

The Perfect Modern Trust Including Income Tax Sheltering Opportunities

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THOUGHT PROVOKING IDEAS PLANNING OPPORTUNITIES



Many of the discussion items contain planning thoughts that should *always* be considered. Alternatively, reasonable advisors may conclude differently with other proposals and approaches.

PRIMARY DISCUSSION TOPICS

- ❑ Is There a Single “Best” Trust Design Strategy?
 - ◇ Minimal But Meaningful Changes
- ❑ Structuring Trusts
 - ◇ The Competent Inheritor
 - ◇ Others – Immature, Incompetent...
- ❑ The “Use” Trust – Simpler Than a RT
- ❑ Modern Trust Design Offers Powerful I/T Shelter Opportunities

FUNDAMENTAL ESTATE PLANNING RULE:

**“OWNING PROPERTY IN TRUST IS ALWAYS
BETTER THAN OWNING THAT SAME
PROPERTY OUTRIGHT”***

***Provided, that the trust is properly structured**

WHY ARE ALMOST ALL TRUSTS?

- ☐ Poorly/Inefficiently/Erroneously Designed?
- ☐ Take So Long To Draft?
- ☐ Or, Not Done at All?

CLIENT'S PRINCIPAL OBJECTIVES

- ☐ Reduce or Eliminate Taxes
- ☐ Creditor Protection
- ☐ Pass Wealth the “Right Way”

COMMON QUOTES

- ❑ “All I Want is a Simple Will”
- ❑ “My Clients Don’t Want the Complexities of Trusts”*

* Or, Trusts “Impose Too Many Controls”; “Are Only for the Very Wealthy”; “Are Income Tax Inefficient”; “Are Too Expensive”

REBUTTAL

- ☐ Was it an Informed Decision?
- ☐ Then You Need to Try Harder!
- ☐ Your Clients Will do What You Tell Them to Do!

CONSEQUENCES OF NOT PLANNING PROPERLY

*“The old refrain, “All I want is a simple will,” helps explain why so many people, **including many advisors who should know better**, so often overlook trusts when planning for the transfer of wealth as an inheritance within the family. In the rush to achieve simplicity, **such persons fail to realize the enormous, unnecessary and irretrievable loss of assets (to taxes, divorce, and creditors) that many families will suffer for failing to appreciate the protections that a trust can provide** when passing wealth from generation to generation. To quote from an excellent article on the subject, “trusts should be the vehicles of choice for all dispositions to individuals.”*

IT HELPS TO EVALUATE THE ESTATE PLANNING PROCESS IN THE CONTEXT OF A BUSINESS DECISION



- ☐ Would You Ever Recommend a Business Entity That Could Be Pierced By Creditors?
- ☐ Would you Ever Recommend a Business Entity That Would Be Subjected to Unnecessary Taxes?
- ☐ Why Would a Client Want and/or an Advisor Suggest (or Summarily Accept) Wealth Transfers That Unnecessarily Expose Wealth to Claimants and the Taxing Authorities?

COMMON GOALS

☐ Business Entity

- ◇ Creditor Protection
- ◇ Tax Avoidance

☐ Estate Planning

- ◇ Creditor Protection
- ◇ Tax Avoidance

ADVISORS ATTITUDES BUSINESS PLANNING v. ESTATE PLANNING

- ☐ In Business Planning - Advisors Never Would Summarily Accept a Client's Pushback Regarding the Implementation of an Entity
- ☐ Why Does a Passive Attitude Occur With Regularity in the Context of Trust Planning?

WHY INHERITING IN TRUST IS ALWAYS BEST

- ☐ The “Wish” List Theory
- ☐ What Do You Want?
- ☐ Everyone Wants the Same Six (6) Things
- ☐ Priorities Will Vary

CLIENT'S "WISH" LIST

1. Control
2. Use and Enjoyment
3. Flexible/Amendable
4. Creditor/Divorce Protection
5. Save Taxes
6. Avoid Complexity

SHOW “WISH” LIST TO CLIENTS



- ❑ “Is There Anything Else You Want?”
- ❑ “Is There Anything That You Don’t Want?”
- ❑ “Which of These Do You Want (or Not Want)”
 - ◇ “For Your Children?”
 - ◇ “For Others?”
- ❑ Clients Will Always Want Shelters
 - ◇ But May Vary Controls

CONTROL IT; DON'T OWN IT

- ❑ Control Plus Beneficial Enjoyment
- ❑ Unintended Consequences of Legal Title

IS THERE A “BEST” TRUST DESIGN STRATEGY TO OBTAIN ALL OF THE COMPONENTS OF THE “WISH” LIST?

