2015 MDRT Annual Meeting e-Handout Material

Title: Unique and Creative Uses of Modern Trusts Involving Investments and Insurance

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Presentation Date: Tuesday, June 16, 2015
10:00 - 11:30 a.m.

Million Dollar Round Table
325 West Touhy Ave.
Park Ridge, IL 60068 USA

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Unique and Creative Uses of Modern Trusts
Involving Investments and Insurance

Global Wealth Transfer – Intergenerational Planning:

- **Next three decades world's ultra high net worth (UHNW) bequeath $16 trillion globally**:
  - **$6 trillion U.S.**
    - Germany, Japan, U.K. and Brazil (next largest wealth transfers)
  - **$300 billion charitable globally**
  - **Perspective**: Current U.S. GDP just under $17 trillion
  - **Transfer from .3% of world's population**
  - **68%** - **Self-made** globally
  - **Richest 1% own 50% of global wealth**

Source: *U.S. News & World Report*

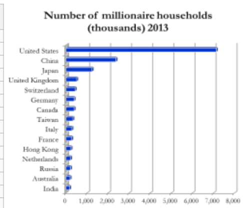
U.S. Wealth Statistics:

- **U.S. Private wealth** – Expected to reach:
  - $54 trillion by 2018
  - Up from $46 trillion in 2013
  - Top 1% → 40% of wealth: Closely-held business and/or real estate
  - **64 million over age 50** control $20 trillion of wealth in the U.S.
- **China** will **rank second** with **$40 trillion**

Source: *Euromoney*

Global Wealth – Wealthy Countries:

	Country	Number of millionaire households 2013
1	United States	7,135,000
2	China	2,378,000
3	Japan	1,240,000
4	United Kingdom	513,000
5	Switzerland	435,000
6	Germany	386,000
7	Canada	384,000
8	Taiwan	329,000
9	Italy	281,000
10	France	274,000
11	Hong Kong	238,000
12	Netherlands	221,000
13	Russia	213,000
14	Australia	195,000
15	India	175,000



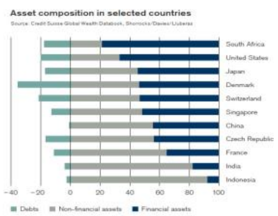
Source: *BCG Global Wealth Market-Sizing Database 2014*

Update - International *Forbes* 2014 Billionaire List Data:

- **2014 *Forbes* List**:
  - **1,645 billionaires** on the 2014 *Forbes* list (268 were added in 2014)
  - **Overall net worth** is **$6.4 trillion** (up from $5.4 trillion last year)
  - **U.S. leads** the way: **492 billionaires**
    - **China** (152), **Russia** (111), **Germany** (85), **Brazil** (65), **India** (56)
  - **Wealth is spreading to new places** – Billionaires for the first time in Algeria, Lithuania, Tanzania and Uganda.
  - Also for the first time, an African, Aliko Dangote of Nigeria, breaks into the top 25
  - Roughly **66% of the billionaires built** their **own fortunes**
    - **13% inherited** them; and
    - **21%** have been **adding on to fortunes** they received

Source: *Forbes*

Asset Composition Selected Countries:



Source: *Credit Suisse Global Wealth Databook*

U.S. Cities with the Most Millionaires:

1. New York – 894,000
2. Los Angeles – 330,000
3. Chicago – 264,000
4. Washington, D.C. – 221,000
5. San Francisco – 199,000
6. Boston – 148,000
7. Philadelphia – 136,000
8. Houston – 131,000
9. Dallas – 113,000
10. San Jose (Silicon Valley) – 122,000
11. Detroit – 108,000
12. Seattle – 88,000

Source: Study by RBC Wealth Management and Capgemini

Income, Net Worth, and Financial Worth in the U.S. by percentile:

Wealth or income class	Mean household income	Mean household net worth	Mean household financial (non-home) wealth
Top 1 percent	$1,318,200	$16,439,400	$15,171,600
Top 20 percent	$226,200	$2,061,600	$1,719,800
60th -80th percentile	$72,000	$216,900	$100,700
40th -60th percentile	$41,700	$61,000	$12,200
Bottom 40 percent	$17,300	-$10,600	-$14,800

Please note: Figures above in 2010 dollars
Source: Wolff, E. N. (2012). *The Asset Price Meltdown and the Wealth of the Middle Class*. New York: New York University.

Wealth Distribution by Type of Asset:

	Investment Assets		
	Top 1 percent	**Next 9 percent**	**Bottom 90 percent**
Trusts	38.0%	43.0%	19.0%
Stocks and mutual funds	35.0%	45.8%	19.2%
Financial securities	64.4%	29.5%	6.1%
Business equity	61.4%	30.5%	8.1%
Non-home real estate	35.5%	43.6%	20.9%
TOTAL investment assets	50.4%	37.5%	12.0%
	Housing, Liquid Assets, Pension Assets, and Debt		
	Top 1 percent	**Next 9 percent**	**Bottom 90 percent**
Principal residence	9.2%	31.0%	59.8%
Deposits	28.1%	42.5%	29.5%
Life insurance	20.6%	34.1%	45.3%
Pension accounts	15.4%	50.2%	34.5%
TOTAL other assets	13.0%	37.8%	49.2%
Debt	5.9%	21.6%	72.5%

Please note: Figures above based on 2010 US Census
Source: Wolff, E. N. (2012). *The Asset Price Meltdown and the Wealth of the Middle Class*. New York: New York University.

U.S. Intergenerational Planning:

- **Key group #1**:
  - **66.3%** population **below age 50**
    - 77 million **Baby Boomers** (Born 1946 - 1964)
      - Make up roughly 13% of population
      - Roughly 4 million Baby Boomers retire each year
      - 10,000 per day
- **Key group #2**:
  - **64 million** people **over age 50** control **$20 trillion** wealth
    - "Leave family enough money so they do something; not leave enough money so they do nothing." - Warren Buffet
- **Both groups** very **interested** in **estate planning** and **trusts**

Source: *US Census*

Defining Core and Excess Capital – How Much to Give?:

Goals for Wealth		Allocation Strategy	Transfer Strategy
Lifestyle Spending Emergency Reserve	**Core Capital**	• Invest for security • Balanced mix of liquid traditional asset classes	• Minimum amount that must always remain in the estate(trust)
Children Grandchildren Great-Grandchildren Charity	**Excess Capital**	• Invest more aggressively • Tailor allocation to the risk profile of the beneficiaries	• Amount that can safely be transferred out of the estate(trust) •Incentive trust assets to promote fiscal & social responsibility

Source: *AllianceBernstein*

Summary of the Most Popular Desires of an UHNW Person's Trust Planning:

1. **Family Governance/Involvement, Education,** and **Succession**
2. **Control and Flexibility Regarding Trust Administration**:
   - "Trusts are no longer vehicles that lawyers and banks create to keep what is rightfully the beneficiaries."
   - "**Directed Trusts**", "**Special Purpose Entities**" and "**Private Family Trust Companies**"
3. **Control and Flexibility Regarding Investment Planning:**
   - Modern **Directed Trust** with **family investment committee**:
     - "I am not so concerned with the return on my money as the return of my money" – **Mark Twain**
       - Principal & Income; **Current vs. remainder beneficiaries**
     - **Proper asset allocation** – "directed trust"
     - Ability to **hold one asset without asset diversification** – "directed trust"
     - **Illiquid assets** – Directed trust

Summary of the Most Popular Desires of an UHNW Person's Trust Planning (cont'd):

