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Trust UPDATE

Stillman BANK

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What is a directed trust?

Historically, a traditional trust had a single trustee and many beneficiaries, often in multiple generations. The trustee was responsible for administering the trust according to its terms, which included asset management responsibilities. If a trust allowed for discretionary distributions to beneficiaries, it was up to the trustee to exercise that discretion, subject to the strictures of fiduciary duty. Such distributions might be related to education, to health, or even to living according to an accustomed standard.

Recently, there has been a trend toward dividing these responsibilities up. For example, if the trust will own a family business, the creator of the trust may want to entrust business and investment decisions with someone other than the trustee. When it comes to discretionary distributions, some may feel that family members should have a voice in the process. A trust may also employ a mechanism for granting someone other than the trustee the power to change the trust itself in response to changing circumstances.

When there are multiple responsible parties for trust management, the administrator of the trust is said to be directed by the others, and hence the genesis of the "directed trust." The modern trust may have four, five, or more fiduciary and non-fiduciary positions. Many of these positions, because they are relatively new, are known by different names. Different state laws might use different terminology, and there are wide variations in how different attorneys draft the provisions governing these positions. Thus, trustees, beneficiaries, and anyone involved with a trust should review the specific terms of each instrument governing each position and not presume that a particular title has a specific meaning without further investigation.

Divided responsibilities

Administrative and general trustee. An institutional administrative and general trustee may be designated, typically a bank trust department or trust company. This position will hold all trustee powers in the governing instrument that have not been allocated to other fiduciaries. The administrative trustee handles the bookkeeping, statements, the tax filings, and implementing investment changes.

Investment trustee. A person may be designated to make all of the investment decisions, which the executor will then execute on behalf of the trust. The investment trustee may decide, for example, that a concentrated holding should not be sold, notwithstanding the general duty of trustees to diversify and make productive the assets

of the trust. Another area of contention may be whether the investments should be chosen to maximize current income for the income beneficiaries or whether growth should be the focus, so as to have more for the remainder beneficiaries.

Distribution trustee. The trust could name a person, or group of persons acting as a committee, to be responsible for trust distributions. This puts the responsibility in the hands of persons with a more intimate knowledge of family dynamics. However, caution should be exercised as the power to distribute is a tax-sensitive power that could cause trust assets to be included in the power holder's estate if not properly handled. The trust creator may be safer in terms of accomplishing trust goals by leaving this function under the auspices of an independent institutional general trustee.

Insurance trustee. A person could be designated to be responsible for life insurance decisions of the trust. This person should not be the insured. By providing for a separate person to be responsible for insurance decisions, and including prohibitions against the settlor/insured being involved in these decisions, the trust can hold both life insurance and other assets. Some of the advantages of this include the ability to use a single trust to hold business interests and life insurance, instead of multiple trusts, and the ability to use income generated by trust investments to pay for life insurance premiums.

Trust protector. This is a person appointed to hold important powers over the trust and, perhaps, to perform certain other defined roles. The protector may be given the power to remove and replace existing trustees, correct drafting errors, modify administrative provisions, change trust situs and governing law, and other powers depending on the circumstances and goals.

Substitutor. This person, who may be the settlor or another person, can be given the power to exchange or "swap" assets of the trust for assets of equivalent value. The common application of this technique is to swap highly appreciated trust assets back into the grantor's estate so that on death they will qualify for a step-up in income tax basis. Provisions should be added to the client's durable power of attorney to address this power in the event of disability. It also is prudent to arrange lines of credit to facilitate acting on this swap power in an emergency situation.

Charitable designator. One of the means of creating grantor trust status is to empower a person to add to the class of beneficiaries, such as a charity. With the new restrictions on income tax benefits of itemized deductions, perhaps it is advisable to include a mechanism to add charitable beneficiaries in more trusts to provide flexibility for settlors to make contributions out of irrevocable trusts if that proves advantageous in the future.

Would you like to know more?