- ☐ Simplicity
- ☐ Shelters
- ☐ Controls

PRIMARY TRUST DESIGN STRATEGIES

- ❑ Maximum Benefit Trust
 - ◇ Entitlements
 - ◇ Force-outs
- ❑ Fully Discretionary Trust
 - ◇ Distribution Control
 - ◇ Requires an “Independent Trustee”
- ❑ Professional Trustee

MAXIMUM BENEFIT TRUST COMPONENTS

- ☐ Pay Income Annually or More Frequently
- ☐ HEMS
- ☐ Power to Withdraw Greater of 5% or \$5,000
- ☐ Staggered Distributions
- ☐ Beneficiary Can Be Sole Trustee

TRADITIONAL “MAXIMUM BENEFIT TRUST” PLANNING PROCESS

- ❑ Give Menu of Available Options
- ❑ Client (With Guidance) Selects Options
- ❑ Law of Unintended Consequences
 - ◇ More is Not Always Better
 - ◇ Does Client Really Understand Full Impact of Choices?

DISCRETIONARY TRUST COMPONENTS

- ☐ Fully Discretionary
- ☐ Dynastic
- ☐ Beneficiary-Controlled (at Proper Time(s))
- ☐ “Use” Concept
- ☐ Amendable - Broad SPAs – “Re-Write Powers”
- ☐ Favorable Situs
- ☐ Requires an Independent Trustee

“PERFECT TRUST” DESIGN PROCESS

REVERSE ENGINEERING



- ❑ Start With the “Wish” List
 - ◇ How Do We Obtain All Components
- ❑ Trust Design Always Preserves Protections and Simplicity
- ❑ Make Minimal, But Meaningful Alterations
 - ◇ Adjust Controls
 - ◇ Adjust Guidance

MAXIMUM BENEFIT TRUST TAX AND CREDITOR SHELTER INEFFICIENCIES AND FLAWS

Violates “Wish” List

PAYS OUT INCOME AT LEAST ANNUALLY



- ❑ Force-outs Terminate “In-Trust” Shelters
 - ◇ Transfer Tax Inefficient – Leakage
 - ◇ Income Tax Inefficient
 - ◇ Creditor Exposed

ASCERTAINABLE STANDARD

“HEMS”*

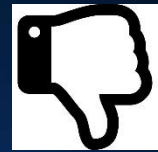


- ☐ “Support Trust” Issue**
- ☐ Relies on Spendthrift Trust Provision
- ☐ Exception Creditors
 - ◇ Statutorily Created – See Restatement 2nd
 - ◇ Judicially Created – Bacardi v. White, 463 So. 2d 218 (Fla. 1985); Garretson v. Garretson (306 A. 2d 737 (Dela. 1973))

* Some State Statutes Protect HEMS Trusts; Will That Be Respected By Judges In Other Jurisdictions If There Is No Other Contacts With The Governing Law States?

**Steven J. Oshins, Asset Protection Other Than Self-Settled Trusts: Beneficiary Controlled Trusts, FLPs, LLCs, Retirement Plans and Other Creditor Protection Strategies; The 39th Annual Heckerling Institute on Estate Planning, University of Miami School of Law, June 2005.

LAPSING POWER TO WITHDRAW “5% OR \$5,000” ANNUALLY



- ❑ Estate Tax Exposure
- ❑ Creditor Protection Adversely Impacted
- ❑ Income Tax Inefficient PLR 9034004
- ❑ Administrative Nightmare
 - ◇ Expense
 - ◇ Added Complexities

DISTRIBUTES ASSETS AT SPECIFIED AGES



- ☐ Force-outs Terminate “In Trust” Shelters
- ☐ At What Age Do You Distribute From a By-Pass Trust?
- ☐ Multiple “Bite of the Apple” Alternative
 - ◊ Distribute to a BCT

Ed Morrow often asks business owners (and sometimes attorneys)
“At what age do you have your LLC/corporation expire?”