4. **Privacy**: Litigation, all court matters, keep trust silent to beneficiaries if desired
5. **Asset Protection**
6. **Tax Savings**
7. **Family Management** - Promotion of Social and Fiscal Responsibility:
   – Modern "Directed" Dynasty **incentive trusts**:
      - "I want to leave my family enough money so they do something; not leave enough money so they do nothing." – **Warren Buffet**
      - Remember **names and values** of **great great grandparents**
      - **Videotape** of family values and goals (transcribe)
      - Draft Family **Mission Statement**

Estate Plan Maximizing Gift Planning Strategies and Trust Opportunities (Zero Estate Tax Trust Plan):

- ✓ **Will/Revocable Living Trust**
- ✓ **Education Planning**
- ✓ **Irrevocable Insurance Trust**
- ✓ **Private Foundation/Donor Advised Fund**
- ✓ **Advanced Trust Planning – See Below:**

Asset Protection:

Self-Settled Trust

- ✓ Self Settled – Tax neutral
- ✓ Purposefully Included in Estate
  >Incomplete Gift
  > No need to use Gift or GST tax exemptions
- ✓ Grantor Trust for Income Tax Purposes, i.e., Taxed to Grantor
- ✓ Funded Lifetime
- ✓ Grantor Remains Permissible Discretionary Beneficiary
  > Generally 10-40% of Assets
- ✓ Situs in Self Settled Trust State (i.e., Alaska, Delaware, Nevada or South Dakota)

Sale of Appreciated Assets:

Charitable Remainder Trust

- ✓ Sale of appreciated property without immediate income or capital gains taxes
- ✓ Income tax deduction
- ✓ Estate tax reduction
- ✓ Income to Donor and family
- ✓ Beneficiary: Fund Private Foundation or provide for charity directly
- ✓ Hedges the CLAT

Preserve Key Assets:

Purpose Trust

- ✓ Pets
- ✓ Key Family Assets
- ✓ Private Family Trust Company
- ✓ Trust Situs: Delaware or South Dakota

Education Planning:

HEET Trust

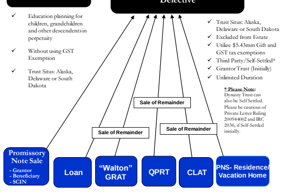
- ✓ Education planning for children, grandchildren and other descendents in perpetuity
- ✓ Without using GST Exemption
- ✓ Trust Situs: Alaska, Delaware or South Dakota

Shifting Growth on Assets:

Dynasty Trust "Defective"

- ✓ Trust Situs: Alaska, Delaware or South Dakota
- ✓ Excluded from Estate
- ✓ Utilize $5.43mm Gift and GST tax exemptions
- ✓ Third Party/Self-Settled*
- ✓ Grantor Trust (Initially)
- ✓ Unlimited Duration

*** Please Note**: Dynasty Trust can also be Self Settled. Please be cautious of Private Letter Ruling 200944002 and IRC 2036, if Self-Settled initially.



Trust Overview:

- **Types of trusts**:
  - **Inter-vivos** (lifetime) versus **testamentary** (death)
  - **Third party** versus **self-settled** (grantor permissible beneficiary)
    - Only 15 states have self-settled statutes
  - **Grantor trust** (grantor pays income tax for trust) versus **non-grantor trust** (trust pays income tax)
    - Generally both completed gift trust utilized to save both estate and/or generation skipping transfer taxes
- **Elements of a trust**:
  - **Settlor/grantor** (establishes trust)
  - **Trust agreement**
  - **Beneficiaries** – Beneficial owner of trust property
    - **Please note**: **Exception Purpose Trust** (no beneficiaries)
  - **Trust property**
  - **Trustee** – Administers trust (legal owner of trust property)
    - **Full trustee**: All 50 states (one-stop shopping)
    - **Delegated trust administration** – All 50 states
    - **Directed trust administration** – Selected states (best of class model)

States with Self-Settled Trust Statutes:	
Alaska	Oklahoma
Delaware	Rhode Island
Hawaii	South Dakota
Mississippi	Tennessee
Missouri	Utah
Nevada	Virginia
New Hampshire	Wyoming
Ohio	

Who to Name as Trustee?

- **Popular** trustee or co-trustee **choices** are:
  - **Family** members
  - **Business colleagues** (possible conflicts)
  - **Friends**
- **70%** of wealthy families **do not use** corporate trustees (FOX)
- **Biggest family trustee concerns** and **liability issues**:
  - **Concentration of assets/lack of diversification**
    - Proper asset allocation
  - **Business interests**
  - **Delegated trusts**: Improper due diligence and monitoring of investments/trust assets
  - **Distributions**: Taxable versus non-taxable, independent decision makers for taxable, documentation
  - **Environmental**
- **Personal liability**: Most states – High standards
- **Solution**: Modern "directed" trusts **limit liability** of family and family friends as fiduciaries: gross negligence and/or willful misconduct standards as well as provide **flexibility and control**

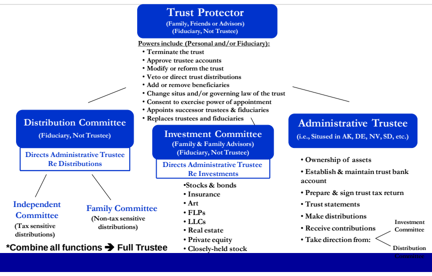
Modern Directed Trusts:

"Trusts are no longer vehicles that lawyers and banks create to keep what is rightfully the beneficiaries'"

- Modern Directed Trusts created with "**open architecture**"
  - Not available in all states
- **Collaborative relationship** among **beneficiaries** and **trustee**
- **Multiple trustee** and **managers** assume **duties once assigned** to **single trustee**
  - Specialization of function (investments, distribution, custody, administration/accounting)
  - Active family involvement
- Provides **flexibility & control** to family
- **Compare**:
  - **Full trustee** (available in all states), i.e., bank or trust company provides all services for trust
  - **Delegated trustee** (available in all states), i.e., family member trustee delegates responsibilities to other trustees or fiduciaries such as investment management
    - Need to do due diligence and monitoring

Typical Modern Directed Trust Structure

with a Trust Protector Promoting Flexibility and Control:



Modern Directed Trusts:

- **<u>“Directed” Trustee</u>** – **<u>Trifurcates</u>** the **<u>traditional trustee role</u>** into an **<u>investment committee</u>**, **<u>distribution committee</u>** and a **<u>directed administrative trustee</u>**:
  - **<u>Section 185 2nd Restatement of Trusts</u>** – the directed administrative trustee is generally not liable for following the instructions of an empowered person (i.e., investment and/or distribution committees) within the trust instrument – State Statutes.
  - The **<u>administrative trustee</u>** has **<u>no discretionary investment (3rd party) duties</u>** regarding the trust. The selection of investment managers is generally the responsibility of the investment committee run by the family.
  - The **<u>administrative trustee</u>** takes **<u>direction</u>** from either a **<u>co-trustee</u>**, **<u>trust advisor</u>**, **<u>investment committee</u>**, or LLC regarding both investments and distributions.
  - **<u>State statutes</u>** and the **<u>trust document</u>** **<u>exonerate</u>** the **<u>administrative trustee</u>** from taking direction for investments and/or distributions. Typically “gross negligence and willful misconduct statutes”.
    - **<u>Please Note</u>**: Some advisors utilize “directed” trust language without state “directed” trust statutes (not as powerful).
  - **<u>Great combination</u>** of independent administrative trustee, family, friends and family advisors
  - Provides **<u>flexibility</u>** and **<u>control</u>** regarding investments and distributions
  - **<u>Liability Protection</u>**: Gross negligence/willful misconduct standard for liability of family members serving as co-fiduciaries
  - **<u>State Statutes</u>** – Not all states have directed trust statutes (i.e., Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming)

Selected Popular Modern Directed Trust States with No State Income Tax:

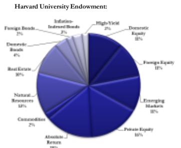
Alaska
Delaware
Florida (Limited Directed Trust Statute)
Nevada
New Hampshire
South Dakota
Wyoming

<u>Please note</u>: Client does not have to live in these states to take advantage of their favorable trust and tax laws. All they need to do is to establish a trust in the states administered by a trustee in these states.

