

John Andrews
DEPC March 3, 2022 Presentation
Modern Trusts

1. Traditional Trusts

Purpose - Management of Assets

Features Often a full service Corporate Trustee

Children beneficiaries

Termination at certain age

2. Modern Trusts

Purposes – Asset Protection, Transfer Taxes, Management of Assets

Features – Irrevocable and last for lifetime

Flexibility

3. Intentionally Defective Grantor Trust ("IDGT")

Purpose – Ignore existence of trust for income tax purposes, grantor pays taxes on trust income, amounts to tax free gift to trust

Not ignored for estate tax purposes

Benefit

Sale of Assets disregarded

Cash or guarantee for 10% of purchase price

Swap Power to achieve grantor status

4. Section 678 Trust / Beneficiary Defective Trust ("BDT")

Structure - \$5,000 gift from third party

Beneficiary is Trustee

Buy assets from beneficiary with promissory notes

Purpose – avoid estate inclusion of business opportunity or appreciating assets

Benefits – Realization of profit outside of taxable estate

Retention of control and benefit of assets

Asset protection

Sale of assets disregarded

Withdrawal Power over all gifts to achieve Grantor status

Special Power of Appointment – control over disposition of assets on death

5. Spousal Lifetime Access Trust ("SLAT")

Purpose – Use of transfer tax exemption

Typical structure – Spouses establish trust for each other and gift assets to trusts

Benefit – Asset Protection

Estate exclusion

Indirect access to assets

Gifts of discounted assets such as limited partner interests in Family Limited Partnership

Non-reciprocal Trusts – Significant difference in trust terms, assets, trustees and beneficiaries

Trust for one spouse only for use of Estate Exemption

Special Power of Appointment – Flexibility to add beneficiaries from a class including Grantor. Avoid implied agreement to add Grantor

6. Domestic Asset Protection Trust ("DAPT")

Traditional effects of self-settled trust: No asset protection, no exclusion from taxable estate

DAPT States – Nevada, Delaware, Alaska and 16 others

Chapter 166 of Nevada Revised Civil Statutes known as the Spendthrift Trust Act of Nevada

Section 166.015 provides that if Grantor is a beneficiary, Trustee must be either individual resident of Nevada or a trust company or bank with trust powers with an office in Nevada, and all or part of trust administration performed in Nevada

Section 166.040 requires that for a trust for Grantor's benefit to be not subject to creditors or Grantor, trust must:

- (1) Be irrevocable
- (2) Not require distributions to Grantor
- (3) Not be intended to hinder, delay or defraud known creditors
- (4) Not allow Grantor to make distributions to himself or herself without the consent of another person

Self-settled does not cause loss of asset protection, or loss of estate exclusion so long as no powers retained under IRC Section 2036 or 2038

Typical Structure –

Corporate Trustee in DAPT state acts as Distribution Trustee and Administrative Trustee

Investment Trustee – Client and/or family members

Reduced trustee costs compared to full service

Reduced liability exposure for family members

Useful for single persons to use exemption, or married couple wanting more access than SLAT

Assets can be owned by LLC formed in state of trust situs

Grantor or family members can be compensated for services rendered to LLC

Issues with effectiveness of trust for non-residents of DAPT state

Possible use of SLAT for one spouse and DAPT for other, differentiation

7. Special Power of Appointment Trust

Can form in any state. Grant an individual acting in a non-fiduciary capacity authority to direct the Trustee to make distributions or loans to the Grantor

Trustee has no discretion to add the grantor as a beneficiary

Avoid implied agreement with appointer to appoint the Grantor

Should avoid self-settled trust finding, protect assets and not cause estate inclusion.

