IN THIS ISSUE

Trust UPDATE

Stillman BANK

Inheritance planning for adult and minor children

Thoughtful planning may create a lasting legacy.

Those who have built wealth during a lifetime of hard work are rightfully concerned about how best to use that wealth for family financial security. As has been noted often, the wealthy want their heirs to have enough to be able to do anything, but not so much that they don't have to do something. Now more than ever, a family fortune is something to be protected and nurtured.

What is the answer? How can wealth be conserved and deployed on a long-term basis for the benefit of heirs? *Trusts* could be the answer, for many families.

Trust planning comes immediately to mind when planning for a surviving spouse or an heir who is a minor. With a trust one gets professional investment management guided by fiduciary principles.

Continued on next page

Testamentary trusts

A great variety of wealth protection strategies may be implemented with careful trust planning. Among the choices to evaluate:

Marital trusts	Several options are available to provide lifetime asset management and financial protection for a surviving spouse.
Credit shelter trust	A married couple may expand the benefits of federal estate tax exemptions with this trust.
Support trust	For an adult child who needs a permanent source of financial support, with the trust principal protected from the claims of creditors, a support trust may provide a solution. The beneficiary's interest is limited to just so much of the income as is needed for his or her support, education and maintenance.
Discretionary trust	The trustee has sole discretion over what to do with the income and principal, just as the grantor does before the trust is created. The beneficiary has no interest in the trust that can be pledged or transferred. When there are multiple beneficiaries, the trustee may weigh the needs of each in deciding how much trust income to distribute or reinvest, when to make principal distributions, and who should receive them. The trust document often will include guidelines on such matters.
Gift-to-minors trust.	For young children, contributions of up to $14,000 per year to this sort of trust will avoid gift taxes. A married couple can together set aside $28,000 each year for each child or grandchild, so in a few years a significant source of capital may be built up. Assets may be used for any purpose, including education funding, and will be counted as the child's assets for financial aid purposes. The assets of a gifts-to-minors trust must be made fully available to the child when he or she reaches age 21. However, the child may be given the option of leaving the assets in further trust.
GST trust	The generation-skipping trust takes advantage of the exemption from the federal generation-skipping tax, a tax that otherwise may apply in addition to the gift or estate tax.

For young beneficiaries, a trust can provide for education funding, and for getting a good financial start in life.

But what about when the children are fully grown, established in their careers and financially mature, in their 30s or even 40s? Even then, trust-based planning will be an excellent idea for many affluent families.

Trusts in action

Among the key benefits that can be built into a trust-based wealth management plan:

Professional investment management. A significant securities portfolio is a wonderful thing to have, but it requires serious care and attention, especially when economic growth is weak; interest rates are low; and taxes are uncertain. How can adequate income be provided to beneficiaries without putting capital at risk? What is the best balance between stocks and bonds? How can portfolio management be made more tax efficient? These sorts of questions will be addressed by corporate fiduciaries, such as us.

Creditor protection. One of the most frequent questions that we hear is, "How can I keep my money and property out of the hands of my son-in-law (or, sometimes, my daughter-in-law)?" The inquiry is understandable, given the high divorce rates in this country. Our answer: Use a trust to own and manage the property, and give your heir the beneficial interest in the trust instead of the property. A carefully designed trust plan can protect assets in divorce proceedings, as well as protect from improvident financial decisions by inexperienced beneficiaries.

