A Total Return Unitrust
Can Help Maintain Family Harmony

A traditional trust can sometimes create a conflict between the lifetime and remainder beneficiaries. For example, investment strategies that provide growth that benefits remainder beneficiaries can leave lifetime beneficiaries with little or no annual payouts. This makes it more difficult for a person's estate plan to achieve his or her objectives and places the trustee in a difficult position. A total return unitrust (TRU) may offer a solution.

A TRU frees the trustee to employ investment strategies that maximize growth (total return) for the remainder beneficiaries without depriving lifetime beneficiaries of income. Rather than pay out its income to the lifetime beneficiary, a TRU pays out a fixed percentage (typically between 3% and 5%) of the trust's value, recalculated annually, regardless of the trust's earnings.

Issues to consider when creating a TRU

It is important to plan a TRU carefully, such as by projecting the benefits that beneficiaries will enjoy under various scenarios, including different payout rates, investment strategies and market conditions. Keep in mind that, for a TRU to be effective, it must produce returns that outperform the payout rate, so the rates should not be set too high. As an additional option, the payout could be based on a rolling average of the trust's values.

State's trust laws also must be considered, as some do not allow TRUs. Also, many states establish payout rates (or ranges of permissible rates) for TRUs, so flexibility in designing a TRU may be limited. Finally, if a trust is required to pay out all of its income to a current beneficiary, be sure that unitrust payouts will satisfy the definition of "income" under applicable state and federal law.

Converting an existing trust into a TRU

If an existing, irrevocable, income-only trust seems unfair to certain beneficiaries, it may be possible to convert it into a TRU. To do so, the conversion must be permitted by applicable state law. Coordination with an attorney and other trusted advisors is essential for the preparation of related legal documents.

An IRS private letter ruling clarifies that converting a trust into a TRU according to state law should not have any negative federal tax implications. It does not cause the trust to lose its grandfathered status for generation-skipping transfer tax purposes.

Is a TRU the best option?

By aligning beneficiaries' interests, a TRU can relieve tension among loved ones and allow a trustee to concentrate on developing the most effective investment strategy. For more information, contact your Anchin Relationship Partner or Tamir Dardashtian and Michael Rudegeair, members of Anchin Private Client, at info@anchin.com or 212.840.3456.

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