

THE WELL-PREPARED FAMILY

Is a 'letter of wishes' right for your trust?

As a complement to your trust agreement, this letter can help ensure that your intentions are understood.

If you place assets into a long-term, irrevocable trust, you may give your trustee broad discretion over distributions. That way, as facts and circumstances evolve—beneficiaries' lives change, and assets ebb and flow—the trustee will be able to exercise judgment about releasing funds. A letter of wishes can help communicate your views.

This letter, sometimes called a “statement of intent” or “family values statement,” travels with your trust agreement for as long as the trust exists, providing general guidance rather than specific, legally binding direction.

Your letter of wishes can be shared with your beneficiaries to give them insights into your thinking. Or you can arrange for your letter to be seen by the trustee only.

As a corporate trustee with a global presence, we have handled a great many letters of wishes over the years. Here, we share some **additional perspective, five best practices that we've identified, and a few scenarios that may help you think through the issues.**

A GROWING TREND

Letters of wishes have long been common in some countries, but more recently have gained popularity in the United States. Several factors may be driving this trend:

- **Concern about outdated instructions.** Many people don't want to include directions that may no longer apply and want to provide explanations of their instructions.
- **Proliferation of multigenerational or perpetual trusts.** Trust creators often appoint a close friend or relative as the initial trustee, thinking that person understands their values. But successor trustees are less likely to have that insight and this lack of familiarity may increase over time. Additionally, the preservation of real wealth is often the goal of a multigenerational trust, where trustees may benefit from guidance on whether and to what extent sustainable distribution levels should be maintained.

CREATING A FAMILY TRADITION

A matriarch used a letter of wishes to convey a philosophy of “take only what you need and pass the rest on.”

A family asked one of our trust officers to participate in their family meeting and explain to their youngest members:

- The mechanics of their family's dynasty trust
- The philosophy of the letter of wishes for this trust

The family's matriarch, long deceased, had written the letter of wishes 50 years earlier. And the message she left for her descendants, our trust officer says, is “elegant.”

She asked the trust's current beneficiaries to view themselves as stewards of the family fortune. They should draw on the funds to help them with their life's basic building blocks, the letter said. But they also should feel responsible for conserving the trust assets for future generations.

Use trust funds, she wrote, only to finance your education, your first home and your first business. After that, she asked them to rely on their own funds. However, neither the trust she created nor her letter prohibits the trustee from going beyond the basics, if need be.

“This letter of wishes established a tone—setting expectations—and everybody rose to the occasion,” the trust officer says. “The family took this philosophy extremely seriously. The letter of wishes helped create a strong family tradition.”

- **Desire for the expertise of a corporate trustee.** Some of our most sophisticated clients create letters of wishes because, as one J.P. Morgan trust officer explained, “They want the benefit of an independent fiduciary with the comfort that the fiduciary understands their values.”
- **Globalization.** A growing number of multinational families and professional advisors are involved in cross-border issues. These families and advisors may be familiar with letters of wishes because they have long been routinely used with non-U.S. trusts.

BEFORE YOU BEGIN WRITING...

It is important to understand the flexibility and limitations of your letter of wishes. Only a trust agreement legally binds the trustee. And, once signed, a trust agreement cannot be changed in many cases—except by court order.

In contrast, you can change, replace, and even discard your letter of wishes, as circumstances change. The letter is meant to communicate your vision when establishing the trust.

For example, many U.S. trust agreements direct trustees to provide for the “health, support, maintenance and education” of the beneficiaries. In a letter of wishes, you may want to offer more detail about what “education” means to you. After all, one person’s idea of education may be a Ph.D. in economics, while another’s may be a yoga class taken for health and self-discovery.

Even your close friend serving as trustee might not grasp the nuances of what your trust agreement means by saying funds should be used to enable your children to continue living “in the style to which they have grown accustomed.” Does that mean a new luxury car every two years, a “pre-owned” vehicle every few, or something in between?

Some letters of wishes run to 20 pages and read like contracts, while others are more like intimate family messages. You can write a letter of wishes when creating a trust or, as often happens, long after. Some letters last decades, while others are frequently amended or replaced. And while some people have their lawyers draft their letters of wishes, others write it themselves. If you draft your own letter of wishes, we recommend you have your lawyer review it to be sure you don’t contradict your trust document.

TRUST OFFICERS’ PERSPECTIVE

Corporate trust officers should welcome well-crafted letters of wishes or other expressions of intent, but the letters are not essential to effective trust administration.

A trust officer at J.P. Morgan explains, “I like when a trust creator provides a letter of wishes because the more information a trustee has to carry out the trust creator’s intentions, the better.”

But, adds another trust officer, “Not everyone needs a letter of wishes because a good trustee and a good trust document are usually sufficient. A letter might serve as a helpful complement, but I certainly have never felt stymied for lack of one. While individuals are unique, human behavior and fiduciary duties have patterns, so experienced professionals are able to respond appropriately.”