THE ANATOMY OF THE PERFECT TRUST

Component Analysis

1. Fred Keydel and Harvey Wallace; Design Strategies for Dynasty Trusts; ACTEC March 6, 1999
2. Ronald D. Aucutt, *Structuring Trust Arrangements for Flexibility*, 35 U. Miami Inst. Est. Plan., Ch. 9 (2001)
3. T. Calleton, N. McBryde and R. Oshins, *Building Flexibility and Control Into The Estate Plan— Drafting From The Recipient's Viewpoint*, NYU 61st Institute on Federal Taxation
4. Richard A. Oshins and Steven G. Siegel, *The Anatomy of the Perfect Modern Trust – Parts 1 & 2*, Estate Planning (Jan and Feb 2016)
5. Richard A. Oshins and L. Paul Hood Jr., *Innovative Trust Designs Better Serve Inheritors*, Estate Planning (June 2017)

THE PERFECT TRUST PHILOSOPHY

- ❑ “Own Nothing; But Control Everything”*
- ❑ Satisfies All Components of the “Wish” List
- ❑ Legal Title Creates Exposure to Predators and the Taxing Authorities

THE PERFECT TRUST

Dynastic; Discretionary (with distribution discretion in the hands of an Independent Party who can be fired and replaced); **Beneficiary Controlled Trust** (unless (i) controls are undesirable or (ii) impermissible under law to avoid the taxing authorities and other claimants); **where the use of trust assets rather than distributions are encouraged** (unless distributions are beneficial or desirable); **sitused** in a trust-friendly jurisdiction.

**MORE IS NOT ALWAYS
BETTER**

COMMON COMPONENTS

☐ Do These Help?

- ◇ Pay Out Income at Least Annually
- ◇ Ascertainable Standard (“HEMS”)
- ◇ Lapsing “5 or 5” Power

☐ If They Do Not Improve the Trust Then Why Use Them?



FREQUENTLY USED TRUST PROVISIONS

- ❑ Beneficiary v. Third Party Controlled Trust
 - ◇ Investment Committee
 - ◇ Distribution Committee
- ❑ Do They Add Anything to a BCT?
- ❑ Perception (and Reality)
 - ◇ Too Complex
 - ◇ Too Controlling

OBTAINING “WISH” LIST COMPONENTS

3.1.1 Discretionary Distributions of Income and/or Principal. **The Independent Trustee**, in its sole, absolute and unreviewable discretion, shall have the power, the exercise of which shall be absolutely binding on all persons interested now or in the future in this trust, to distribute to or apply for the benefit, enjoyment or use of any one or more of the following permissible distributees:

- A. The primary beneficiary,
- B. The spouse of the primary beneficiary,
- C. The descendants of the primary beneficiary who are then living (even though not now living),
- D. Any then living spouse of any such descendant who is then deceased (provided such spouse was living with such descendant at the time of such descendant's death or was unable to do so for reasons of health), and/or
- E. **Any trust for the primary benefit of any one or more of the above-described permissible distributees** (even one created by the Independent Trustee hereunder), whether now existing or hereafter created, except...

so much of the income or principal, or both, of the trust estate, in equal or unequal proportions, and at such time or times as such Independent Trustees shall deem appropriate for such beneficiaries' benefit, care, comfort, enjoyment or for any other purposes, after taking into consideration their income or other resources...

SIMPLICITY

THE “USE” TRUST 
SIMPLER THAN A REVOCABLE
TRUST

“USE” TRUST KEY CONCEPTS*



- ❑ Keep “Legal Title” In Trust Wrapper
- ❑ Just “Use” Trust Assets
- ❑ Available to All Beneficiaries
 - ◇ To Primary Beneficiary on a Preferential Basis

* See Richard A. Oshins, Megatrusts™; Representation Without Taxation; NYU 48th Inst. On Federal Taxation, Ch 19 (1990); §19.02

RESULT

ALL COMPONENTS OF “WISH” LIST

- ❑ Full
 - ◇ Control
 - ◇ Use and Enjoyment
- ❑ Full
 - ◇ Shelter
- ❑ Minimal Complexity

“USE” TRUST EQUALS SIMPLICITY

- ❑ Similar to a Revocable Trust
- ❑ Except
 - ◇ No Gratuitous Transfers
 - ◇ Income Tax Return for Non-Grantor Trust

