



# Controlling from the Grave – Timing Distributions to Beneficiaries

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A Client may decide to leave their assets outright to their beneficiaries, either because the amount is modest or because the beneficiaries they have chosen are sufficiently mature to handle a sudden influx of wealth. However a client may also elect to distribute the assets in their estate gradually after death. A testamentary trust is the simplest way to achieve this result.

What follows is an overview of the circumstances and structure of the timing to distribute Capital and Income after death.

## Overview

Gradual, or multi step, distribution is desirable whenever a Client's concerned that their beneficiaries may not be ready to properly manage a large sum of money or they wish to ensure that their surviving spouse and infant children enjoy the benefits of tax effective income. Inherent in this belief is an assumption that a high percentage of people who inherit money will spend the bulk of their inheritance before they realise what they are doing. Some Clients may elect to distribute their entire inheritance shortly after their death, even if the distribution will be several million dollars. Their philosophy is that the children or (or other beneficiaries) should lead their own life and make their own mistakes, no matter how financially costly.

Others prefer to establish a testamentary trust that can hold and invest the inheritance, provide income as needed to the beneficiary, and then make several lump-sum distributions as needs arise.

## Gradual Distribution

If a Client is fortunate to be able to give their children or grandchildren more opportunities through their achievements, such Client's may not be comfortable leaving the children or grandchildren assets outright upon their death.

If, a Client dies before their children are old enough to be well established or the children continue to struggle financially despite the opportunities that a Client has worked hard to provide, or need to separate their assets from commercial or other family risks, a Client may prefer a gradual distribution process of assets that allows a Client's appointed trustee to distribute income as necessary or helpful each month, but transfers complete control of a Client's assets gradually to allow their children to develop financial responsibility (and, if necessary, learn from their own mistakes with only a portion of a Client's assets). Most often, this will take the form of a three-step distribution process at designated ages or stages in children's lives. Factors that should be considered in



developing a gradual or multi-step distribution plan are discussed below.

### **Providing Supplemental Income**

If a Client elects to defer distribution to their children (or other beneficiaries), a Client with the help of an Adviser will need to determine rules for distributing income to each child during the period after death and before the initial beneficiaries will receive complete control of their assets. The Client must first decide what they wish to accomplish by delaying distribution that are left in a Testamentary Trust. If a Client is delaying distribution so that their children will be forced to earn their own way, then the Testamentary Trust should allow distributions during the interim period only daily for maintenance or emergencies, such as income during times of disability or expenses of medical treatment. A Client may, or may not, choose to modify this to allow distribution to pay educational expenses (or even living expenses while a beneficiary is enrolled in a full-time educational program), depending upon the Client's views regarding the value of the Client's child earning his or her way through secondary school and on to tertiary education.

Alternatively, a Client may elect to provide income to each of their beneficiaries to maintain a lifestyle that they consider appropriate. This will require a Client to define the lifestyle that they are willing to support so that the trustee can implement their wishes. This can be difficult to define, and can create tension between beneficiaries and the trustee, but the Client is free to define a lifestyle with standards of a particular

geographic community, or with respect to a lifestyle or the lifestyle that has been achieved by most of their children. If a Client chooses to distribute income in a restrictive manner, they may consider working with a solicitor experienced in testamentary trust law to minimise the potential tension between a beneficiary and trustee.

A common standard for distribution of support to beneficiaries could be through an advancement clause "maintenance, education or advancement". It is a ballpark approximation of the beneficiary's lifestyle. This is easy to determine for a surviving spouse, since it should approximate that the lifestyle that the Client and their spouse have been enjoying. It is a little more difficult to pinpoint when applied to children or other beneficiaries since it may still be a moving target (for example, if a child is still in secondary school at the time of death, his or her lifestyle may be modest, although a Client and the trustee are likely expect it to become more substantial after secondary or tertiary education). Most trustees are comfortable with the guidance provided by referring to "maintenance, education, advancement or benefits", but if a Client wishes to tailor a more specific standard (and can carefully define their wishes), they are free to do so.

"Maintenance" is a provision made in a Will for a lump sum of money or property (real or personal) or an annuity to be advanced from capital on the testator's death to children, who may or may not be the testator's own children, in order to support and maintain



them in life and provide for their future by setting them up in business or providing for their education into a profession. The term "Maintenance" may include food, clothing, custody, safe conduct, transport, lodging care, medicines and other necessities: *Hayne v Hayne* (1994) FLC 92-512 at 81, 296.

The term "advancement" traditionally referred to the establishment in life of the beneficiary or at any rate some step that would contribute to the furtherance of his or her establishment: *Brooke v Brooke* (1911) 3 OWN 52. Advancement is expenditure for setting up or advancing a child for life or for conferring a special benefit of a permanent kind upon a person designated in a Will. An Advancement clause is inserted in a testamentary instrument to authorise the trustee or executor to make an advance out of a capital in which a named beneficiary or minor has a vested, presumptive, or contingent interest for the purpose of advancing or establishing that person in life: *Re Gosset's Settlement* (1854) 19 Beav 529.