Advantages of a Modern Directed Trust:

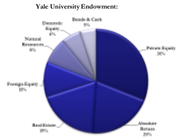
- **<u>No requirement</u>** to **<u>diversify</u>** trust **<u>investments/assets</u>**
  - Can hold large concentration in one stock (public or closely-held)
- **<u>Ability</u>** to **<u>provide</u>** **<u>broad</u>** **<u>asset allocation</u>** models for trust assets, for example:

Harvard University Endowment:



Source: *Harvard University Endowment, Harvard Management Company, 2013*

Yale University Endowment:



Source: *Yale University Endowment, Yale University Investments Office, 2013*

- Investment committee responsible for initial **<u>due diligence</u>** and **<u>quarterly monitoring</u>** of investment assets
  - Directed Administrative Trustee does not have to interfere
- Excellent **<u>control</u>** and **<u>flexibility</u>** in both up and down economic cycles

Designing the Incentive Family Bank Dynasty Trust:

- **Incentive Trust Defined**: Trusts with provisions designed to **encourage** or **discourage** certain **types of behavior**.
  - Trying to **help beneficiary recognize** some aspect of **what got grantor** to where they got so that some aspect of **grantor's heritage** can be **valued** and **perpetual** (*Calibre*).
  - Leave kids enough so they do something, but not enough so they do nothing - Warren Buffet
  - Remember **values** and **names** of great-grandparents
  - Promoting **social** & **fiscal responsibility within** the **family** (family values)

- **Best**: If "**Directed**" regarding **trust administration** and **discretionary** regarding **distributions**
  - **Family and family advisors**: Distribution committee (mentors)
  - **Key Ages for Beneficiary Development:** 20-40
    - Generally: post age 40 retain trust for tax savings, asset and divorce protection, etc.

Designing the Incentive Family Bank Dynasty Trust (cont'd):

- **Various trust distribution options**:
  - **Mandatory Distribution Standards** (poor option for incentive trusts):
    - All income distributed
    - 1/3 of principal age 25, 1/3 age 30, balance 35
  - **Discretionary Support Interest**:
    - Health, Education, Maintenance and Support (HEMS) distributions (not best option for incentive trusts)
  - **Total Discretionary Trust**:
    - **Total discretion:** best option for incentive trusts
    - **Successful children** become **members** of **distribution** and investment **committees** as well as **mentor**
    - **Separate shares** vs. **single pot**:
      - Unequal distributions with **single pot** – Could negatively impact family relationships
      - Competition for single pot may breed animosity and distrust
      - Solution – **separate shares** with LP of A (once distributions begin)
    - **Reform/Modify or Decant existing trust with mandatory and/or discretionary support provisions**
      - **Total discretionary**

Inheritance:

- **Percent who consider it important to leave inheritance to children/heirs**:
  - 76% (younger ages 18-46)
  - 55% (Baby Boomers)
  - 73% (older age 67+)
- **One in three Baby Boomers (31%): Rather give money to charity**
  - Twice as many as younger ages 18-46
  - Twice as many as older ages 67 plus
- **61% of high net worth parents are not confident children are**:
  - Well **prepared** to **handle** financial **inheritance**
- **33% of wealth parents**: Have **disclosed** their **wealth** to their children
  - 50% believe children mature enough 25-34 years old
  - 25% believe children mature enough 40 years old

Source: U.S. Trust study

Sample Incentive Provisions for Directed Trusts:

- **Promotion of Fiscal Responsibility:**
  - Draft **family mission statement** [and] **videotape family goals** (transcribe);
  - **Incentive Clauses** (i.e. $2 of trust income for each $1 of W-2 income) – exceptions, i.e. **disability**;
  - **Distribution audit** to determine suitability of future distributions – Cap distributions based upon beneficiaries' net worth indexed for inflation;
    - Assumption **$7.5MM enough to live well**, but have to protect it (*Financial Counsel*).
  - Supplemental income for **socially responsible profession**, i.e. artist, musician, teacher, etc;
  - Monthly Stipend for **stay at home parent**, also **adult child to care for elderly relative**;
  - **Education costs** for family in perpetuity;
  - Lump sum received at **college graduation** and/or advanced degree(s) (depending upon quality, academic rigor and college reputation);
    - If stipulate 3.0 GPA, may choose easier courses.
  - Monthly payments for **Academic Excellence** ;
  - **Medical costs** for family in perpetuity;
  - **Real Estate** – "Use Factor": buy real estate for children, grandchildren within the trust and they "use" it tax free (operates as Family Time Share);
  - Clause to **encourage descendants to stay in marriage** while the children are minors – "vest" extra in trust;
  - Clause to **encourage descendants to get married** (wait until certain age, marry right person, etc.);
  - **Divorce protection**;
  - **Floating Spouse Clause** (in-laws): define in-law spouses as "spouse I am married to and living with";
  - Deny trust payments unless beneficiary has a **prenuptial agreement**;
  - **Beneficiary conflict clause** – if beneficiary sues, they get nothing;
  - Denial of distributions if beneficiary fails a **drug test** or **psychological treatment**;
  - **Family Bank**: Loan to Beneficiary (term insurance purchased to provide repayment);
  - Denial of distributions if beneficiary does not **participate in family meetings** re charitable giving, family investments, estate planning and trusts.

Sample Incentive Provisions for Directed Trusts (cont'd):

- **Promotion of Social Responsibility**:
  - **Successful philanthropy can reinforce family values and strengthen a family legacy**
  - **Prepare written document or transcribed videotape** illustrating charitable desires, goals, values and purpose (i.e. mission statement);
    - ✓ As part of trust or as letter of wishes
    - ✓ Get buy in from family, advisors and distribution committee
    - ✓ Education – develop a family learning plan, family/distribution committee meetings, site visits to charities, advice from other philanthropists
  - **Governance** – distribution committee made up of family members (i.e., service members and junior members; possibly hire outside charitable advisor consultants)
  - **Direct or indirect**: Require trust make distributions to **charity named** in the **trust** [or] permit **beneficiaries** to **select charities** under guidelines outline in the trust (i.e., research and community involvement)
  - **Participation**: Require beneficiary to **actively participate** in **charity** if they want distributions made
  - **Control over donations**: If want beneficiaries to have control over distributions, the trust's distribution committee directs that distributions be made to **private foundations**, **donor advised funds**, **community foundations**, **supporting foundations**, etc.
  - **Charitable donations** by family in perpetuity once dynasty trust attains a **certain FMV**:
    - ✓ The family distribution committee makes donations from the trust directly to charity, thus actively involving the family with charities and thus promoting the family values and mission statement
  - **If beneficiary fails to meet trust performance standards**, then funds divert to charity
  - **Child works for charity,** family foundation, or volunteers – Supplement Income
  - **Encourage giving**: Provide for trust to make **matching distributions** to beneficiaries equal to the percentage of charitable contributions they make each year.
  - Limited powers of **appointment**/separate shares (charitable giving option)
  - **Charity gift over**