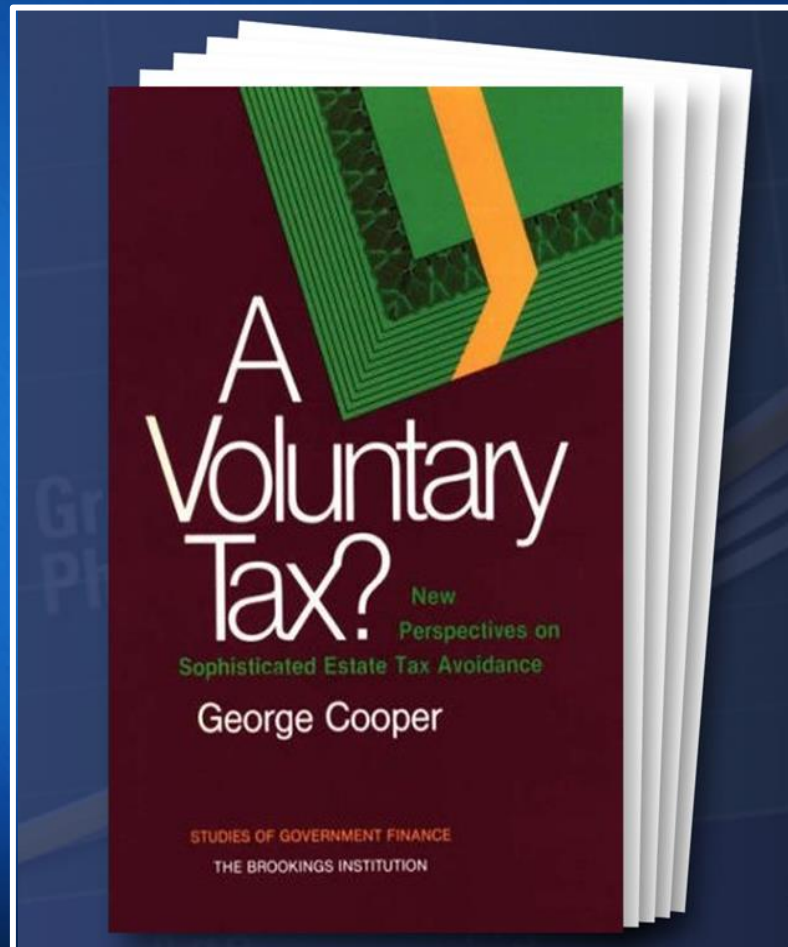
HOW SIMPLE IS THE “USE” TRUST?

- ❑ Simpler than Outright
 - ◇ Long Term
- ❑ What is Complex?

DISTRIBUTIONS ARE PERMISSIBLE, BUT DISCOURAGED

- ❑ Unless there is a Compelling Reason to Make Them
 - ◇ Needed
 - ◇ Wanted
 - ◇ Makes Sense
- ❑ Consider “F/B/O”
- ❑ Separate the Fruit From the Tree

A VOLUNTARY TAX?



TRANSFER TAXES

“In fact, we haven’t got an estate tax, what we have is, you pay an estate tax if you want to; if you don’t want to, you don’t have to.”

— Professor A. James Casner

Estate and Gift Taxes: Hearings Before the House Ways and Means Committee
94th Congress, 2d. Sess., pt. 2, 1335 (March 15-23, 1976)



TRUSTS AS THE QUINTESSENTIAL INCOME TAX SHELTER

TRUSTS OFFER SUBSTANTIAL INCOME TAX PLANNING OPPORTUNITIES NOT AVAILABLE WITH OUTRIGHT TRANSFERS

❑ Rethinking Trusts as an Income Tax Sheltering Strategy

- ◇ Misperception – Because of Compressed Trust Income Tax Brackets Trusts Are Inefficient

❑ Virtues

- ◇ Sprinkling to Low Brackets
- ◇ State Income Tax Avoidance Opportunities
- ◇ Basis Planning

BASICS

☐ Sprinkling

- ◇ Bracket Leveling

- ◇ 65-Day Rule

☐ State Income Taxes

- ◇ Compounding – The 8th Wonder of the World*

COMPARISON OF PAYING STATE INCOME TAXES AND NOT PAYING THEM OVER TIME

Impact of State Income Tax on Dynasty Trusts

This model compares the impact of state income tax for a dynasty trust over the period of 120 years. The hypothetical trust has one group of stock that pays annual dividends at a constant rate (x% of principal). The stock's value grows by y% per year. We assume that all dividends, after tax, are reinvested in the same stock. All income is in the form of dividends, so it is taxed as ordinary income. We compare the ultimate impact of the state income tax by comparing the value of the trust assets depending on whether the trust is situated in New York (outside New York City and within New York City), California, Massachusetts, or in a state that does not impose an income tax. The income tax rates are based on 2014 state rates, updated for 2015 when available, and 2015 Federal income tax rates.

