in the case of use or consumption of an illegal drug or illegal substance, examinations indicate no such use, and in all cases of dependence described in Section ____ until Trustee in its sole judgment determines that the beneficiary is fully capable of caring for himself or herself and is no longer likely to dissipate his or her financial resources. While mandatory distributions are suspended the trust will be administered as a discretionary trust to provide for the beneficiary's health, education, support, and maintenance.

1.9.5 Exoneration of Trustee. No Trustee shall have a duty to inquire whether any trust beneficiary is engaged in substance abuse nor shall any Trustee have the obligation to affirmatively investigate whether any beneficiary has substance abuse problems that may cause the beneficiary to use trust distributions to further his or her abusive activities, even if such Trustee has reason to believe a beneficiary is engaged in such activities. It is not Settlor's intention to make Trustee (or any doctor, psychiatrist or other professional retained by or otherwise assisting Trustee) responsible or liable to anyone for a beneficiary's actions or welfare. Trustee (and any doctor, psychiatrist or other professional retained by or otherwise assisting Trustee) shall be indemnified from the trust estate and held harmless from any liability of any nature in exercising its judgment and authority under this Section ____ including any failure to request a beneficiary to submit to medical examination, and including a decision to distribute suspended amounts to a beneficiary.

1.10 Compulsive Behavior and Involvement With Cults. If Trustee suspects that the beneficiary is a member of a "cult," Trustee shall require that the beneficiary submit within 30 days after actual notice (written or oral) to such physical and psychological testing procedures as Trustee, in Trustee's absolute discretion, deems appropriate to determine whether such beneficiary is subject to any unreasonable "compulsion" relating to such beneficiary's membership in such "cult." All such tests shall be conducted by licensed practitioners. If such tests indicate that the beneficiary has any such "unreasonable compulsion," Trustee shall require the beneficiary to undergo appropriate clinical assessment, including such physical and

psychological evaluations as deemed necessary or appropriate by Trustee and the licensed practitioners who conducted the tests. After completion of such clinical assessment, if it is determined that the beneficiary has any such "unreasonable compulsion," Trustee shall require the beneficiary to follow the course of treatment or conduct prescribed by the licensed practitioners who conducted the tests, including without limitation inpatient and outpatient treatment, individual and group counseling, and continued attendance at one or more support groups. If such beneficiary has any such "unreasonable compulsion" (or if the beneficiary has refused to proceed in the manner required by Trustee as described in this section), then notwithstanding any other provisions of this Trust Agreement, no distributions (except medical expenses) may be made from the beneficiary's trust from the time that Trustee requires the beneficiary to submit to testing procedures until it is determined that the beneficiary does not have (or no longer has) any such "unreasonable compulsion." For purposes of this section, a "cult" shall include, without limitation any organization involving "extreme" devoted attachment to, or "extravagant" admiration for, a person, principle, or other object of devotion. Trustee shall have the discretion to determine what constitutes a "cult" under this definition and Trustee's determination shall not be rejected unless Trustee has made such determination in an arbitrary and capricious manner.