Many trust officers say they encourage trust creators to write a letter only if they have strong feelings about a particular issue. For example, you may want to be sure to tell your trustee to support your descendants’ ability to engage in charitable work or to pursue careers in a less financially rewarding profession (such as teaching). Or maybe you want to encourage family members to see themselves as stewards, rather than as consumers, of an inheritance.

FIVE BEST PRACTICES

Lawyers have varying opinions on the usefulness of letters of wishes. Some lawyers say that guidance is better placed in the trust agreement itself; others express concerns about how a letter of wishes may be interpreted by beneficiaries or tax authorities.

If you and your advisors decide that a letter of wishes is right for you, please consider these five best practices:

01 Your legal advisors should write your letter of wishes, or at least review it.

Your lawyers can help you ensure that your letter of wishes is consistent with your trust document.

02 Write your letter of wishes with the understanding that it cannot change the original trust document.

If there is a contradiction between your trust agreement and your letter of wishes, the trust agreement controls; if it didn’t, you’d risk having the trust assets included in your taxable estate.

For example: A mother created a trust for the benefit of her son and, in the trust agreement, authorized the trustee to be extremely generous, to keep the son in a very comfortable lifestyle and to favor him over the remaindermen (those who would inherit whatever remained in the trust when the trust term expired).

Later, the mother and son had a falling-out. She grew critical of the son’s life choices, friends and views. She provided the trustee with a letter of wishes expressing her wish that distributions to her son be scaled back to a minimum.

The trustee could not follow the new instructions and explained to the mother that the trust agreement was being followed and that the existing level of distributions was both reasonable and maintainable.

Had the trust officer followed the mother's letter of wishes, U.S. Internal Revenue Service (IRS) might reasonably have argued that there was an implied agreement between the mother and the trustee to follow the mother's wishes regarding trust distributions. Such an implied agreement would have given the mother (the trust creator) a legally impermissible amount of control over the trust funds. She'd be acting as the owner of the trust assets. The IRS might then have a claim that the trust assets should be included in the mother's estate.

03 Keep in mind that your heirs might see the letter of wishes.

Hurt feelings and friction may result from beneficiaries seeing a letter of wishes. Consider how a beneficiary might feel discovering in a letter of wishes that his parents were disappointed with his lifestyle and thought him incapable of handling his finances. While such an insight might be useful for the trustee, you may want to weigh the benefit of writing that to the trustee against the potential damage this disclosure might do to your beneficiary's feelings and family relationships.

If a beneficiary were to ask for a copy of a letter of wishes, a trustee may be hard-pressed to deny the request. Trustees are generally required to provide beneficiaries, on request, with any information relevant to the beneficiaries' interest in the trust and to allow beneficiaries to inspect the trust's books and records. It is unclear whether a letter of wishes, which could shed light on the grantor's intent, would be included in this list of relevant trust documents. We have found no reported U.S. cases specifically addressing this question. Presumably, though, a letter of wishes would be discoverable in litigation if it were relevant to the subject matter of the lawsuit.

A few courts outside of the United States have addressed the discoverability of letters of wishes. In these offshore jurisdictions, a beneficiary generally is not entitled to demand a copy of the letter of wishes, as it is thought to be related to the reasons for a trustee's use of discretionary powers, and intended to be confidential. An exception is made, however, if a trustee's bad faith is suspected.

Better, then, to accept that there is a risk that your beneficiaries may one day see your letter of wishes. It is therefore wise to write these statements with an eye on how these beneficiaries might perceive your words.

On the other hand, we've seen some of the letters that are meant to share messages about the trust creator's family values, not only with trustees, but also with the current beneficiaries and future generations.

04 Consider your trustee's ability to carry out your specific wishes.

Letters of wishes sometimes direct trustees to determine what is happening in beneficiaries' lives before making a distribution.

For example, a trustee may be asked to consider withholding a distribution if a beneficiary has a substance or gambling abuse problem. The difficulty is that trustees often do not have enough daily contact with a beneficiary to properly make such determinations.

If you want your beneficiaries to be closely monitored, consider appointing a co-trustee or trust "advisor" in the trust document, who is more familiar with the beneficiary's lifestyle and has access to information that could help make such determinations.

If you were to provide this type of instruction to your trustee solely in a letter of wishes, it would be important to carefully state in your letter of wishes that you are identifying "considerations" as opposed to outright requirements.

05 Simple, up-to-date letters of wishes may serve you best.

The simpler the language and suggestions, the less likely you may feel compelled to later revise or amend your letter of wishes.

That said, J.P. Morgan wealth advisors in Asia report that clients typically review and update their letters every two to three years.

In the United States, our trust officers find clients tend to update letters of wishes when they are older and revisiting their estate planning documents. One trust officer said, "People consider it an active part of their plans: Do they have a health proxy? Are their letters of wishes up to date?"

