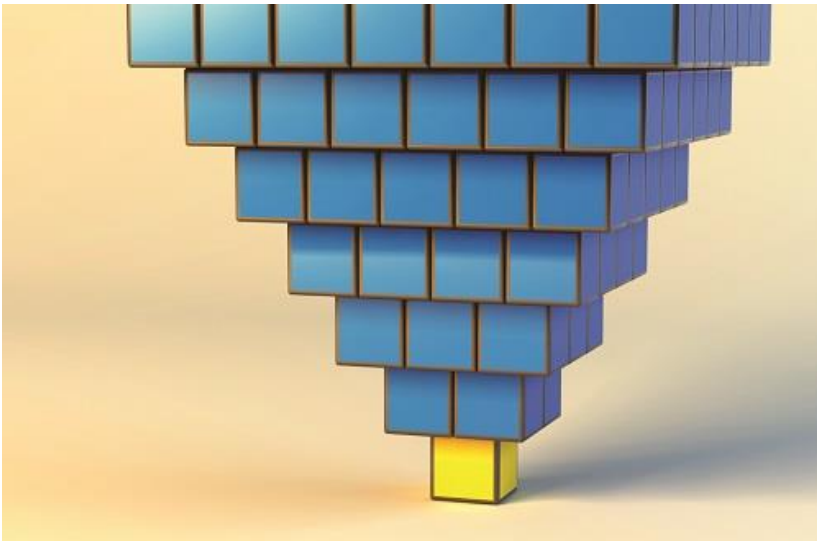


Not Your Grandfather's Irrevocable Trust



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The irrevocable trust today is nothing like the typical trust of only a few years ago. Then, most trusts included just a single trustee or possible co-trustees to fulfill all of the roles. Now, however, a trust is likely to divide the traditional trust function into many components and it may include other important positions.

Planners need to understand some of the functions that might be included in a modern trust. This will assure that their clients are really getting optimal planning, and that trust assets are being properly invested.

KEY ROLES

Here are some of the newest roles that are turning up in trusts, depending on the planning objectives involved:

General or administrative trustee. This person or entity fulfills the traditional administrative roles, including maintaining records and filing tax returns.

Identifying a general trustee, who is free from other roles, meets the standards of four key states whose tax laws are regarded as most favorable to trust planning: Alaska, Delaware, Nevada and

South Dakota. They are among 16 states that permit a client to create a trust, be a beneficiary of the trust and have trust assets outside the estate and yet be unreachable by creditors.

Investment trustee. Certain states, including the key four, permit a trust to designate a person to be in charge of investments. This is known as a directed trust. It is critically important for planners to understand this mechanism. It can enable a client to set up a trust in a friendly jurisdiction but hold private equity (such as a family business) and continue to work with his or her investment manager.

Distribution committee. A separate fiduciary or group of fiduciaries can be empowered to make distribution decisions. Because distributions are a tax sensitive power, however, it can be preferable to leave this power in the hands of an independent institution.

Trusts protector. This is a separate fiduciary position that often holds powers to fire and replace trustees and to change the governing law and location of the trust. These can be significant powers. The protector is a relatively new concept, and there have been many differences in the titles used and powers granted.

ADDITIONAL POSITIONS

Besides slicing and dicing the traditional trustee function into multiple roles, modern trusts can include a variety of additional positions and functions. Here are some of them:

Loan director. A person can be granted the power to make loans to the settlor, the person who created the trust. This odd power can help characterize the trust as a grantor trust for income-tax purposes. That causes all trust income to be taxed to the settlor, and this can be a valuable tax and asset protection provision.

Substitutor. A person, typically the settlor, can be given the right to swap assets of the trust for property of equivalent value. This is a valuable mechanism that can enable the settlor to swap highly appreciated assets held in the trust for cash. This can be important in positioning assets so that they will qualify for a basis step-up upon the client's death.

Charitable selector. This person is granted the power to add a charitable beneficiary to the class of beneficiaries.

Adding beneficiaries. Some trust might give a person the right to name additional beneficiaries. Why might this type of power be granted? Say a client wants to remove assets from her estate but is concerned that she might need access to them in the future.

One approach: The client can create a trust for all her intended beneficiaries, initially excluding herself. A friend might be granted the power to add the descendants of the settlor's grandparents as beneficiaries of the trust.

In the future, if the client needs access to the assets in the trust, the power holder could exercise the power and name her a beneficiary.

OTHER CONCEPTS

There are a number of other commonly used modern trust concepts that complement some of the above positions and also add more flexibility to trust planning.



Decanting. This is the right to pour an existing trust into a new trust. Doing so can permit the revision and improvement of the trust document to modernize it, change administrative provisions and more.

While about 20 states have laws that permit decanting, it can be quite advantageous to include decanting, merger and similar provisions in the trust document itself. That might offer more flexibility than a particular state's laws permit.

In the past, trusts were almost universally created in the state where the settlor lived. There can be significant legal and tax benefits, however, in creating or moving a trust to a state with more favorable trust or tax laws.

Change in situs and governing law. Including this provision can make it easier to move the trust from, for example, a high-tax state to a low-tax state. Since one can never be certain what might occur in any particular state in the future, including this flexibility into the trust document can be advantageous.

Power of appointment. This is another important right found in some trusts. It grants an individual the right to designate where assets held in a trust will eventually be distributed.

There are two types of appointment powers. Limited powers exclude the person from appointing the trust assets to herself, her creditors, her estate or the creditors of her estate. General powers of appointment include the right to appoint to at least one of those four categories — for example, the creditors of the powerholder's estate.

Powers of appointment are valuable to infuse flexibility into an estate plan. Giving each generation a power to designate how the next generation will inherit trust assets effectively permits each generation to rewrite the terms of an irrevocable trust so it can remain current with developments in the law, planning and family circumstances.

If someone holds a limited power of appointment, the assets over which he or she can exercise control are not included in the powerholder's estate.

If someone holds a general power of appointment, the assets over which he or she can exercise control are included in the estate.

With the estate tax now offering a \$5 million inflation-adjusted exemption, having assets included in the powerholder's estate may not trigger any federal estate tax, but it will permit those assets to have their tax basis stepped up on the powerholder's death. That is potentially a tax free way to eliminate capital gains.

Within the trust, a person can be given the right to modify the powers of appointment from general to limited, or vice versa, to achieve whatever the optimal estate and income tax planning result is. This is another means of infusing flexibility into an irrevocable trust plan.

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