Modern trust drafting, tax uncertainty, longevity, and a range of other factors are transforming how trusts are planned, drafted, and administered. The wide array of positions, fiduciary and non-fiduciary, that may be included in a trust instrument are among the most affected areas. Creative and careful selection of these positions, and the persons named to serve in them, can infuse substantial flexibility into trust planning.

How would a modern trust benefit you and your family? We would be pleased to explore that question with you. For those who have shied away from trust planning out of a fear of "tying up" assets, the directed trust approach may be one that gets them over the hurdle. ☐

Auditioning for trustees

The responsibilities and duties of trusteeship don't have to reside in a single person or institution. Some trusts are dividing up the job along these lines:

ROLE	RESPONSIBILITY
Administrative and general trustee	Clerical duties, communications, recordkeeping
Investment trustee	Asset management
Distribution trustee	Discretionary transfers of trust assets
Insurance trustee	Pay premiums, evaluate policies
Trust protector	Change trustees, modify administrative provisions
Substitutor	Swap trust assets
Loan designator	Provide the settlor with temporary access to trust assets
Charitable designator	Add charitable beneficiaries

Source: M.A. Co.

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Target: Elder financial abuse

There was a national uproar in March upon the report that 50 people had been indicted for cheating related to college admissions. Allegedly, several dozen wealthy parents paid hundreds of thousands of dollars to someone who would arrange for phony SAT tests. Another strategy was paying bribes to coaches to designate students as recruited athletes, which virtually guaranteed admission.

As disturbing as this news was, it overshadowed a far more significant event that also happened in March.

Arrests by the FBI

The U.S. Attorney's Office and the FBI announced a major sweep of elder fraud cases. The cases involved more than 260 defendants from around the world, with total alleged losses by their victims of over $750 million. The action follows a similar fraud sweep last year. This year's action involved twice as many fraud victims, 28% more criminal defendants, and 28% more in losses than last year.

As welcome as this development is, it may be only the tip of the iceberg. Many seniors are reluctant to report when they have been victimized, for fear that family members may conclude that their competence has been impaired.

Don't do these things

Some commonsense tips on how to avoid becoming a victim:

- Don't share personal information with anyone you don't know.
- Don't pay a fee for a prize or lottery winning.
- Don't click on pop-up ads or messages.
- Delete phishing emails and ignore harassing phone calls.
- Don't: send gift cards, checks, money orders; wire money; or give your bank account information to a stranger.
- Don't fall for a high-pressure sales pitch or a supposedly lucrative business deal.
- If a scammer approaches you, take the time to talk to a friend or family member.
- Keep in mind that if you send money once, you'll be a target for life.
- Remember, it's not rude to say, "NO."
- A good rule of thumb is, if it's too good to be true, it's likely a scam.

A cornucopia of scams

Fraudsters are very resourceful in trying to separate seniors from their money. Examples of actual financial frauds:

Lottery phone scams. Callers convince seniors that a large fee or taxes must be paid before they can receive lottery winnings.

Grandparent scams. Seniors are told that their grandchildren are in trouble and need money to make rent, repair a car, or even pay bail.

Broken computers. Caller claims that a problem has been detected on the victim's computer, but that repair is possible over the internet upon payment of a fee.

Romance scams. Victims are lulled into believing that their online paramour needs funds for a U.S. visit or some other purpose.

IRS imposter scams. Fraudsters pose as IRS agents and claim that victims owe back taxes—in some cases demanding to be paid in gift cards!

Sham business opportunities. Victims are persuaded to invest in business opportunities or investments that turn out to be bogus or Ponzi schemes.

When a fraudster makes contact

The Federal Trade Commission is looking for help from the public in combating fraud. You can report an attempted scam at 1-877-FTC-HELP (1-877-382-4357), or you can file a report online at https://www.ftccomplaintassistant.gov/#crnt&panel1-1. ☐

Trust division

Donor created an irrevocable trust before the effective date of today's generation-skipping transfer tax. The trust has many beneficiaries. Class one consists of Donor's grandchildren, class two of their spouses, class three of their children. There are currently 17 grandchildren, six spouses, and eight great-grandchildren.