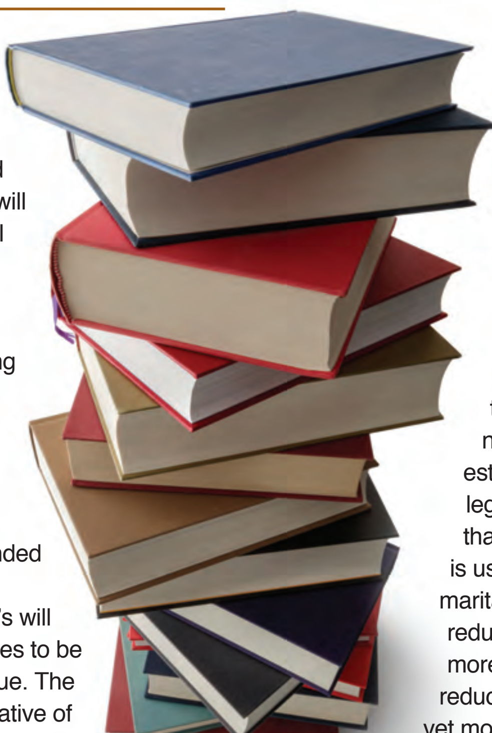
Future flexibility. Parents typically have a fuzzy definition for treating their children "equally." As each child is unique, his or her needs may need financial support that is out of proportion to that of siblings. By utilizing a trust for wealth management, one may give a trustee a similar level of discretion, permitting "equal treatment" on something other than gross dollar terms. The trust document may identify the goals of the trust and provide standards for measuring how well the goals are being met for each of the beneficiaries.

Capital foundation. A trust may provide a capital foundation that avoids successive imposition of transfer taxes, and, thus, keep more hard-earned wealth in the family.

Our invitation to you

We specialize in trusteeship and estate settlement. We are advocates for trust-based wealth management planning. If you would like a "second opinion" about your estate planning, if you have questions about how trusts work and whether a trust might be right for you, we're the ones you should turn to. We'll be happy to tell you more. ☐

What does "equal" mean?



The estate plan of noted author Tom Clancy is an example of using trusts for minor and adult children. His will created three equal trusts, one for the children of his first marriage, a marital trust for his surviving second wife, and a family trust for the second wife and the daughter they had together. The trusts were funded from the residuary estate, and Clancy's will called for death taxes to be paid from the residue. The personal representative of the estate (who also had drafted the will) proposed to pay half of the federal estate taxes due on the $83 million estate from the trust for the adult children, the other half from the family trust. The taxes came to roughly $15 million.

Mrs. Clancy objected. Before his death, Clancy had executed a codicil to his will, to make it clear that he intended both the family trust and the marital trust to qualify for the marital deduction. Assets that don't create an estate tax burden should not be tapped to pay estate taxes on other legacies. To the extent that the widow's share is used to pay the tax, the marital deduction must be reduced, which means still more tax, and a further reduction in deduction, and yet more taxes, in an extended circular computation. If Mrs. Clancy's share is free from the tax burden, the actual estate tax due drops by nearly a third, to roughly $11 million.

That's is the correct interpretation of the will and the codicil, the probate court decided. In a 4-3 decision the Maryland Court of Appeals affirmed in August. A savings clause in the codicil "explicitly directs that the personal representative not act to adversely impact the benefit of the marital deduction of the marital trust and the family trust." The dissent objected to so radical a change to plan of disposition based solely upon the language of a tax savings clause.

The result is decidedly unequal for the five children. The child from the second marriage will get roughly one-third of the estate, undiminished by taxes. The share for the other four will be reduced roughly 40% for taxes, and so is hardly equal after taxes. Then it must be split four ways. Whether Mr. Clancy expected an outcome for his estate plan to be as convoluted as the books that he wrote remains an open question.

A meltdown for family limited partnerships?

The family limited partnership, *Wealth Management Magazine* declared back in 2000, is the ice cream sundae of estate planning strategies. By using a partnership to pass portions of a family business, real property or even a portfolio of marketable securities to family members, wealthy donors can generate substantial valuation discounts for gift or estate tax purposes.

Could the ice cream social be nearing an end? That's the threat posed by newly proposed IRS regulations. Some observers think the regs. could be finalized before we have a new president in the White House.

The IRS takes aim at family businesses

IRC §2704 was added to the tax code in 1990 to limit valuation discounts for certain transfers to family members. Perhaps the provision has not been as successful as its proponents had hoped, because the IRS has lost several important cases in this area. A number of the proposed regs. are aimed at reversing those outcomes.

The biggest change included in the proposed regs. is that a right to liquidate an interest in six months' time will be imputed, regardless of any other restrictions on the interest, even if a right to liquidate does not exist and never will exist. The lack of a right to liquidate an interest or force the liquidation of the entity has been the bedrock justifying valuation discounts for lack of marketability and lack of control of a minority interest. There are many other elements in the proposed regs., but the "deemed put" is the one that drives a stake through the heart of minority interest discounts for intrafamily transfers.

