

IMPORTANT ISSUES IN MODERN TRUST DESIGN

Presented to:

MONTGOMERY COUNTY ESTATE PLANNING COUNCIL OF PA

May 17, 2021

Lawrence J. Macklin

Managing Director

Wealth Strategist

Bank of America Private Bank

410-547-4518

Lawrence.Macklin@BofA.com



DISCLOSURE

IMPORTANT: This presentation is designed to provide general information about ideas and strategies. It is for discussion purposes only since the availability and effectiveness of any strategy are dependent upon your individual facts and circumstances. Clients should always consult with their independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

Neither Bank of America Private Bank nor any of its affiliates or advisors provide legal, tax or accounting advice. Clients should consult with their legal and/or tax advisors before making any financial decisions.

Bank of America Private Bank operates through Bank of America, N.A., and other subsidiaries of Bank of America Corporation. Bank of America, N.A., Member FDIC.

© 2021 Bank of America Corporation. All rights reserved. | 0518LMA |



Introduction

Dynasty Trusts Increasing in Popularity

- Virtually All States Have Modified Common Law RAP
 - 20 PA Cons Stat § 6104, generally eliminated as of 2007
- Most Modifications Enacted About 20 Years Ago
- Created for Children, GCs, and Further Descendants
- Often Funded by Leveraging the Grantor's Generation Skipping Transfer (GST) Tax Exemption
 - \$11.7 Million in 2021
 - Additional Value via Other Planning Techniques
 - Assets Grow Avoiding Transfer Tax Forever



Flexibility For The Long-Term

- Trust May Last for Several Decades or Several Generations
- Must Be Able to Address Numerous Unforeseeable Events that Will Occur With Respect to:
 - Assets
 - Beneficiaries
 - World At Large
- These Trusts Should Not Be Treated Like a Commodity



Building Flexibility into Trusts

- Trustee Appointment and Removal Provisions
 - Avoid Fixed Trustee Lists
 - Empower Client, Spouse, Beneficiaries, and Others
 - Give Power to Specify Terms and Conditions
 - Give Power to Specify Roles and Power Limits
 - Consider Qualifications (Family Exceptions?)
 - Require Independent or Corporate Trustee?



Building Flexibility into Trusts

- Beneficiary as a Co-Trustee (at certain age)
 - Distributions limited to HEMS (without a co-trustee)
 - Power to Appoint Independent Trustee
 - Can Be Appointed as Needed for Discretionary Distributions
 - Not a Current or Future Beneficiary
 - Not Related or Subordinate (Section 672(c))
 - Administrative Only Co-Trustee
 - Protects “Friends and Family” Trustees by keeping accurate records, filing returns and documents, preparing required accountings, etc.
 - Other typical duties include maintaining custody of assets, and maintaining an office for trust business
 - Creating sufficient nexus to satisfy the desired state law



Building Flexibility into Trusts

- Investment Trustee (or Advisor)
 - Grantor as Investment Trustee or Advisor
 - Will Not Cause Estate Tax Inclusion
 - Should Exclude:
 - Power to Vote Controlled Company Stock
 - “Incidents of Ownership” over Life Insurance
 - Directed Trusts (Investment or Distribution Advisors)
 - Clarify the Requirement to Take Direction (Limiting Trustee’s Discretion)
 - Take Direction From Whom



Building Flexibility into Trusts

- Trust Protectors
 - Generally Limited in Scope
 - Power to Amend Administrative Provisions
 - Scrivener Errors
 - Facilitate Administration (Grantor Intent)
 - Adjust for Changes in Tax Code
 - Power Related to Investments or Distributions
 - Fiduciary Standards/Duties?



Building Flexibility into Trusts

- Limited (or Special) Powers of Appointment
 - Liberal Use of LPOAs
 - Spouse
 - Beneficiaries
 - Trusted (Non-Beneficiary) Third Parties
 - Allow Exercise in Favor of Another Trust Reserving Same LPOA
 - Allow for Exercise Outright, In Trust, and With Additional POAs
 - Allow for Partial Exercise and for Property Later Added



Building Flexibility into Trusts

- **Contingent General Powers of Appointment**
 - Consider If Estate Tax is Less Than or Equal to GST Tax
 - Make Sure to Consider State Estate Tax (Combined with Federal May Exceed GST)
 - To Use a Beneficiary's Estate Tax Exemption Amount (including State)
 - For Basis Adjustment (Step Up)
 - Limit to Only Appreciated Property
 - Limit to the Extent Does Not Cause Estate Tax
 - Make Contingency based on Default Distributions (Ignoring LPOAs)
 - Give Trustee Power to Grant or Remove a GPOA, Only at Powerholder's Request
 - Consider Only Including the Creditors of the Estate, not:
 - Powerholder
 - Estate of Powerholder
 - Creditors of Powerholder



Building Flexibility into Trusts

- **Separate Trusts vs. Pot Trusts**
 - Pot Trusts are Practical and Sensible
 - To Limit Management to One Investment Portfolio
 - Only One Tax Return Filing Required
 - When Beneficiaries are Young (College or Younger)
 - Allows for Unequal Distributions
 - Separate Trusts Make Sense
 - When Beneficiaries are Older (Youngest Child Over College Age)
 - Avoids Judgement by and Conflict with Siblings
 - Separate Lives, Assets, Families, Incomes, Needs, Spending Habits, Risk Tolerance, etc.
 - Should not Wait Until Older Generation is Deceased
 - Give Trustee Discretion to Terminate and Divide Early