8. Delegated Trusts

Permitted in all states

Delegation of powers to agent is authorized in Section 113.018 of Texas Property Code

Trustee authority to delegate duties, usually investments, increases liability and cost to Trustee to vet and monitor the company managing the investments

Under Section 113.018(d), Trustee is liable to the trust or beneficiaries for the actions of the agent

9. Directed Trusts

Allowed in DAPT states and in Texas under Texas Property Code 114.031, adopted in 2015

Allows non-Trustee or committee to direct the Trustee with respect to investments or distributions

Results in lower cost of Trustee and less liability exposure of family members.

10. Trust Protector

Person other than Grantor or beneficiaries appointed for protection of Trust

Developed in offshore trusts to give some control over offshore trustee

Authorized in Texas Property Code Section 114.0031, adopted in 2019

Powers – Amend Trust

Terminate Trust

Change Trustees

Change Trust situs

Other powers

Provide for election and succession

Issues as to Fiduciary status, in Texas Section 114.0031 characterizes the protector as a fiduciary unless the protector's authority is limited to removing and appointing trustees or other advisors or protectors and the protector does not exercise the power to appoint himself or herself

11. Retirement Benefits Accumulation Provision

SECURE Act of 2020

Avoid full distribution of trust assets from IRA to non-spouse within 10 years

12. Modification of Existing Trusts

Amendment by Grantor and beneficiaries, not a revocation. If the Grantor is alive and all of the beneficiaries consent, a Texas trust may be modified or terminated. Musick v. Reynolds, 798 S.W.2d 626 (Tex. Civ. App. – Eastland 1990), (no writ); Becknal v. Atwood, 518 S.W.2d 593 (Texas Civil App. – Amarillo 1975), (no writ); and Sayers v. Baker, 171 S.W.2d 547 (Texas Civ. App. – Eastland 1943), (no writ)

Judicial Modification, authorized under Section 112.054 of Texas Property Code
expensive and privacy concerns

Texas trusts can be modified by the Court under any of the following circumstances:

- (1) Purposes of trust have been fulfilled or have become impossible to fulfill;
- (2) Unforeseen circumstances require order to further purposes of trust;
- (3) Necessary to prevent waste or impairment of administration;
- (4) Necessary or appropriate to achieve Grantor's tax objectives;
- (5) Continuance of trust not necessary to achieve any material purpose and distribution bequest or deemed to consent; or
- (6) Order is not inconsistent with a material purpose of the trust and beneficiaries consent or deemed to consent

13. Merger of new and old trusts

Section 112.057(c) of the Texas Property Code permits a trustee to combine two or more trusts into a single trust "if the result does not impair the right of any beneficiary or adversely affect achievement of the purposes of one of the separate trusts." Notice of a proposed combination must be given to the beneficiaries at least 30 days before the effective date, and the beneficiaries may waive the notice.

14. Sale of assets from old trust to new trust

Often used for life insurance trusts because of three year rule

15. Decanting of old trust to new trust

Section 112.072 of the Texas Property Code adopted in 2013, permits a Trustee with full discretion to distribute principal, to distribute all or part of the principal for another trust benefiting one or more than one beneficiary of the first trust. Section 112.073 protects a trustee with limited discretion to distribute principal (such as most trustees whose

discretion is limited to making distribution for health, education, maintenance and support) to distribute all or part of the principal to a second trust so long as the current and remainder beneficiaries and powers of appointment do not change. At least 30 days notice of the proposed modification must be given to the beneficiaries unless waived. The trustee is authorized to act "in good faith, in accordance with the terms and purposes of the trust, and in the interest of the beneficiaries."

16. Gift Tax Issue

Possible deemed gift if interests of beneficiaries change

17. Long-Term / Perpetual Trusts

Traditional Rule Against Perpetuities - Lives in being at the time of trust creation plus 21 years

Many states now either permit perpetual trust or have longer terms

Texas adopted 300 year term in 2021 in Section 112.036 of the Texas Property Code

Effective for trusts that become irrevocable on or after September 1, 2021

Also effective for trust before then if trust instrument is amended to say it is subject to Section 112.036

The statute prohibits restricting the sale of real estate beyond 100 years, but unclear if it applies to an LLC that owns real estate