Trust Principal	\$1,000,000
Annual Dividends	6%
Annual Appreciation of Principal	0%



©2015 Chart prepared by Abigail O'Connor of Holland & Knight
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ADVANCED PLANNING USING TRUSTS ESPECIALLY GRANTOR TRUSTS

- ☐ Basis Bump Planning – Upstream and Lateral
- ☐ Monitoring Grantor Trusts
- ☐ Downstream Planning



* **Edwin P. Morrow III**, Basis Bump Planning - For Two Outstanding Discussions on this topic, please see: "The Optimal Basis Increase and Income Tax Efficiency Trust"; **Paul S. Lee**, Paradigm Shift: "Permanent" Changes in Perspective

REVERSE AND LATERAL PLANNING USING GPAs* - RULES



- ❑ IRC §2041 Inclusion
- ❑ IRC §1014 Basis of Property Acquired From a Descendent
- ❑ Previously Transferred Assets
 - ◇ Carryover Basis

*Or, Delaware Tax Trap

BASIS BUMP PLANNING

- ❑ Many People Will Die With Unused AEA
- ❑ Expand List of Permissible Distributees of Trusts
 - ◇ E.g., Parents, G/Ps; In-laws; Siblings...
- ❑ Most Clients Will Want to Help Needy Parents/In-laws
- ❑ Distribution Standards Can Vary
 - ◇ Preferential Beneficiaries – Happiness
 - ◇ Secondary - Need

INDEPENDENT TRUSTEE OR TRUST PROTECTOR CAN GIVE, TAKE AWAY AND DESIGN GPAs

- ❑ Formula GPA
- ❑ Ordering of Best Assets – e.g., -
 - ◇ Low Basis/Negative Basis Depreciable Commercial Real Estate
 - ◇ Capital Gain Assets
- ❑ Ordering of Specific Assets

PREVENTING EXERCISE OF GPAs



- ☐ Can Require Prior Notice of Exercise –
Treas. Reg. §20.2041-3(b)
- ☐ Can Require Consent of a Non-Adverse Party –
IRC §2041(b)(1)(c)(2)
- ☐ Beneficiary Does Not Have to Know of Existence
of the Power – *Estate of James C. Freeman*

ILLUSTRATION:

- ❑ Client Doctor/Business Owner Owns Office Building
- ❑ Beneficiary Grantor Trust – IRC §678
- ❑ FMV \$5 Million – Basis \$1 Million
- ❑ Parents, In-laws, Spouse Are Also Beneficiaries of Trust
- ❑ All (5) Pre-decease Client

Query- What is the Value of the Multiple Basis Step-ups?



EXCHANGES WITH GRANTOR TRUSTS BY OWNER OF TRUST

- ☐ Rev. Rul. 85-13
- ☐ Trust Owns Low/Negative Basis Assets
- ☐ Client Owns Assets – FMV Less Than Basis
- ☐ Exchange
 - ◇ Step-up For Decedent
 - ◇ Preservation of Basis Transferred to Trust



GIFT OF “OPPORTUNITY TO PLAN” CASCADING BDITs



3.1.1 Discretionary Distributions of Income and/or Principal. **The Independent Trustee**, in its sole, absolute and unreviewable discretion, shall have the power, the exercise of which shall be absolutely binding on all persons interested now or in the future in this trust, to distribute to or apply for the benefit, enjoyment or use of any one or more of the following permissible distributees:

- A. The primary beneficiary,
- B. The spouse of the primary beneficiary,
- C. The descendants of the primary beneficiary who are then living (even though not now living),
- D. Any then living spouse of any such descendant who is then deceased (provided such spouse was living with such descendant at the time of such descendant's death or was unable to do so for reasons of health), and/or
- E. **Any trust for the primary benefit of any one or more of the above-described permissible distributees** (even one created by the Independent Trustee hereunder), whether now existing or hereafter created, except...

so much of the income or principal, or both, of the trust estate, in equal or unequal proportions, and at such time or times as such Independent Trustees shall deem appropriate for such beneficiaries' benefit, care, comfort, enjoyment or for any other purposes, after taking into consideration their income or other resources...