"Education" is the process of acquiring knowledge about the world and the skills and competencies required to participate effectively in that world. Educational process may be formal, that is, undertaken through structured courses of study at primary, secondary or tertiary level or informal, that is, acquired by experience of life generally or learning through experience in the workplace. Education has been interpreted to mean any manner of acquiring skills which may be of use in life: In the *Marriage of O'Dempsey and Van Raay* (1990) FLC 92-178. Education was found to be the provision of tuition and other

services to enable individuals to undertake structured courses of study at primary, secondary or tertiary level.

### **Matching Distributions to Financial Maturity**

The primary goal of a multi-step distribution process is to match the ultimate distribution of assets - that is, the turning over of complete control of a Client's assets - to the coming of age (financially) of their beneficiaries. When a Client is controlling assets for the benefit of their children, a Client may wish to defer the transition of control until a point in time when their child is likely to understand the value of money. A Client may therefore need to explore when this may occur given their family history and the social environment in which they are raising their children. With rare exception, most people do not begin to understand the value of money until they have been self sufficient, and employed full time, for at least a few years. Some take much longer than that. Guessing precise age that any child reaches financial maturity is impossible. A Client can, however, make a reasonable guess by looking at family and neighbourhood influences, and factoring in what they have observed about their children's personalities (some children spend their allowance within hours while others save for larger objectives).

If a Client is planning to assist their children financially through tertiary education, the Client may want to delay the first lump-sum distribution until a few years after they anticipate they will graduate from the tertiary institution. Again, look at the family history and social environment to help guess



whether a Client's child is likely to graduate in four years, six years, or more. If the Client and most of their siblings attended tertiary education and graduated in four years, it is probably reasonable to assume their children will do the same (unless they are aware of other factors that make it unlikely). If that is the case, they may wish to permit the first of the three lump-sum distributions at say age 25 (about three years after anticipated graduation). However, if children in a Client's family are not fully grown until completing graduate school (at age 25 or 27), then they may wish to set the first distribution at 29 or 30. Of course, if they are still alive, no distributions will be made to anyone (except a spouse). In case the Client dies prematurely, try to pick an age when they expect a Client's children to be financially mature enough to manage the assets the Client leaves behind.

Once the Client determines the age for the first distribution, they will need to decide how far apart to space out subsequent distributions. The purpose of spacing out distribution is to allow children time to learn from their mistakes. If a son receives a lump-sum distribution of \$150,000 when he turns 28, he will likely feel quite wealthy. Even if he is several years out of tertiary education and is making \$150,000 per annum, he is not used to receiving a single cheque for \$150,000. When he receives the initial \$150,000 cheque, he will undoubtedly think he is wealthy. There is a reasonable possibility that six months later, he will be looking around wondering what happened to all the money. If that

happens, it's not the end of the world (or his inheritance). By utilizing a three-step distribution, we have been able to keep the bulk of his inheritance preserved and protected for his benefit. After he has learned his lesson (by blowing through his first inheritance) - perhaps two to five years after the first distribution - the trustee can make a second distribution. Make sure the second distribution is sufficiently large so that the son will feel rich again (twice as large as the first distribution is probably sufficient). This will give the son a second chance to learn how to hold on to, and manage, money. Then, schedule the final distribution for two to five years after the second distribution. Unless a Client is of a mind to control the money for their child's entire life - and a Client can if they wish - the third chance will be the end of the line. If he hasn't learned from the first two opportunities, he just might never learn to manage money.

After the Client selects the appropriate age for distribution, they will need to decide what percentage of their estate to distribute at each age. A Client should try to make each distribution large enough so that their child feels wealthy when he or she receives the gift cheque. While a Client may hope a child is financially mature before the first distribution, the real purpose of the multi-step distribution plan is to allow their children to learn from their mistakes. The impression that the mistake makes on a child is directly proportional to how wealthy the child receiving the first distribution. If the distribution is only \$10,000, the fact that it is gone in



just a few months is no surprise (and does not teach the child anything). At the same time the initial distribution should not be too large. An initial distribution of 10 to 20 percent of each child's total share of the estate is ideal. If the son "blows through" the first distribution without even noticing, there is still 80 to 90 percent of the value remaining after the first opportunity to learn the lesson. The second distribution can be 20 to 35 percent of the remaining balance and still be significantly larger than the first distribution (to increase the chance that your son will learn the second time if he didn't quite get the message the first time around). Even if your son is a slow learner (financially speaking), he'll still have 50 to 70 percent of his inheritance left after the first two mistakes. If he has matured financially by the third distribution, the inheritance you left him can still make his life substantially easier.