THINKING THROUGH THE ISSUES

To help you decide what guidance to provide your trustee, consider your personal values.

We have an exercise that many clients find useful. We present them with a series of short, hypothetical situations and ask what they would like their trustee to do. This helps them express their values around critical issues such as:

- Productivity and education
- Family unity and continuity
- Maintenance and support
- Family legacy
- Preservation of principal and loans

To give you an idea of how that exercise works, review some scenarios that pertain to a few of these common areas of concerns. What should your trustee do?

SCENARIO 1: PRODUCTIVITY AND EDUCATION

Asking for Seed Capital

A daughter, a hardworking recent graduate of the Wharton School of the University of Pennsylvania, has put together a solid business plan to buy two tattoo parlors in Daytona Beach, Florida. She would like \$500,000 in seed capital. (The trust has \$5 million in assets, all liquid.)

What should your trustee do? Check one:

- Pay \$500,000 to cover the seed capital.
- Pay the seed capital only after an outside consultant has determined that the business plan is sound.
- Decline the funding, because the type of business is inappropriate.
- Other, please explain: _____

Would your answer be the same or different if the request came from a grandchild? A great-grandchild? If the trust had \$20 million in assets?

SCENARIO 2: FAMILY UNITY AND CONTINUITY

Asking for a Destination Wedding

A 25-year-old son living in Los Angeles wants a destination wedding in Hawaii for 100 people at an estimated cost of \$750,000 and has asked the trustee to make a distribution for the full amount. (The trust has \$10 million in assets, all liquid.)

What should your trustee do?

- Pay 100%.
- Pay 50%.
- Ask the son to revise plans, as this wedding is too lavish.
- Other, please explain: _____

Would your answer be the same or different if the request came from a grandchild? A great-grandchild? If the trust had \$20 million in assets?

SCENARIO 3: MAINTENANCE AND SUPPORT

Asking to Subsidize Roommates

A son just graduated from the University of the Arts London and has secured a marketing job in New York City. He would like to rent an apartment in a safe neighborhood with two friends from his university. The friends, together, will be able to afford only a quarter of the monthly rent. The son has asked for a monthly distribution of \$4,000 to cover both his portion of the rent and to subsidize his roommates. (The trust has \$5 million in assets, all liquid.)

What should your trustee do?

- Pay 100% of the rent every month because the son will be in a new city with people he knows and trusts.
- Pay only the son's share of the rent.
- Ask the son to find a less expensive apartment.
- Other, please explain: _____

Would your answer be the same or different if the request came from a grandchild? A great-grandchild? If the trust had \$20 million in assets?

SCENARIO 4: MAINTENANCE AND SUPPORT**Asking for an Elaborate Trip**

A 35-year-old son and daughter-in-law want to homeschool their three young children while sailing around the world for the year as a 360-degree learning experience. They would like to make the trip in a 75-foot sailboat with a three-person crew to cook, clean and teach the family how to operate the vessel. The son has asked that the trust fund the trip, which he estimates will cost \$1 million. (The trust has \$20 million in assets, all liquid.)

What should your trustee do?

- Pay 100%.
- Offer to pay the amount of the son's and daughter-in-law's combined replacement salaries.
- Tell them the plan is too lavish and ask them for another plan that is more sensible.
- Other, please explain: _____

Would your answer be the same or different if the request came from a grandchild? A great-grandchild? If the trust had \$50 million in assets?

SCENARIO 5: MAINTENANCE AND SUPPORT**Asking to Help a Sick Friend**

A 40-year-old daughter's lifelong friend does not have health insurance and needs a kidney transplant to avoid dialysis treatment several times a week. The daughter begs the trustee to give her the money to cover the expenses. (The trust has \$20 million in assets, all liquid.)

What should your trustee do?

- Cover the expense 100% to encourage the daughter's altruism.
- Lend the daughter the money to pay for her friend's medical procedure, setting up a schedule of repayment.
- Simply tell the daughter that the expense is beyond the scope of the trust.
- Other, please explain: _____

Would your answer be the same or different if the request came from a grandchild? A great-grandchild? If the trust had \$50 million in assets?

BOTTOM LINE

You may want to provide guidance to your trustee regarding distributions in a manner that goes beyond the broad or more general language in your trust document. If so, a letter of wishes may help you to accomplish this.

If you are considering a letter of wishes, we recommend that you consult with your advisors to help ensure it is consistent with legal standards and the provisions of the trust.

Because the practical application of a letter of wishes is critical, you and your advisors may want to consult with the designated trustee early in the drafting process.

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We look forward to helping you with your wishes—for you and your legacy.

FROM THE ADVICE LAB AT J.P. MORGAN PRIVATE BANK

The Advice Lab is a team of specialists with deep experience in a variety of disciplines, and who develop strategies in executive compensation, asset allocation, analytics and ownership structures to maximize our clients' wealth, after taxes and across generations.

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