Although the proposed regs. will apply prospectively, they also include a recapture rule for transfers within three years of death. Thus, even transactions that already have occurred could be vulnerable. These new rules will apply regardless of the size of an estate, even to nontaxable estates.

The real target

What "abuse" was the IRS going after with these proposed regs.? Estate planner Ronald Aucutt was quoted in *The Wall Street Journal* as suggesting that the target was the strategy of placing marketable securities into a family limited partnership or limited liability company and taking discounts as shares are distributed to the family ["The Controversial Way Wealthy Americans Are Lowering Their Estate Taxes," August 19, 2016]. Substantial estate taxes may be avoided in this way. The family waits until three years after the owner's death (when the statute of limitations has expired), then dissolves the entity holding the securities. "This drives the IRS crazy," he said.

However, the proposed regs. are not limited to partnerships or corporations that serve as portfolio repositories, but hit operating businesses as well. Many tax observers have objected that these rules are overly harsh and unrealistic in the context of a family-owned operating business.

Prospects

A public hearing on the proposed regulations is scheduled for December 1, 2016. If they are finalized immediately, they could become effective as soon as the first of next year. Many believe that there is a push to have the new rules finalized before President Obama leaves office.

The outlook is further clouded by the disparity in views on the future of the estate tax among the presidential candidates. Donald Trump advocates eliminating the estate tax entirely, which would moot the proposed regulations. Hillary Clinton favors reducing the exempt amount and increasing the tax rate, which would make the proposals even more painful for family-owned businesses. What's more, in the event that Hillary Clinton does win the presidency, the odds of the Democrats retaking the Senate also increase considerably. Should that happen, many other proposals for tightening up the estate tax, as included in each of President Obama's budget messages, stand a reasonable chance of enactment as well.

For that reason, many estate planners are getting in contact with their wealthier clients, warning them of the coming changes. The proposed regs. could be a game changer, writes estate planner Martin Shenkman, if they are adopted without significant modification. Year-end estate planning in 2016 could rival the frenzy of 2012, when many were concerned that the federal estate tax exemption might fall to $1 million. ☐

The presidential candidates on federal estate taxes

The federal estate tax has remained unchanged since 2012, giving estate planners and their clients time to adjust to the permanent larger exemption and the portability of the estate tax exemption between spouses. That comfort level could change in 2017, as both presidential candidates have called for major changes in the federal estate tax.

Donald Trump advocates the complete repeal of the federal estate tax. Repeal would not mean the end of planning for death taxes, however. During the year that the federal estate tax was suspended, 2010, executors and heirs had to learn the intricacies of carryover basis, which took the place of the estate tax. Presumably a similar rule will take the place of a repealed estate tax, so tax planning would still be needed.

Hillary Clinton goes to the other extreme. She wants to roll the federal estate tax exemption back to the level it was in 2009, $3.5 million, coupled with a bump in the estate tax rate to 45%. She likely also would advocate a range of technical restrictions on estate tax planning strategies, similar to what President Obama has included in his budget proposals.

The Tax Foundation ran economic models on the two strategies. For revenue effects, they used both static and dynamic analysis. The difference between the two modes of analysis is that static analysis measures consequences assuming no other changes in the economy. Dynamic models estimate the economic feedbacks that may be caused by large tax changes. The table below summarizes the Tax Foundations's findings.

Effect	Clinton plan	Trump plan
Static 10-year revenue gain (loss)	$107 billion	($240 billion)
Change to GDP	(0.1%)	0.8%
Capital investment	(0.3%)	2.3%
Jobs	(14,000)	156,000
Dynamic 10-year revenue gain (loss)	$82 billion	($19 billion)

Source: http://taxfoundation.org/article/modeling-estate-tax-proposals-2016; M.A. Co.

According to the models, increasing federal estate tax will slow the growth of the economy and cost 14,000 jobs. Eliminating the tax will cost tax revenue—this tax cut won't pay for itself—but it would generate jobs to soften the blow.

The two visions for the federal estate tax are not expected to play any role in the outcome of the election, but those who are planning to make or review estate plans might want to keep these points in mind. ☐