The trust is to be divided into 17 separate trusts, one for each grandchild. The spouses and descendants of each grandchild would become beneficiaries of the grandchild's trust. Should additional grandchildren be born, an additional separate trust will be created for that grandchild, with a proportionate amount taken from the earlier trusts to create the new one. The trusts are all funded with shares of a closely held company.

The IRS finds that;

1. the new trusts will continue to be GSTT exempt;
2. the division will not trigger any gift tax;
3. the division will not cause any trust to be included in any grandchild's estate;
4. the allocation of assets will not cause income or capital gain or loss to any trust or family member;
5. the adjusted basis and holding periods for the assets will be unchanged.

This was the result for which the family was hoping.

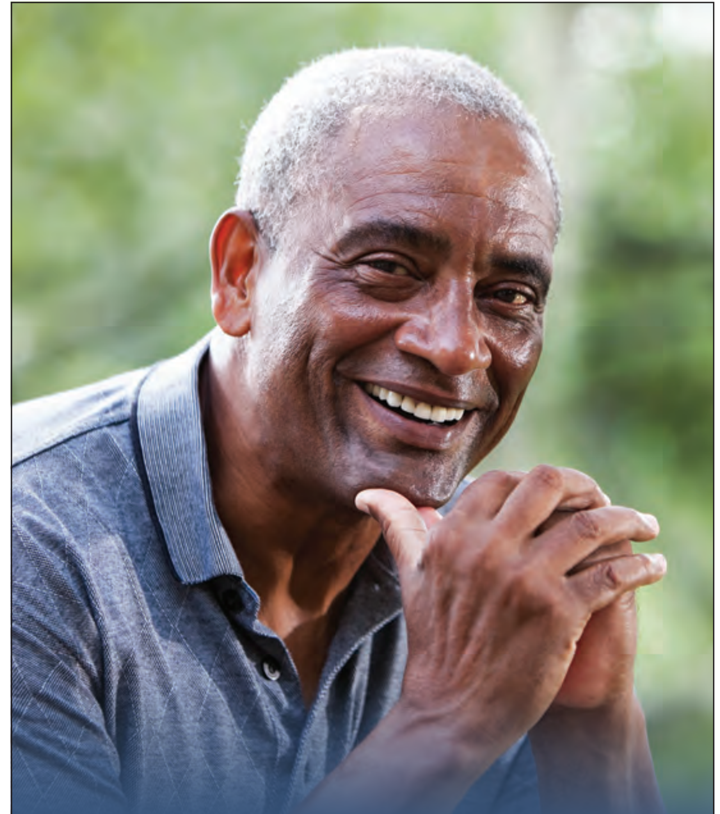
Attempted trust transformation

An irrevocable trust cannot be amended. However, it is possible in some circumstances to pour the assets from one irrevocable trust into a different trust, a process known as "decanting." In general, decanting works for changing administrative provisions, but does not work for changing beneficial interests.

Hodges created two irrevocable trusts in 2004, one that would be exempt from the generation-skipping transfer tax and one that would not be. Hodges owned a successful real estate development and holding company, HDC. The trusts were funded with all of the nonvoting shares of HDC, representing 98% of the firm's equity. The 2% retained by Hodges had all the voting power. Hodges named his attorney and a business associate as the trustees.

The beneficiaries of the trusts were Hodges' wife and his five children. Some of the children had worked for HDC, but apparently not very well. There was a falling out with some of the children, and Hodges' marriage fell apart as well. Hodges prevailed upon the trustees to decant the irrevocable trusts into new trusts, and after three decantings the interests of the wife and three of the children were extinguished. The children sued.

The court found that the trustees had failed to take into account the beneficial interests of the excluded children, and had failed in their duty of impartiality. What's more, because they abused their discretionary powers in the decanting, the trustees were removed. ☐



Going solo?

Everyone needs a "Plan B" for financial management in retirement.

Ask us about how a living trust can enhance your security as you age.

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