New Approach to Family Bank Dynasty Trust Incentive Provisions –
Providing Guidelines for Trustee Discretion:

Family distribution committee makes distribution based upon following factors:

1. The ability to **live within one's means**, i.e., managing spending consistent with one's level of income;
2. The ability to **manage spending relative to income** in a manner that would be consistent with being able to save a portion of income, as needed;
3. The ability to **understand and manage credit and debt processes**, leading to avoidance of excessive debt;
4. The ability to **maintain reasonable accounting** of one's financial resources;
5. The ability to **understand and manage one's personal assets**, either using basic investment procedures and principles oneself or to delegate these actions responsibly to appropriate advisors;
6. The ability to **generate income for spending needs** if additional resources are required or desired beyond trust distributions;
7. The ability to **show initiative**, **engage in entrepreneurship**, and **demonstrate purpose in paid or unpaid work**.
8. The ability to **use of a portion of one's income and/or financial resources** to **support charitable activities** of one's choosing; and

Source: Heckerling 2011- "Use and Abuse of Incentive Trusts: Improvements and Alternatives" Jon & Eileen Gallo and James Grubman Ph.D.

Additional Approaches to Trust Administration:

- **Option #1**: **Directed Trust** – Previously discussed
- **Option #2**: **Special Purpose Entity** combined with **Directed Trust**
- **Option #3**: **Private Family Trust Company (PFTC)**

Option #2:

Special Purpose Entity (SPE) or Trust Protector Company

(i.e., Delaware, Nevada, South Dakota & Wyoming)
(Combined with Separate Investment Management LLC):

Typical South Dakota Example:

Special Purpose Entity (South Dakota LLC)

- Board of Managers
- Trust Protector
- Investment Committee
- Distribution Committee

– **Unique South Dakota SPE Statute**
– **Not a trust company**
  - **Registers with the South Dakota Division of Banking**
– **D&O, E&O Insurance**
– **More ties to South Dakota situs**
– **Answer to governance**

Directs:

- **Trust Protector**
- **Investments:**
  – Directs directed administrative trustee to hold investment management LLC
- **Distributions**:
  – As determined, usually discretionary

Directed Trust

South Dakota Trust Company-
Administrative Directed Trustee

- Directed Trust
- Administrative Trustee

Trust assets

South Dakota Investment LLC
(South Dakota Trust Company – Member)
(Family members or other – Manager)
Investment Management

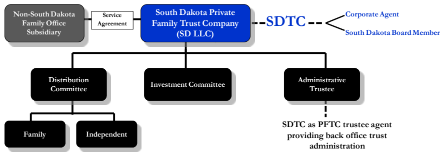
- **Trust protector**, **investment committee** and **distribution committee** are **housed** in an **LLC** **acting** as **agents or employees** of the LLC to further **tie** the **trust** to the **favorable situs state** and **reduce** their **liability** by purchasing insurance (D&O) as well as **provide** **continuity**.
- **Other states**: Delaware Trust Protector company, Nevada and Wyoming (all less formal, and case-by-case)

Option #3:

Private Family Trust Companies (PFTC) - Introduction:

- A **growing** and **popular** **trend** among **ultra wealthy** **families** is the **creation** of their **own** **Private Family Trust Company (PFTC)** to **serve** as **trustee** for their trusts:
  – Generally **LLC** authorized by state law to operate as family trust company
  – **Popular PTC states**: South Dakota, Nevada, Wyoming and New Hampshire
    - South Dakota: Industry leader for regulated family trust companies
    - SDTC is the leader in the set up, operation and administration of PFTCs
  – **Example** – South Dakota: $200k capital and $75-100k total set up costs
- **When** does a **family** **create** a **Private Family Trust Company**:
  – **Family members and advisors** are **named** as **trustees** for family's trust(s) with **personal liability** – PFTC provides D&O/E&O insurance
  – **Families experiencing issues** with **bank/institutional trustees**
  – **Allows** for a **sophisticated asset diversification** model (i.e., Yale Endowment, FOX, IPI)
  – **Illiquid assets in trust** (i.e. closely-held stock, real estate, oil & gas interests, gambling interest, etc.)
  – Provide flexibility to **not have to diversify**, i.e., ability to hold one asset in trust
  – **Governance**
  – **Privacy**
  – **SEC exemption**: Common trust funds & business trusts

Example: Typical Modern PFTC – Promoting Flexibility and Control:



Step 1: Form a SD LLC and apply to SD Division of Banking to be a PFTC

- Need office in South Dakota, one SD Board Member, and a SD Corporate Agent – SDTC sits on the board and serves the role as corporate agent i.e. providing office space to PFTC, collecting mail and answering the phone, service of process.

Step 2: South Dakota PFTC leases services from FO in another state.

Step 3: Trust administration can be done in South Dakota to benefit from South Dakota's favorable trust laws by hiring SDTC as trustee agent for PFTC [or] administration can be done in another state (interstate administration allowed) by family office and its advisors. The latter will not garner the benefits of South Dakota trust and tax laws.

Existing Trust - Change of Trust Situs:

Step 1: **Substitute current trustee** with trustee located in modern trust jurisdiction

Step 2: **Procedure**:

- **Reformation/modify** trust in court (see appendix A)

  [or]
- **Decant** from old trust to new trust in modern trust jurisdiction (see appendix A)
- **Add**:
  - **Directed Trust** provisions (distribution and investment committees)
    - Incentive provisions (promoting social & fiscal responsibility)
  - **Trust Protector**
  - **Special Purpose Entitiy**
  - **Beneficiary quiet provision**: Ability to keep the trust quiet/silent to beneficiaries and ability to waive beneficiary notice of trusts assets
- **Remove**:
  - **Mandatory** (i.e., pay all income and/or pays 1/3 principal at age 25, 1/3 at age 30 and 1/3 at age 35) and/or **support** (HEMS) **distribution provisions**
    - Add discretionary trust provisions

Two Major Types of Irrevocable Inter-Vivos (Lifetime) Trusts with Beneficiaries:

- **Third Party**: **Grantor** is **not** a **permissible beneficiary**. The only beneficiaries are family and others
  - Available in all 50 states
- **Self-Settled**: **Grantor** is **permissible beneficiary** along with family and/or others
  - Only available in 15 states with statutes:

Alaska	Nevada	South Dakota
Delaware	New Hampshire	Tennessee
Hawaii	Ohio	Utah
Mississippi	Oklahoma	Virginia
Missouri	Rhode Island	Wyoming

Please Note:

→ **Tax Neutral Domestic Asset Protection Trusts (DAPTs)** - Self-settled and included in estate

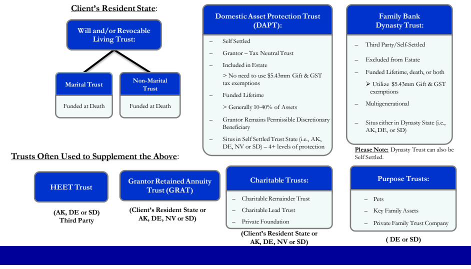
→ **Dynasty Trusts, GST, ILITs** - Either self-settled or third party, or both and excluded from estate and GST taxes

  → Possible Federal estate and GST tax issues: PLR 200944002 and IRC 2036

→ **GRAT**, **QPRT**, **HEET**: Third party

Common South Dakota Situs Estate Planning Strategy –

Separating DAPT (included in estate) from Family Bank Dynasty Trust (excluded from estate):