STRATEGY

- ❑ Independent Trustee Sets Up BDITs
 - ◇ For Spencer's New Business
 - ◇ For Katie's Existing Business
- ❑ Sharing Not Desirable
 - ◇ Controls
 - ◇ Fruits of Sweat Equity

INCOME TAX VARIATIONS

- ❑ Beneficiary Grantor Trust (“BDIT”)
 - ◇ Beneficiary Has Lapsing Power of Withdrawal
 - ◇ Basis and Burn
- ❑ Complex Trust
 - ◇ Basis

RESULT – BENEFICIARY HAS

- ☐ Full Control
- ☐ Beneficial Enjoyment of Trust Owned Assets
- ☐ Creditor / Divorce Protection
- ☐ Transfer Tax Shelter
- ☐ “Tax Burn” of Personal Wealth

CREDITOR AND DIVORCE PROTECTION



CREDITOR PROTECTION IS AS MUCH A PART OF ESTATE PLANNING AS TAX PLANNING*



- ☐ Asset Protection Maximum
- ☐ Legal Title Harmful

*Attributable to Skip Fox “Current Financial and Estate Planning Trends”, CCH Financial and Estate Planning, (Nov 26,2007), “... I would argue that there may very well be an affirmative duty to talk to your clients about (an asset protection trust).” at p. 83 and, “...it could be any advisor.” at p. 84.

PROTECTION FROM CLAIMANTS

“A discretionary trust with “... the distribution discretion held by an independent trustee... is the ultimate in creditor and divorce claims protection – even in a state that restricts so called ‘spendthrift’ trusts – since the beneficiary himself has no enforceable rights against the trust.” (Emphasis supplied)

Frederick R. Keydel

“Trustee Selection, Succession, and Removal: Ways to Blend expertise with Family Control,” 23 U. Miami Inst. On Est. Plan., Ch 4 (1989) at §409.1

Caveat - Under Current Law, I Would Add, “provided that the trust is situated in a trust friendly jurisdiction”.

REASONABLE CONTROLS, USE AND BENEFICIAL ENJOYMENT DO NOT SACRIFICE SHELTERS

□ Controls



- ◇ Managerial Control Not Impactful
- ◇ Independent Trustee Has Tax and Creditor Sensitive Powers

□ Situs



- ◇ Rent Protective Situs
- ◇ No Exception Creditors

IMPORTANCE OF SITUS



WHY MOST LAWYERS STAY LOCAL?

☐ “My Client’s Want to Stay Local!”

- ◇ Did You Ask the Client?

- ◇ Really?

