DRAFTING OUTSIDE THE LINES: *PRECATORY LANGUAGE AND LETTERS OF INTENT*

ALL LIES AND JEST, STILL, A MAN HEARS WHAT HE WANTS TO HEAR AND DISREGARDS THE REST

– *SIMON AND GARFUNKEL, THE BOXER*

Your Words Have Meaning

"It's not what you say, it's what they hear" is an important mantra in political campaigns (and most compliance discussions). Estate attorneys know this dilemma intuitively as we struggle to bridge the gap between the extremely technical and precise language of our documents required by the law and communicating these nuances to our clients. Planners also balance the reverse translation of documenting a client's wishes, which are often enumerated in excruciating detail, with the need to leave discretion in the hands of trustees, providing necessary flexibility for the administration of trusts decades hence. We try to communicate to clients through newsletters, exhaustive memos as to trust administration and conferences, yet many of these efforts fail to educate clients as to the implications of technical decisions they are making or re-focus our clients on the ramifications of the choices being made.

Adding three simple items to an estate plan can greatly increase your overall satisfaction with the estate planning process as well as clarifying of the tradeoffs in the actual language used in the documents. Moreover, it can ensure that the eventual administration of the trust is in keeping with your goals. In short:

(1) Include letters of intent for all entities or trusts created,

(2) Incorporate precatory language in documents whenever possible, and

(3) Draft direct letters to your beneficiaries explaining the choices you have made.

Letters of Intent

In twenty-some years of reading thousands of legal documents from attorneys around the world, it is the rare situation to find a robust letter of intent is created as part of the planning process. If done at all, the letter tends to be short, focused on one or two items, and often will quickly lapse into bland directions, which will be of little use to a trustee when confronted with a difficult decision. Worse yet, many letters turn out to be a form letter from the law firm that simply reiterates language already in the document, such as the discretion given to a trustee to determine income but without any guidance as to what matters to the grantor. While there are some nuances to drafting a "letter of intent" or "letter of wishes," we believe that this type of communication should be a key part of any estate or gifting process and should be written in clear language, as close to the grantor or testator's own language as possible.

Generally speaking, a letter of intent, also known as a **"side letter,"** is a letter from the grantor to the trustee that provides guidance to the trustee in the exercise of some discretionary power. A well drafted letter of intent can allow the trustee to identify actions that would be in keeping with the grantor's intent at the time the trust was

created; conversely, it can provide the trustee with comfort that the goals and objectives for the trust are being met when circumstances within the family have changed. Some tips on side letters include:

PROVIDE CLEAR GUIDANCE. A letter of intent allows the grantor to feel that their voice is being heard, often by allowing the grantor to put into plain English certain goals or actions which might be improper or confusing if included in the main documents. By allowing the grantor to state clearly their fears or concerns, it can provide the trustee with greater comfort in exercising distribution around concepts like HEMS ("Health, Education, Maintenance and Support"). For example, a recent trust we worked with included language directing the trustee to withhold payments if the beneficiaries were leading an "unproductive life." The grantor did not want to spell out in the trust his true concerns, which centered on the inability of his sibling to hold a steady job because the family wealth offered too many "distractions" and essentially eliminated any need to work. At the same time, he felt strongly that taking a less intense job which allowed more time for family and a better work-life balance was one of the benefits of the wealth created and did not want his children to have to feel they had to work at a job they disliked because the trust purse-strings were kept tightly closed. The side letter allowed him to put this into clear examples for the trustee as to when to make distributions or what caveats should be considered.

Guidance to the trustees should be clearly stated and provide examples where possible:

> *"Do not give money outright to my son as I worry about his ability to make business investments on his own; I would prefer that you consider carefully before making distributions of principal and encourage you to request a business plan or structure the distribution as a loan to be collateralized by future income distributions," or*
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> *"I would like to benefit my children and grandchildren more than future generations and do not want the trustees to be overly focused on preservation of principal," or*
>
> *"Travel has been a huge part of my life and is something I would do with our children if I were living; please make generous distributions for travel and educational opportunities. Even a pleasure trip can have tremendous advantages in terms of experience and maturity."*

REMEMBER, THESE ARE NOT LEGALLY BINDING. Letters of intent are not legally binding, a point needs to be repeated often. It is fairly well settled that the courts are unwilling to interfere or second-guess a trustee's exercise of discretion unless there is proof of bad faith or motive. As such, your trustee will have very broad latitude on whether to follow your guidance or to ignore it in favor of more current circumstances. That said, it can be helpful reference for the trustee and provide you a forum to be candid in your comments, usually without the fear that it will be disclosed to the child, although disclosure is always possible.

