The Total Return Trust:
Providing for Your Partner in Same-Sex Relationships

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How do you plan your estate if you want to provide for your partner (or same-sex spouse) but ultimately want to see your wealth go back to other family members after your partner passes?

This article will present a look at one of my favorite methods for maximizing asset value for the surviving partner and the ultimate beneficiaries – the total return trust.

Let's take it as a given that you want to provide for the financial security and protection, and even over-protection of your partner. But, what do you want to have happen upon the death of your partner? What if your partner has different end beneficiaries than you? Do you want your money to eventually pass to your partner's beneficiaries at the expense of your beneficiaries? I will further assume you want to provide for your partner and after your partner passes, you would like to see what is left of your money go to your beneficiaries.

If all you want to do is provide for your partner and not worry about what happens after your partner passes, then this solution is not for you. If by far your biggest concern is protecting your partner and you have some but not much concern for what happens to your money after your partner passes, please see the section below: An Alternative to the Total Return Trust.

But, if you want to provide for your partner and your end beneficiaries, then creating a trust is one effective way to have your wishes respected. However, the terms of traditional trusts may create the potential for conflict between your partner and your ultimate beneficiaries.

Consider this example. Let's assume that you want to provide for your partner for the rest of your partner's life, but you want what remains of your money to go to your sister's children on the death of your partner. The trust stipulates that upon your death, your partner will receive the income from the trust for the remainder of his or her life. Upon the death of your partner, the principal remaining in the trust will be distributed to your nieces and nephews. The individual you choose as trustee has the responsibility of managing the fund to satisfy the interests of both your partner and your sister's children.

In a traditional trust agreement, the income beneficiary receives the income from the trust assets for a defined period of time, in this case the life of your partner, and after that, the remaining beneficiaries receive the trust assets. The term "income" is usually defined as interest and dividends from stocks and bonds or cash investment accounts. Income does not generally include appreciation from assets that have significant growth potential.

If the trustee invests conservatively, the "income" may be one or two percent. Fooey. This would be miserable for your partner.

In our example, your partner, the income beneficiary, may want the trustee to invest in assets paying significant interest, like junk bonds, but your nieces and nephews, the remaining beneficiaries, or remaindermen, may prefer that the trustee invest in high growth assets. One choice limits growth and is risky, the other limits income. What should a trustee do?

Using the classic definition of income, there is no good answer.

A prudent trustee using the trust I recommend for this situation, the total return trust, could invest in assets providing the best total return of both income and growth of principal. In this manner, a total return trust disregards the classic definitions of income and principal. Instead, income is defined as a percentage of principal. We can utilize such a trust to benefit both the surviving partner of a same-sex couple and the ultimate beneficiaries and avoid conflict between them.

Let's further assume there is $1 million in a trust and "income" is defined as five percent (5%) of the balance of the trust. This means that the income beneficiary is assured of receiving $50,000 annually even if the assets do not grow. Of course, without being restricted to investments that produce sufficient interest and dividends for the income beneficiary, the trustee is likely to obtain a much better investment rate of return than if he or she were to invest in CDs or bonds. Let's assume the trustee is successful and achieves a combination of income and growth equal to 7% of the principal. The trust balance the following year would be $1 million plus $70,000, or $1,070,000. Of that, $50,000 is distributed to the income beneficiary (5% of the original $1 million), leaving a balance of $1,020,000. If income and growth remain at 7%, the trust will continue to increase. The "income" to the income beneficiary (your partner) would continue to grow. Since the income beneficiary is receiving a percentage of the principal, his or her income keeps growing as the investments grow.

With a total return trust everyone benefits. The income beneficiary benefits when the corpus of the trust increases, and the ultimate beneficiaries also benefit from the growing principal because, after the death of the surviving partner, they will get more money. The trustee is also happy because he or she can now look for investments that will maximize the principal in the trust without hurting either the income beneficiary or the ultimate beneficiaries. This type of trust is more likely to preserve peace and unity between your surviving partner and your nieces and nephews and your trustee. It is a win-win-win situation. This trust is not appropriate, however, if your main concern is your partner's welfare and the total return income would not be sufficient for his or her needs.

Years ago, it came to me that the total return trust meshed seamlessly with estate plans for many of my clients in same-sex relationships. And, to my satisfaction, the total return trust has enjoyed enthusiastic approval. Of course, the total return trust is only one strategy same-sex couples may utilize. But if your objective is to yield more wealth for both your surviving partner and your ultimate beneficiaries, incorporating a total return trust into your estate plan is one way to accomplish this goal.

An Alternative to the Total Return Trust

The total return trust is certainly not appropriate for many same-sex couples that have different goals and different fact patterns. Let's now assume that by far your most pressing goal in planning your estate is the comfort and security of your partner. Let's also assume the estate is smaller and the income on a total return basis isn't sufficient for your partner. Or, maybe it is sufficient if there are no extraordinary expenses, but maybe your partner will have expensive medical costs or other costs after you die.

In that case, the total return trust would not be appropriate.

You could leave everything to your partner, but then if there is some of your money left over after your partner dies, that money may go to your partner's heirs, not your heirs.

What is the solution to this problem?

You could do a different type of trust that would give your partner income and the right to invade principal for health, maintenance and support if needed. That used to be a common trust for traditional opposite-sex marriages. The downside of this solution is you still have the cost and aggravation of setting up, and more importantly, the cost and aggravation of maintaining a trust after the first death. The trust must file its own tax return and it complicates the tax return of the beneficiary.

Finally, there is one more solution that many conservative attorneys would shoot me for even daring to suggest it. What if you made a deal with your partner that went something like this:

When I die, I am going to leave my money (or a portion of my money) to you. You may spend it as you see fit but I would like you to keep it in a separate account (or accounts). Then, in your will, you designate those accounts to my beneficiaries. If you need it for your purposes, fine. My beneficiaries won't get anything. But if there is money left over, then it will go to my beneficiaries or heirs, not yours.

This deal could either be made orally or even in writing. There are lots of problems with this idea, especially if your partner isn't trustworthy. On the other hand, for many couples, this might be preferable to either leaving the money to your partner outright or using a total return trust.