Dynasty Trust – Enormous Size Potential:

- **Assumptions** - $5.43 million Gift to Trust; Trust lasts 150 years and earns 3% after- tax; 46% transfer tax every 30 years
  - Three Generation GST Trust (Common Law RAP or USRAP)- $74,199,681
  - Dynastic trust (unlimited duration/perpetual or long term)- $471,216,794

Number of Years	Value of Perpetual Dynasty Trust After # Years	Three Generation Dynasty Trust (i.e., Common Law or USRAP State)
31 Years	$13,575,436	$13,575,436
61 Years	$32,951,147	$32,951,147
91 Years	$79,981,082	$79,981,082 ($36,791,298) Taxes $43,189,785
121 Years	$194,135,080	$56,609,789
151 Years	$471,216,794	$74,199,681

Generation Skipping Transfer (GST) Trust and Dynasty Trust States:

Generation Skipping Transfer (GST) Trust States		Dynasty Trust States	
Common Law Rule Against Perpetuities States (90-110 years)	**Uniform Statutory Rule Against Perpetuities (USRAP) States (90 years)**	**Term States****	**Unlimited Duration States (Listed Chronologically by Year of Statute Enactment)**
Iowa	Arkansas	Delaware*** (1995) (Real Estate 110 years)	Idaho* (1959, Pre-1986)
Mississippi	California	Alaska (2000) (1000 years) w/ LPofA	Wisconsin* (1967, Pre-1986)
New York	Connecticut	Colorado (2001) (1000 years)	South Dakota* (1983, Pre-1986)
Oklahoma	Georgia	Florida (2001) (360 years)	Delaware* (1995)
Texas	Indiana	Washington (2002) (150 years)	Alaska* (1997, 2000)
Vermont	Kansas	Wyoming (2003) (1000 years)	Arizona (1998)
	Massachusetts	Utah (2004) (1000 years)	Illinois (1998)
	Minnesota	Nevada (2005) (365 years)	Maryland (1998)
	Montana	Tennessee (2005) (360 years)	Maine (1999)
	New Mexico	Alabama (2011) (360 years)	New Jersey* (1999)
	North Dakota		Ohio (1999)
	Oregon		Rhode Island (1999)
	South Carolina		Virginia (2000)
	West Virginia	*** Generally place real estate in LLC, hence subject to unlimited duration	Missouri (2001)
			Nebraska (2002)
			Washington D.C. (2001)
			New Hampshire* (2006)
			North Carolina* (2007)
			Pennsylvania (2006)
			Michigan (2008)
			Hawaii (2010)
			Kentucky (2010)

* Eight states follow the Murphy case in whole or in part re the method for abolishing their RAP by dealing with both the required "vesting" and "timing" issues associated with the RAP. The IRS acquiesced in the Murphy case, which allows for an unlimited trust duration.

** Please note the term states do not address both the required vesting and timing issues associated with the RAP and the IRS may only recognize 90 years. No authority for the term states to arbitrarily choose a term extending the 90 year statute.

Third Party & Self-Settled Dynasty Trust Tax Savings:

- Federal Estate Taxes
- Federal Generation Skipping Taxes
- State Death Taxes
- State Income Taxes
- State Premium Taxes
- **Zero Tax Dynasty Trust** → Life Insurance (also saved federal income tax)
- **Please note**: Trust **distributions** are taxed federal and state income taxes in the resident state of the beneficiary
  - **Exception**: Life insurance (i.e., tax free policy distributions from trust)

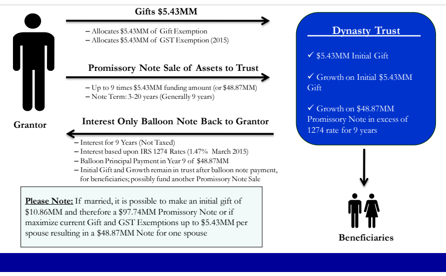
Dynasty Trust Planning/Funding Alternatives:

- **Goal**: To maximize the amount which passes free of Generation Skipping Tax (GST) (i.e. leverage the $5,430,000 GST exemption or $10,860,000 if married).
- **Solution**: Generally invest in **assets** that you expect to **grow** and **appreciate** substantially (particularly during grantor trust status):
  - Financial Assets/Investments
  - Closely-Held Stock
  - Limited Partnership Units/LLCs
  - Life Insurance
  - Personal Residence/Vacation home (for grantor and/or beneficiary)

  Additional strategies to leverage growth within Dynasty Trust:

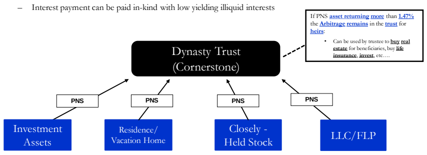
  - Promissory-Note Sale
  - Sale of a Remainder Interest (GRAT, CLAT, QPRT)
  - Other
- **Non-grantor trust status**: Consider selling selected assets in trust to save state income and capital gains taxes
  - Non-grantor trusts save state income tax and capital gains tax if in AK, DE, NV, SD, NH & WY

Promissory Note Sale –
Dynasty Trust Leveraging Strategy:



Promissory Note Sale (PNS) to Grantor Defective Dynasty Trust:

- **Fund trust** with **$5.43 million** (use Gift & GST tax exemptions)
- **Justifies PNS** of nine times $5.43 million or **$48.87 million post discount** (All PNS combined cannot exceed)
- **1.47% Interest** rate for March 2015 on **$48.87MM 9YR Note**- **$718,389 annual interest payment**
  - Annual interest payment federal and state income tax free to grantor (revenue ruling 85-13)
  - Interest payment can be paid in-kind with low yielding illiquid interests



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Planning for Family Residences or Vacation Homes with Dynasty Trusts:

- **Purchase For Child or Grandchild:**
  - Rather than purchase home outright for child or grandchild, purchase in Trust so divorce & creditor proof
  - Children or grandchildren live rent-free: "use" provision
    - Creditors?
- **Qualified Personal Residence Trust (QPRT):**
  - Typically uses too much of gift tax exemption
  - Cannot get house back out of QPRT
  - Sale of remainder interest to Dynasty Trust
- **Promissory Note Sale** of residential real estate to Dynasty Trust

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Zero Tax Dynasty Trust - Solutions for Large Insurance Premium Payments:

- $14K Per Beneficiary (Crummey Notices)
  - May Not Be Able To Buy Enough Insurance
- Gift $5,430,000 To Trust To Buy Insurance
  - Modified Endowment Contract Issue
- Loan to Trust – Pay Back From Cash Value
- Promissory-Note Sale to Defective Grantor Trust

Please See: Steve Oshins, Al King & Pierce McDowell: "Sale to a Defective Trust: A Life Insurance Technique" *Trusts & Estates*, April 1998.