It is important to discuss the letters (or at least the idea of the letters, if not the content) with your attorney and designated trustee. Most attorneys do not want the letter to become binding on the trustee for a few reasons. First, providing too much legal direction in a side letter could cause the side letter to be considered a revision or codicil to a will; we once saw a side letter that was longer than the will itself and exhaustingly detailed in direction, yet hopelessly out of date with its expectations for the beneficiaries' lifestyles. It is better to avoid repeating the language of the trust or setting out a litany of "maintenance and support" discussions. Be clear about what you are expecting of the trustee. Second, and more importantly, if the letter was binding, and considered to be part of the trust documents, the side letter will be discoverable by beneficiaries and could be enforced by a court. We usually recommend that the side letters are not shared with beneficiaries and that the grantor draft a separate letter to the beneficiary for any direct communication with them.

We had a client several years ago who directed in a side letter to his will that the trustee of the spousal trust (his son) be "exceedingly generous" with his surviving spouse (the step-mother), where the couple had married late in life and each had adult children (and adult grandchildren) from a prior marriage. The decedent had significant wealth and his wife was of very modest means. His intent had been to ensure that the wife was not limited to her pre-marital standard of living. The son-trustee shared the letter with his stepsister and then spent the next several years handling her demands for larger and larger payouts for her mother's care, conveniently couched in the form of significant renovations to the daughter's home!

PROVIDE CONTEMPORANEOUS BENCHMARKS. When used, most attorneys seem to favor side letters for very long duration trusts or situations where there is (or may be) some family tension. We would encourage their use in shorter-duration trusts as well, such as ILITs where the letter can provide guidance on the intent of the policies, and, ideally, some contemporaneous guidance on the policy purchase or, perhaps, benchmarks for performance. Recently, we were working with a trust recently where several large policies were taken out to provide a repayment function for an installment sale, where the note had been repaid decades before. A side letter might have alerted the trustees to the grantor's intent and directed them to reconsider the policy coverage once the notes were repaid. We have also seen letters where the expectations for a life insurance policy (in terms of cost and payment) were laid out in the side letter; while it seems normal to expect that a trustee would understand the policy expectations and would review insurance policies on a regular basis, this sadly is not a common practice. Having guidance from a grantor that helps the trustee understand the expectations on returns might prompt a more proactive approach if the policy underperforms.

Likewise, these letters can be helpful for trustees where gifts are made to trusts under which the trustee is given latitude to distribute income or principal, I like to provide contemporaneous references that may help a trustee in the administration of the trust. We have seen letters that presumed a rate of return on a portfolio that would seem aggressive today but was roughly equivalent to the then-prevalent yield of a moderate duration municipal bond portfolio. Consider, for example, the power of a letter that included guidance such as "*at the time of funding, it is my expectation that the trust will generate sufficient income to pay for tuition for my children or to help them with the down payment on a home. Tuition is averaging about $50,000 per year at most private colleges, perhaps more, and a "starter home" in our area is about $450,000. I would expect that the children should be able to finance most of the home purchase but would ask that you be generous in making distributions outright to allow them to buy in a better neighborhood or perhaps a slightly larger home, if they seem to be financially responsible and you believe this is a good use of their inheritance*." Certainly this type of language implies an active and engaged trustee (which may or may not be the case), but hopefully guidance like this can also lead to a better discussion with a trustee as to the expectations on their involvement with the family.