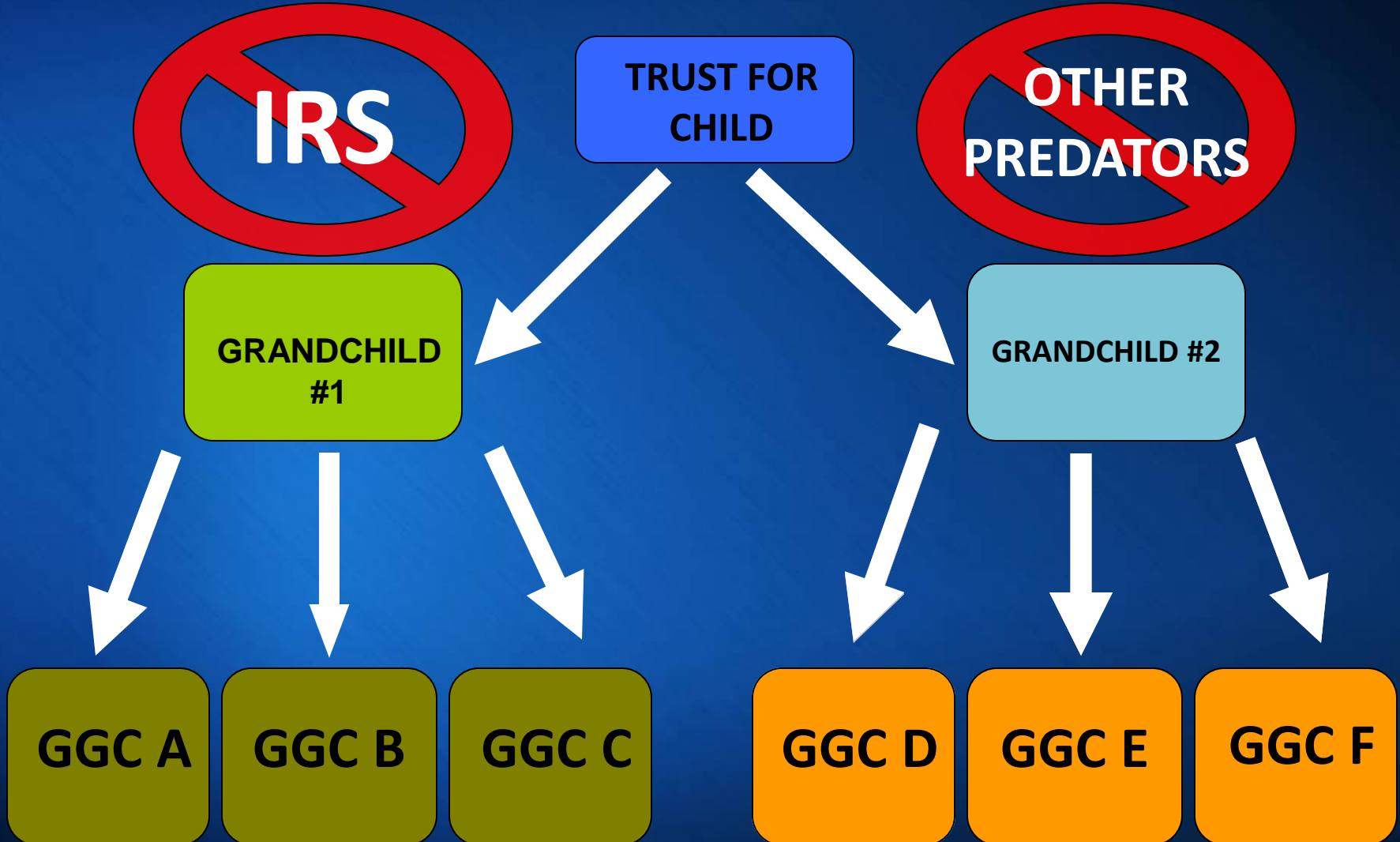
- ◇ Then You Did Not Explain the State Disparities Correctly

☐ Can Rent Situs Cheaply

PRIMARY FACTORS IN SELECTING JURISDICTION

- ☐ RAP
- ☐ Creditor Protection Laws
 - ◇ No “Exception Creditors”
- ☐ No State Income Taxes
- ☐ Cost of Renting Jurisdiction
- ☐ Cooperation of Situs Trustee

RECYCLE



And so on, all Subject to Amendment through a Power of Appointment by the Senior Generations.



CONTROLS

“OWN NOTHING, BUT CONTROL EVERYTHING”*

*Quote attributable to John D. Rockefeller

BENEFICIARY CONTROLLED TRUST

DUAL TRUSTEESHIP

- ❑ Primary Beneficiary Controls
 - ◇ Investments
 - ◇ Identity of Independent Trustee
- ❑ Independent (Distribution) Trustee
 - ◇ Controls All “Tax Sensitive” Decisions
- ❑ Situs Trustee – Can Be One of the Foregoing
 - ◇ Distribution and Situs Trustee Often the Same

AMENDABLE/FLEXIBLE “RE-WRITE” POWERS

- ☐ Special Power of Appointment (“SPA”)
- ☐ Deal With Changing Laws, Family Dynamics and Needs
- ☐ Deal With Dissident Subordinate Beneficiaries

**ALL TRUSTS SHOULD HAVE LIFE
INSURANCE PROVISIONS IN
THEM UNLESS IMPERMISSIBLE
AS A MATTER OF LAW**

COMPONENTS OF LI POLICY



- ☐ Inside Build-up
- ☐ Death Benefit

LIFE INSURANCE OWNED BY A THIRD PARTY TRUST MAKES THE POLICY MORE VALUABLE



- ☐ Indirect Access to a Conservative Asset Backed by a Powerful, Regulated Financial Institution
- ☐ Death Benefit Out of Estate
- ☐ Funding Complexities and Limitations Avoided