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Examples:

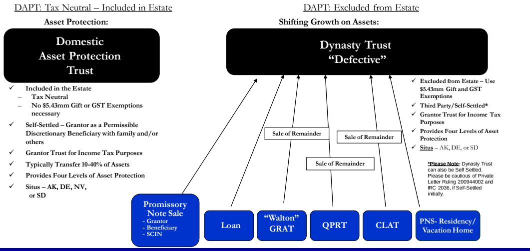
Crummey Trust	· $56K Contribution each year (assumes four beneficiaries) · Assume $20K Premium per $1 million Death Benefit · Trustee purchases $2.4 million of life insurance
Gift $5.43 million to Irrevocable Trust	· No Gift Tax · Assume assets earn 5% · Insurance policy premium of $144K can be supported · Assume $20K premium per $1 million of Death Benefit · Trust can purchase $7.2 million life insurance
Family Limited Partnership (FLP)	· Transfer $2.857 million to FLP · Assume 30% discount with FLP · Gift $2 million · Assume assets earn 5% - $200K per year · Assume $20K premium per $1 million Death Benefit · Trust can purchase $10 million policy
Promissory Note Sale to Defective Trust	· Transfer $5.43 million to Defective Trust · Sell $20 million FLP Partnership interest discounted by 30% (Actually $28.571 million) · Trust equals $30.571million · Assume 5% earnings – Interest $2.14 million · Note Sale Interest 4.63% or $926,000 · Difference earnings $2,140,000 - $926,000= $1,214,000 · Assume $20K premium per $1 million Death Benefit · Trust can purchase $60.7 million policy
Split Dollar	· Problems?

Popular and Powerful Modern Trust Combination:

- ✓ Will/Revocable Living Trust
- ✓ Education Planning and Trusts
- ✓ Irrevocable Insurance Trust
- ✓ Private Foundation and Charitable Trusts
- ✓ Advanced Trust Planning – See Below:

DAPT: Tax Neutral – Included in Estate

DAPT: Excluded from Estate



Self-Settled Domestic Asset Protection Trust (DAPT):

- **General Definition**:
  - **Irrevocable trust**
  - **Properly established** and **administered** under the **laws** of one of the **DAPT jurisdictions** (i.e., 15 states)
  - Allow **settlor** to be **permissible discretionary beneficiary** of the trust
    - **No preexisting understanding** between settlor and trustee
  - **Protects trust assets** from settlor's creditors, if structured properly
    - **Creditors** of settlor **unable** to **access** trust **property interest** as defined by state law – Unlike exception creditors
  - Either **established** to be **excluded** from or **included** in the estate of settlor [or] **both**
  - **Assets not transferred fraudulently** (no fraudulent conveyance)

Self-Settled Trust States:
Alaska
Delaware
Hawaii
Mississippi
Missouri
Nevada
New Hampshire
Ohio
Oklahoma
Rhode Island
South Dakota
Tennessee
Utah
Virginia
Wyoming

Wealth Preservation/ Domestic Asset Protection Trusts (DAPT)

(Self-Settled Tax Neutral DAPT and Self-Settled DAPT Dynasty Trust):

Four Key Levels of Protection:

1. **Trust:**
   - A. **Self-settled** trust statute only in 15 states - If **properly structured** and **administered**, creditors cannot reach trust assets *except*:
     - — **Fraudulent conveyance**/**Discovery period**
     - — **Exception creditors**: If the creditor fits within the type/class of creditor proscribed by the statute, then that creditor may be able to reach the self-settled trust's assets
   - B. **Third Party Trusts**: Available in all states
2. **DAPT property placed in LLC titled** to the **trust** (also third party trusts)
   - — **Charging order protection** as the sole and **exclusive remedy**
     - ▪ **No method** to **force** a **distribution** (waiting game)
     - ▪ **Only right** to **distribution** when and **if** one is **made**
     - ▪ **Rather than** allowing creditor to **attach** all LLC or LP rights
   - — **Sole member protection** as well
   - — Powerful **AK**, **DE**, **NV** and **SD** statutes
3. **Discretionary interest protection based upon Restatement Second** (also third party trusts):
   - — Discretionary interest in trust is **not property interest** or **enforceable right**
     - ▪ **Mere expectancy**
     - ▪ Also applies to **limited power of appointments** and **remainder interests**
   - — **State statutes**: **AK**, **DE**, **NV**, and **SD**
4. **Spendthrift** protection (available in all DAPT states) – Also third party trusts

Self-Settled Trust States:
Alaska
Delaware
Hawaii
Mississippi
Missouri
Nevada
New Hampshire
Ohio
Oklahoma
Rhode Island
South Dakota
Tennessee
Utah
Virginia
Wyoming

Additional protection:

- **Reimbursement of legal fees** if sue trust and unsuccessful
- **Privacy**:
  - – **Litigation**
  - – **Reformation/modification**
  - – **Beneficiary notice**: Can keep trust secret from beneficiary

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Other Key Types of Trusts to Shift Growth after Utilizing Most of $5.43m Gift & GST Tax Exemptions:

- **Walton Grantor Retained Annuity Trust** (see appendix B):
  - – Transfer remainder to Dynasty Trust
  - – Nominal gift
- **Non-Grantor Charitable Lead Trust (Kennedy Trust)** (see appendix C):
  - – Transfer remainder to Dynasty Trust
  - – Nominal gift
- **Health & Education Exclusion Trust (HEET)** (see appendix D):
  - – Utilize crummey gifts
  - – Perpetual deferral of GST taxes without allocation of GST exemption
  - – Always charitable beneficiary so no taxable termination for GST purposes
  - – Distributions directly provide for the education and health services of children, grandchildren, great grandchildren, etc.
- **Purpose Trust**:
  - – Separate Dynasty Trust
  - – Cares for an asset/property
  - – No beneficiaries

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"Purpose Trust" Statute

(No Beneficiaries – Protects an Asset(s)):

- Trend: Domestic versus offshore non-charitable purpose trusts
- Definition:
  - – Trust that **exists** for stated (non-charitable) **purpose**
  - – Established to **care** for "**something**" **rather than "someone"**
  - – No beneficiaries
- Trust Enforcer:
  - – Appointed to ensure the trustees carrying out their obligations in fulfilling the trust's purpose
    - • Ability to go to court
  - – Also **Trust Protector**: Amend trust if needed in event circumstances change
    - • May reform/modify to beneficiary trust in the future
    - • May combine Trust Enforcer and Trust Protector functions
    - • South Dakota: First domestic Trust Protector statute (top ranked)
- Taxes: Typically excluded from estate as completed gift trusts (either grantor or non-grantor)
  - – Also pour over revocable purpose trust with dynasty provisions

Please note: "Trusts without Beneficiaries – What is the Purpose?"" by Al W. King III, *Trusts & Estates* magazine, Feb 2015

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"Purpose Trust" Statute
(No Beneficiaries – Protects an Asset(s)):

- **Examples of purpose trust assets**:
  - Pet care (i.e., dogs, cats, horses, birds, tortoises, snakes, etc.)
    - Including offspring
  - Maintenance of grave sites (honorary)
    - Also supporting religious ceremonies (anniversaries, etc.)
  - Cryogenics – maintain frozen body
  - Maintenance of family property (i.e., antiques, cars, jewelry, memorabilia, etc.)
  - Maintenance of an art collection
  - Maintain family homes (residence and vacation)
  - Long term maintenance of building, property or land
  - Maintain business interests
  - Royalties
  - Digital assets
  - Provide for philanthropic purpose not qualifying for a charitable deduction
  - Maintain Private Family Trust Companies

***Please see**: "Trusts for Purposes: Policy, Ambiguity, and Anomaly in the Uniform Laws" by Adam J. Hirsch, Florida State University Law Review, Vol.26:913

"A Trust without beneficiaries: What is the Purpose?"
South Dakota Top Rated Non-Charitable "Purpose Trust" Statute (Cont'd):

- **Term and Duration**: **Delaware** & **South Dakota** are the only two states with unique non-charitable Purpose Trust Dynasty (perpetual) RAP statutes*
  - Separate Purpose Trust RAP statute due to the unique nature of these trusts without beneficiaries
  - Most states 21 year term
  - Approximately 10 states GST, long term or unlimited duration (see Delaware, New Hampshire, South Dakota and Wyoming for broadest statute)