We have also encouraged the creation of side letters in long duration GST trusts where the older generation of beneficiaries is asked to provide guidance to the trustees for succeeding generations. Again, as these letters are not legally binding, there is no reason not to have a senior generation of beneficiaries write up a letter, and it often increases their sense of stewardship over the family resources. Moreover, the trustees are free to disregard the letters, but the letters can provide a way to update guidance on distributions and address concerns that will morph over generations.

Precatory Language

As side letters are not legally binding, it is important to remember the ability to include precatory language in documents to clarify the settlor's intent in a binding manner. While some attorneys do this as a matter of course, others will recoil in horror when this is suggested. Remember that these are your documents and unless there is a clear legal reason to avoid precatory language (and most of the time, we have found a happy compromise among parties), its worth trying to add it to the documents.

In particular, when property is to be divided unequally or there are clear objectives for the disposition of property, or for how disclaimers will function, use of such language can be tremendously helpful in the event of unforeseen litigation among family members. A statement such as "*I am fully aware of the challenges that come with shared ownership of property and hence, I intentionally leave the vacation home to my son, Jack, outright and in his sole name, with the expectation that it will pass to his children if he should predecease me*" can stop a prolonged battle, or at least some long discussions with disgruntled siblings, and avoid challenges if the recipient of the asset happens to be the executor or the child that may be perceived to have had sway over an aging parent. Precatory language seems to be sporadically used around the country and varies widely from across practices, with some firms using it extensively but only for certain areas, while others incorporate precatory language throughout their documents. We believe the extra work in adding such guidance to standard documents can yield huge benefits in the eventual discussions with beneficiaries and often helps clients to focus on the implications of certain dispositive provisions that might otherwise go unexamined.

Direct Letters to Children

A great opportunity to use a side letter can be those times when a settlor wants to avoid the hard discussion and leave the "bad cop" role to the trustee. It is difficult to look at a child and say "*I really do not trust your wife and your marriage enough to leave you this money without lots of strings attached*." At the same time, we strongly believe that drafting separate letters to be shared at the time of the gift, or at the testator's death, with their children, or (even better) their grandchildren, is a wonderful and compelling way for a settlor to convey his or her beliefs, wishes, and expectations for the money directly to the beneficiaries, and perhaps share a bit of family history or wisdom. We have helped many clients write letters to their (grand) children, and these letters often become cherished family mementos, sometimes with the side benefit of motivating the beneficiaries to become more financially savvy, to take steps to preserve the wealth for another generation or to do bigger things with an inheritance of any size than they might have otherwise. We have also seen hard language of a will softened by these letters, particularly where adult children do not understand why assets were left to them in trust, rather than outright, and the parent has an opportunity to say again, "*trust me, it seems like you need it now but you really will need it later. If you do need it now, you should be able to convince the trustee to give it to you but I want to think in terms of generations, not a kitchen renovation*."

Letters of intent can take many forms and can often tip into unfamiliar territory for some practitioners as they move beyond legal structure into more emotional areas of planning. However, a well-crafted letter of intent can do more for your peace of mind than many other actions we can take as advisors..

Updating and Revising These Documents

Ideally your estate plan should be reviewed every five to ten years, sooner if there is a change in financial or personal circumstances. Any side letters, or letters to beneficiaries should be reviewed when you revise documents to ensure that they remain consistent with the new estate plans. In addition, with the digital world upon us, make sure that an electronic version of the document is clearly accessible to your trustee or executor by giving them a copy (digitally or physically) and ensuring that they know where any updates might be stored (with passwords or locations of passwords to access). Nothing would be worse than drafting a beautiful letter to your daughter or son, only to find its left on the computer and wiped as part of the estate settlement process without reaching its destination!

Conclusion

Creating and updating an estate plan can be a complex process, but it does not end with the documents being signed. Taking additional steps to ensure that your voice, and your long-term plan, is accurately reflected can make a world of difference in your estate planning.

WORKING WITH US: Wealthaven's independent views and deep expertise across business, investments, estate and tax planning can be an invaluable resource for families seeking to ensure seamless and easy transitions across generations. By supplying technical knowledge and an objective voice, we can support your executor and trustees to help ensure that tasks are handled properly and help avoid the costly legal disputes that can occur when large sums are involved.