By the way, if the Client is not comfortable pegging distributions to age, rather than to achievement or actual maturity, it is theoretically possible to condition distribution on the occurrence of specified events, or on the trustee's subjective analysis of your children's maturity. However, each of those concepts has difficult issues. If the son does not complete tertiary education, either because he joins the military or because he starts a successful computer-based business, would a Client defer their inheritance indefinitely? What distribution, if any, would it make if the son marries young and works 60 hours a week to provide for his family (but fails to meet the benchmarks a

Client has set for distribution)? If this gives the trustee discretion to decide when the children are financially mature enough to receive their inheritance, they will set standards for the trustee to follow in making the determination? Whether or not a Client's set objectives standards for the trustee to follow, imagine the tension between the trustee and each of the children over whether or not he or she should have achieved financial maturity. Performance-based (rather than age-based) criteria should be used carefully, and only when they believe that age - based rules will not achieve an objective. If a Client chooses performance-based criteria, work with an experienced estate planning professional to explore the consequences carefully. Take the time to make sure that your distribution criterion doesn't cause unintended consequences.

### **Special Protection**

The three-step distribution works well for many families. It does not, however, work well in every situation. When a Client's beneficiaries display a greater need for protection from themselves- for example, due to mental or physical limitations, financial irresponsibility that persists well into middle age, or alcohol or drug abuse you should consider tailoring your trust to meet these special needs.

### **Financial Irresponsibility - Lifetime Income**

Some children may never grow up. If one or more of the Client's children (or other beneficiaries) spends like there's no tomorrow - particularly if a Client does not approve of the spending decisions he or she makes -



then a Client may not want to distribute assets directly to that child, even in three steps over several years.

A testamentary trust can be structured to provide lifetime income to the financially irresponsible beneficiary without allowing access to the assets in the trust. A sibling of the irresponsible beneficiary, a close family friend, or an institutional trustee can invest the trust assets and make distributions to the beneficiary only as needed to provide monthly support to the beneficiary. The assets that remain after the beneficiary passes on can be left to their children, grandchildren (or anyone else you select). A Client will, of course, need to define how and when to distribute income to the beneficiary, just as would be necessary for supplemental income distributions under the three-step distribution plan. Mandating distribution as necessary for the beneficiary's maintenance, education and advancement can provide reasonable support without permitting the beneficiary to waste the entire estate. Keep in mind, however, that the "maintenance, education or advancement" standard that allows the beneficiary substantial say over the distributions - is not consistent with the purpose of restricting the distributions.

#### **Self Destructive Problems**

As in the case of financial irresponsibility, outright distribution of assets to a beneficiary who is battling substance abuse is not desirable. But where substance abuse is a problem, even monthly distribution to provide basic living expenses can be undesirable.

If a Client is concerned that the estate they leave their children may enable one or more of them to finance self-destructive behaviour - for example, drug or alcohol abuse - a Client should consider giving the trustee the authority to withhold distributions when appropriate. A Client can empower a trustee to limit distribution when outward signs of drug or alcohol abuse appear, or they can vest the trustee with the right to insist on periodic (and/or random) drug testing. In either case, the trustee's job will be difficult and the tension between the trustee and the beneficiary will likely be substantial (not unlike the difficult "tough love" decisions that a parent can be faced with when a child experiences substance abuse problems during the parent's lifetime).

The Client may need to be objective when their children (or other beneficiaries) display self-destructive behaviour and discuss appropriate restrictions with your estate-planning advisor.

#### **Physical and Mental Disability**

A Client should consider substantial limitations on distributions to a beneficiary who is receiving, or is likely to need at some time during their lifetime, government benefits such as Medicare or disability payments that are based upon financial need. A properly structured trust can supplement government benefits, while outright distributions may reduce government benefits (so that the inheritance a Client leaves the child does nothing to improve their situation). If a Client is in this situation, a special needs trust may be designed to meet their child's particular needs.



By doing so, a child's inheritance can enhance their living situation, rather than causing estate shrinkage and at best merely replaces funds previously provided by government programs.

Anyone providing a beneficiary with a lifetime of supplemental income, the assets remaining in the special needs trust can be left to the beneficiary's children, or anyone else that they choose.

### **Protection from In-laws**

As in the case of financial irresponsibility, an outright distribution to an adult child beneficiary may subsequently expose the gift to the son or daughter in law. In this day and age where, in many instances the difference between the in-law and outlaw is that the outlaw is wanted and the in-laws are not; distributions to an adult child beneficiary from a Testamentary

Trust may in certain circumstances protect the gift from the in-laws. It would then be up to the adult child to choose whether they wish on receipt of any capital or income from the Trust to share the proceeds with their spouse; that is your in-law.

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