***Please see**: "Trusts for Purposes: Policy, Ambiguity, and Anomaly in the Uniform Laws" by Adam J. Hirsch, Florida State University Law Review, Vol.26:913

Zero Tax Dynasty Trust Solution – Private Placement Life Insurance (PPLI):

- PPLI is a **variable universal life insurance policy** that provides **cash value appreciation** based on a segregated investment account and a life insurance benefit
  - Designed to **maximize savings** and **minimize the death benefit**
  - Usually, the investment account uses in tax-inefficient hedge fund strategies
- PPLI **cash values** may be **directed** by **client's chosen investment advisor**
- **Cash values accumulate income** and **capital gain tax free**
- **Cash values** are available **tax free** using **withdrawals** of cost basis (total premiums paid) and very low cost loans
- At the insured's death, the **death benefit** is payable **tax free**. Therefore all investment gains, dividends and interest are compounded without income tax
- Assuming any reasonable lifetime investment return, the **costs of the PPLI** will be **much less** than the **taxes** that **otherwise** would have been **paid**
- The PPLI **cash values** are as **liquid** as the **underlying investments**
  - Allow **in-kind distributions**
- The **cash values** are in a **separate account** and are not subject to the general creditors of the life insurance company
- The **investment advisor** may be **substituted** for another advisor in the future
- **Low state premium taxes**

Insurance Taxes:

1. U.S. Insurance Company / Off Shore Operation (953(d))
   - DAC Tax
   - No Premium Tax
2. International Insurance Company (non – 953(d))
   - 1% Fed Excise Tax
   - Have to Travel to Country
3. U.S. Company
   - DAC Tax
   - State Premium Tax

U.S. State Premium Tax Rates:

Alaska	10 bpts.
Arizona	200 bpts.
California	235 bpts.
Colorado	200 bpts.
Connecticut	175 bpts.
Delaware	200 bpts.
Florida	175 bpts.
Georgia	225 bpts.
Hawaii	275 bpts.
Illinois	50 bpts.
Massachusetts	200 bpts.
Minnesota	200 bpts.
Nevada	350 bpts.
New Hampshire	125 bpts.
New Jersey	210 bpts.
New York	200 bpts.
North Dakota	200 bpts.
Ohio	140 bpts.
Pennsylvania	200 bpts.
South Dakota	8 bpts. (Lowest)
Washington	200 bpts.
Wyoming	75 bpts.

Ways to take advantage of a low premium tax state:

1. Establish trust in low premium tax state with one of state's trustee – Purchase policy

[or]

2. Establish an LLC with an LLC agent in the state – Purchase policy

What if existing trust with situs outside of low premium tax state?:

1. Set up an LLC with an LLC agent in the state to purchase the policy

[and]

2. Allocate the LLC units to trust with situs outside of the low premium tax state

Trend with International Families Looking for U.S. Trust Situs and a U.S. Trustee?

Once a No-No; Now a Commonplace Desire:

- Protection of property
  - Resident country
  - Forced heirship
- Blacklisting of offshore jurisdictions by resident country
  - Legislation or regulations that prescribe negative treatment for certain transactions that involve specific listed foreign jurisdictions.
  - For the U.S., the OECD defined features of a tax haven as: no or low taxes, lack of effective exchange of information, lack of transparency, and no requirement of substantial activity.
- Secrecy wall falling apart – Globally
- Improved U.S. trust laws: Directed Trust, Trust Protector, Reformations, etc.
- Favorable taxes
- U.S. property:
  - Real estate
  - Insurance
  - Investments
  - Business interests
- Foreign family members:
  - Foreign students (stay in the U.S.)
  - Foreigners obtain green cards
  - Foreign citizens marry U.S. citizens

Domestic Trusts for International Families

- **Foreign Grantor Trust**:
  - U.S. trustee
  - Holding offshore entity
  - No U.S. assets/no U.S. taxes
- **NRA Dynasty Trust**:
  - Unlimited Gift & GST exemptions
  - For U.S. citizen or green card children or grandchildren
- **Pour Over Dynasty Trust**:
  - From non-grantor foreign trust
  - Saves UNI, accumulated earnings tax
  - No burdensome tax reporting
- **Pre-immigration trust**:
  - Self-settled
  - NRA funds before moving to the U.S.
  - Tax and asset protection advantages

Appendix A:
Existing Trust Change of Situs -Reformation and/or Modification:

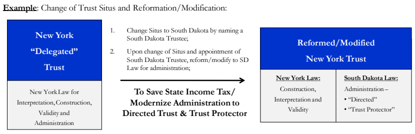
- **Modification**:
  - "Carry out the material purpose of the trust had the grantor known"
- **Reformation**:
  - Mistake of law or fact
  - "What was actually intended"

Appendix A:
Change of Trust Situs: Reformation/Modification of Existing Irrevocable Delegated Trust to a Modern Directed Irrevocable Trust:

Reform/Modify Existing Trust after change of trust situs:

- Generally **keeps original state law** for **construction**, **interpretation** and **validity** purposes
- Reformation/modification cannot conflict with the settlor's "**material purpose**" or "**probable intention**"
- Reform/modify **administrative provisions** or **mistake of law or fact** to **favorable trust jurisdiction's law**
  - Once trust situs is moved to favorable state with the appointment of a trustee within that state
- **Example**: Reformation/Modification **process is generally quick** and **inexpensive** in South Dakota (2 days-2 weeks and $3,000)
- **Grandfathered Generation-Skipping Trusts** – OK (cannot extend duration)
- **Privacy** (varies by state) – South Dakota – Total seal perpetuity
  - Most other states "open to the public"
- **Virtual Representation:** Unborn beneficiaries represented

Example: Change of Trust Situs and Reformation/Modification:



Appendix A:
Additional Reasons Trustees or Beneficiaries Might Wish to Reform or Modify an Existing Irrevocable Delegated Trust:

Add Directed Trust structure:

- **Modernize** an outdated **trust agreement**
  - **Change** the **administrative terms** of the **trust** to **add directed trust structure** with **investment** and **distribution committees**/advisors
  - **Add trust protector**

Additional reasons:

- **Save** state **income taxes**
- **Add flexibility regarding appointment** of **trustees**
- **Change** the **governing law** applicable to the trust
- **Improve** the trust's **governance structure**
- **Improve tax provisions**
- **Change term/dispositive provisions**: Tax and asset protection advantages
  - **Change term:** i.e., remove 1/3 of principal at age 25, 1/3 at age 30, and 1/3 at age 35 and make discretionary for asset protection purposes (family as distribution committee directs administrative trustee as to distribution)
  - **Cannot change** trust **duration** (i.e., RAP)

Appendix A:

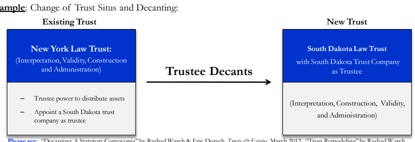
Change of Trust Situs -

Decanting from an Existing Irrevocable Delegated Trust to a New Irrevocable Directed Trust:

Decanting:

- If trustee has both **statutory authority** and appropriate **discretionary power** in the trust document to distribute assets:
  - Change trust situs
  - Generally appoint a new trustee who then decants
  - Distribute from old trust to new trust
  - Generation-Skipping Trusts OK, but caution and cannot extend the duration beyond the existing duration.

Example: Change of Trust Situs and Decanting:



Please see: "Decanting: A Statutory Cornucopia" by Rashad Wareh & Eric Dorsch, *Trusts & Estates*, March 2012. "Trust Remodeling" by Rashad Wareh, *Trusts & Estates*, August 2007.