Building Flexibility into Trusts

- Discretionary Distributions
 - Trustee Should Have Power to Distribute (or Withhold)
 - In “Sole and Absolute Discretion”
 - “Equally or Unequally”
 - With or Without Considering the Beneficiary’s Financial Resources
 - “To or For The Benefit Of” the Beneficiary (Decanting?)
 - Advancement Provisions?
 - Give Authority (Not Direction) for Certain Distributions
 - Add Guidance (with Examples)
 - Exclude for Health Care or Education?
 - Exclude for Distributions While Minor?
 - Could Add Comfort to Trustee for Larger Distributions from Pot Trust



Building Flexibility into Trusts

- Annual Gift Exclusion Withdrawal Rights
 - Donor Should Have Power to Limit or Increase
 - Amounts Subject to Withdrawal
 - Beneficiaries Entitled to Withdrawal
 - “Addition” Triggering Withdrawal Rights Should Be Defined
 - From Limited Donors
 - Non-Testamentary



Trustee Guidance

- Versus Incentive Provisions
 - Simple In Concept But Could Cause Unintended Results
 - For Example – Matching Income
 - Retirement Age Beneficiary
 - Stay at Home Parent
 - Volunteer Work
 - Lower Pay (Teacher) or Altruistic Professions (Nurse)
 - Disabilities – Mental or Physical
 - Applicable During Full-Time Graduate Studies?
 - Similar Issues for Lifestyle Requirements
 - Submitting to Drug Tests
 - Finishing College (Attending Ivy League School?)
 - Requiring Prenuptial



Trustee Guidance

- Guidelines Not Mandates
 - Use Non-Binding Examples and Lists to Encourage/Discourage Behaviors
 - Pursue an Education Through _____
 - Law-Abiding Member of Society
 - Productive Member of Society - Positive Contributions to Community/Family
 - Employment Creating Self-Sufficiency
 - Avoid Wasteful Spending/Handle Money Intelligently
 - Contribute Time and/or Money to Charity
 - Consideration Toward Others
 - Etc.



Other Important Additions

- Conflicts of Interest Waiver – Corporate Trustee
 - Investments by Affiliates
 - Insurance Brokerage Affiliates
- Compensation of Trustees
- Paid Third Party Services
 - Authorize Payment In Addition To Trustee Compensation



Other Important Additions

- **Governing Law – Change of Situs**
 - Potential Savings of State Income Taxes
 - Possibly for More Favorable Trust Laws
 - E.g., Change of Perpetuities Period
 - Consider Effect to GST Exemption
 - Avoid Tying Governing Law to Situs
- **Retirement Plans**
 - Conduit Trusts Should be Modified
 - Consider Paying to Accumulation Trusts
- **Definitions (e.g., Health, Support, and Education)**



Other Important Additions

- Portability Election
- Use of Residence by Beneficiary
 - One or More Residences
 - Rent Free? Include Taxes, Insurance, Maintenance and Repairs?
 - Include Furnishings
 - Extend to Beneficiary's Family or Guardian
 - Qualifying Marital Trust – Only Spousal Use for Less than FMV



Other Important Additions

- Consider Divorce
 - Applicable to Grantor and all Grantor's Descendants
 - As Beneficiaries, Trustees, Powerholders
- Consider Descendants Born Out of Wedlock
 - Use Definition
 - Couples May Not Marry/Marriage After Birth of Child
 - Adoption Issues (Age When Adopted)
 - Parental Written Acknowledgement of Child
- Child Born After Trust Created for Descendants



Other Important Additions

- Trustee Incapacity
 - Deemed Resignation
 - Incapacity Definition
- Trustee Voting
 - Unanimous vs. Majority
- Single Signatory (Convenience)



Other Important Additions

- Waive Annual Accountings Unless Beneficiary Request
- Trustee Liability and Indemnification
 - Except for Willful Acts or Gross Negligence
 - Applicable Only to Non-Corporate Trustees
- Waiver of Prudent Person Rule



Other Important Additions

- Anticipate Decanting
 - Transfer to Other Similar Trusts
 - Merger
- Consider Potential S Corporations
 - Modification for QSST or ESBT
- Disclaimers
 - State Where Assets Go
 - Authorize Trustee or Beneficiary (Eldest)
- Authorize Virtual Representation



Other Important Additions

- Generation Skipping Transfer Tax Provisions
 - Direction to Use Non-Exempt First
 - Power to Divide (Inclusion Ratio)
 - Survivorship Clauses
 - 90 Days to Avoid Inclusion
 - 180 Days for Direct Skip
- Right To Information
 - Those Empowered to Remove/Replace Trustees
 - Grantor and Spouse



LAWRENCE J. MACKLIN, SENIOR WEALTH STRATEGIST

Lawrence J. Macklin is managing director and senior wealth strategist at the Bank of America Private Bank. In this role, Larry provides wealth management guidance and helps clients pursue their individual goals in financial and estate planning, insurance, risk management, wealth transfer, intergenerational planning, business succession, pre- and post-liquidity event strategies, and philanthropy. Larry also coordinates with the client's team of advisors and conducts periodic reviews to help clients monitor progress.

Prior to joining Bank of America, Larry was a tax and estate planning attorney with Venable LLP, a national law firm, and a Tax Manager with Price Waterhouse.

Larry earned his B.S. degree in Accounting from the University of Maryland and earned a Juris Doctorate from the University of Maryland School of Law in Baltimore. He is a member of the Maryland state bar, a Certified Public Accountant, and is an Accredited Estate Planner[®] designee.

Larry does not provide legal or tax advice in his role at Bank of America.



Thank you for your attention

For a copy of the Bank of America Private Bank Wealth Strategy Report on any of the following topics, please send me an email at Lawrence.Macklin@BofA.com

- Dynasty Trusts
- Generation Skipping Tax Planning
- Trust Decanting
- Powers of Appointment
- Incorporating Flexibility into Your Estate Plan
- Disclaimers

QUESTIONS?