Appendix A:

Summary of Some of the More Popular Reasons to Decant are as follows:

(Most are also reasons for Reformation/Modification/Restatement)

1. Amending **administrative provisions** of a trust (adding Directed Trust provisions and/or Trust Protector)
2. Modifying **powers of appointment**
3. Adding **spendthrift** protections
4. Adding (or removing) **grantor trust provisions**
5. Qualifying a trust as a qualified **subchapter S trust**, a QDOT, an IRA conduit trust, etc.
6. **Combining** trusts for greater efficiencies
7. **Separating** trusts to allow investment philosophies to be "fine tuned" for beneficiaries
8. **Segregating** higher risk assets
9. Avoiding state and local **taxes**
10. **Reducing distribution rights** for Medicaid eligibility planning purposes
11. **Amending trustee succession** provisions, removing or replacing a trustee
12. **Extending** the term of a trust
13. Changing the **governing law** provisions of a trust
14. Correcting a **scrivener's error** or ambiguity
15. Decanting a beneficiary's share of a trust to a **supplemental needs trust** in order to preserve or obtain eligibility for public benefits
16. **Combing**, segregating or otherwise improving **irrevocable life insurance trusts (ILITs)** and **credit shelter trusts**
17. **Dynasty trusts**, although less common, are also excellent candidates for decanting

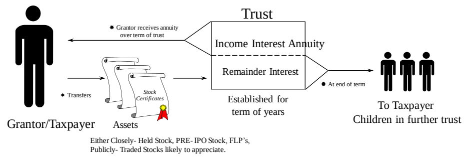
Source: "Decanting and Its Alternatives: Remodeling and Revamping Irrevocable Trusts" by Thomas E. Simmons South Dakota Law Review, 2010.

Appendix B:

Grantor Retained Annuity Trust (GRATs):

- Asset transferred to trust
- Provides annuity to grantor and/or family members for a specified period of time
- At end of specified period, any remaining trust assets pass to children or remain in trust for spouse and/or children
  - Children sell remainder interest in GRAT to Dynasty Trust in order to benefit themselves and all other descendants
  - Spend thrift clause must be drafted so as to allow for sale of remainder interest
- If grantor dies during specified term, substantial amount of assets would be included in his/her estate
  - If survives, out of his/her estate
  - Sale of contingent reversion?
  - Buy term insurance to hedge against grantor's death
- No additional contribution allowed to GRAT

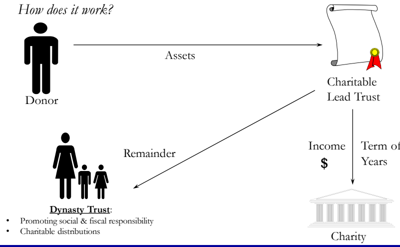
Appendix B -
Grantor Retained Annuity Trust (GRAT):



Gift tax on remainder Interest to children is due when trust is created by reflects discounted value of assets.
Trust is "Grantor - defective" which means Grantor will owe income tax on income earned resulting in an additional estate tax savings.

Appendix C:
Charitable Lead Trust (CLT) Combined with a Dynasty Trust:

How does it work?



Appendix C:
Charitable Lead Annuity Trust (CLAT):

- **Donor** has **no immediate need** for **more income**
- **Forego income** to **realize capital appreciation** via low gift/estate taxes
- **No limitation** on **number of years** (unlike CRT)
- **No minimum payout** (unlike CRT)
- **2 types**:
  - -Grantor Lead Trust (income tax deduction)
    (trust income imputed to donor) – Consider PPLI
  - -Non-Grantor Lead Trust (estate and gift tax benefits)
- **Sale** of Charitable Lead Annuity Trust (CLAT) **remainder** to **Dynasty Trust**

Appendix C -

Testamentary Charitable Lead Trust (Kennedy Trust) – Example:

- Testamentary Annuity Lead Trust
  - Sample Illustration
    - 8% Lead Trust

Original Property Value $200MM → Trust Principal $200MM → Principal to Family $203,699,708

1. Gift assets to lead trust, charitable estate tax deduction of $198,180,130. Deduction reduces taxable estate from $200 million to $1,819,870.

2. Income of 8% to charity for 24 years. No income tax. First year income of $16 million. Total charitable payments in 24 years is $384 million.

3. After term of years, trust distributions to Dynasty Trust of $203 million (net of GST) paid upon termination.

Appendix D:

Charitable Planning with HEET Trust (Health & Education Trusts):

- Provides perpetual deferral of GST taxes without allocation of GST exemption.
- HEET trust and distributions avoid GST tax.
- Always has a charitable beneficiary so no taxable termination for GST purposes.
  - ➢ Taxable termination occurs when trust loses its last non-skip beneficiary and only skip persons have interest in trust
  - ➢ Charity is always non-skip person
- Charities interest must be sufficiently significant (Anti Abuse Rule)
  - – Floor - % income currently
  - – Avoid separate share issue – "Indefinite" right to income and principal initially, then "ascertainable" right after children die.
- Distributions made directly to providers of education and health services.
- Grantor Trust – Income, deduction and credits passed to grantor (§ 642 (c))

Appendix D:

HEET Trust – "Qualified Transfers"

- Education → Tuition to qualified domestic or foreign institution.
  - → Not – books, supplies, room & board
- Health & Medical → Treasury Reg. 25-2603-6(b)(3): "Any person who provides medical care [and] medical expenses arising from such medical care."
  - – Diagnosis, cure, mitigation and treatment or prevention of disease
  - – Hospital services, nursing care, medical laboratory, surgical, dental and other diagnostic and healing services
  - – X-rays, medicine, drugs (both prescription and non-prescription), artificial teeth or limbs and ambulance.
  - – Transportation and lodging for medical care
  - – Long term care insurance and medical insurance
  - – Family office:
    - Medical insurance
    - Employees?

Appendix D: **HEET Trust** (cont'd):

- Charity
  - Trust can designate one or more charities to receive
  - Trustee Authorized to receive each year
  - Caution – Private Foundation
    - Segregate funds
    - Amend by – laws so grantor can't participate in decisions regarding these funds.
      - → Otherwise property distributed from trust to foundation included in grantor's estate

- Fund HEET
  - Annual exclusion gifts
  - Taxable gifts

→ C, GC, GGC all beneficiaries so Crummey withdrawal powers granted to each. (no Cristofani problem).

Appendix D:
Education Planning - HEET Trust (Health and Education Exclusion Trust):

- Section 2503 (e): Excludes from gift tax tuition payments made directly to an educational institution on behalf of an individual.
  - → Same with medical

- Section 2642 (c) (3): excludes from GST gifts of tuition and medical payments on behalf of a grandchild
  - → must be non-taxable under section 2503 (e)

- Payments from a non-GST exempt trust on behalf of a "skip person" (i.e. two or more generations below grantor) made directly to an education institution are not considered GST transfers.
  - → This create trust for C,GC,GGC without allocating GST exemption
  - → Unlimited Duration – South Dakota
  - → Section 2611(b)(1) and LTR RUING 9823006 (6/5/98)

- When Last trust beneficiary who is not "skip person" dies
  - Trust becomes skip person
  - Taxable termination occurs
  - → Charity as beneficiary prevents termination
  - → Section 2652 (c)(2) – interest disregarded if used to postpone or avoid GST
  - → To be safe – Pay Charity 10% FMV annually

Appendix D:
A client whose estate exceeds his/her GST exemption can make a residual bequest to a HEET Trust: