

Elder and Special Needs Law Journal



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Is Your Client's Trust Accomplishing Its Objectives?

By Henry Montag CFP

Clients establish trusts for many different reasons. Some for the management aspects to make sure their assets will be properly invested and not squandered away by a spendthrift child or spouse. Others establish trusts to make sure that if sued, their assets are protected from the claims of a creditor, or for tax purposes. A careful parent or grandparent may establish a trust to provide an inheritance earmarked for the next generation and even to make certain that their child's assets are protected in the event of a divorce. Trusts can also be set up to provide for the welfare of a child, to provide for their educational fund or to send a birthday, graduation or wedding gift even after the grantor has passed away. A Trust is also an excellent way to make a charitable bequest to assure your Legacy will always be remembered.

Some individuals with sufficient assets that choose to leave their IRA principal intact for a grandchild might choose to set up a stretch IRA trust. Doing so would allow the assets in the IRA to continue to grow tax deferred and accumulate for many years without having to take a distribution, a very smart and effective way to defer taxes on assets and even gives one an opportunity to skip a generation of taxes. Creditor protection for a beneficiary may also be another significant reason for a grantor to set up an IRA trust especially if the beneficiary might be sued because of their occupation, or spendthrift personality. Most recently the Supreme Court in its decision regarding inherited IRAs (*Clark v. Rameker*, 134 S.Ct. 678) provided us with another reason as to why a trust could be a very useful tool to protect a beneficiary in cases of bankruptcy.

Prior to the recent 2014 estate tax exclusion increase to \$5,340,000 many attorneys advised their clients to use marital AB Trusts to reduce the size of the assets in their taxable estate to escape the federal estate and state inheritance taxes. Many advisors also suggested that clients place their primary homes in a Qualified Personal Residence Trust (QPRT'S), to avoid having their value included in their taxable estate for estate tax purposes. While there are many reasons for an individual or family to consider the benefits of establishing a trust, it is equally important that individuals review their trusts to make certain they are still operating in their best interest today. For example many individuals that placed their homes in QPRT'S, may wind up pass-



ing the ownership of the home from a parent to child while the owner is still alive. However, in doing so they give up the stepped up basis at death unnecessarily, as estate taxes may no longer apply for them today as a result of the new higher tax exclusions.

Many young families with children that have special needs, set up a Special Needs Trusts (SNT) to enable their child to receive whatever public assistance they may qualify for, and in addition provide them with other assets when parents are no longer alive. While it's always important to choose a trustee wisely, never is it more important than when it comes to providing guidance to the parent to advocate for the best outcome in providing management for the needs of a special needs child for the rest of his or her life. Just as much thought should go into the selection of a trustee, as a trustee should carefully consider the duties and responsibilities he/she is assuming by agreeing to act as a trustee for the family of a close friend.

Many times people will appoint or accept the title as Trustee but don't fully understand the ramifications, the fiduciary liability, nor the moral responsibility they assume when they become personally liable to preserve the assets in that trust. This commonly occurs when a life insurance contract was purchased in order to exclude the death benefit from an Individual's taxable estate. The attorney or accountant advised their client to select an individual to act as trustee for their trust owned life insurance (T.O.L.I.). Often times an oldest son or daughter or good friend or trusted relative was chosen, but they probably didn't have the understanding of how a life Insurance contract works nor did they realize that they assumed 100% of the performance risk for a contract they didn't know wasn't guaranteed, and didn't know required active management, just like any other asset class. This can place the unskilled private trustee in a position where their lack of specialized knowledge concerning their duties as a trustee makes them vulnerable to a lawsuit by other family members, or can place them and their advisers in the center of an uncomfortable, otherwise preventable situation, which more often than not can turn into an unnecessary lawsuit and a loss of reputation.

This most often occurs when a client in their mid to late 80's receives notification from their Life Insurance Company stating that their life Insurance contract, based on the current premiums will expire without value in another 1-2 years, unless a higher premium is paid. How can that be asks the client? I've paid all of my premiums on time and I never borrowed any of

my cash value. What they don't understand nor did their sons and daughters acting as private trustees is that 85% of the life Insurance contract's they and others purchased over the last 25 years was a Flexible Premium life Insurance contract meaning that it wasn't guaranteed to last a life time. Instead 100% of the performance risk of that contract was transferred to the Insured/trustee. And any shortfalls in Interest rates should have been made up by the trustee each and every year. Unfortunately most trustees nor their advisers realized that if that shortfall which amounted to approximately 2.5% over the last 10 years wasn't made up, the end result would cause their life Insurance contracts to expire years earlier than originally anticipated.

An adviser should familiarize themselves and advise their clients and those individuals acting as private trustees, that owning a flexible premium life insurance contract requires active management. Once a performance evaluation is completed a trustee will find that they have several options available to them. The trustee can pay the additional premium, or they can reduce the death benefit maintaining the existing premium. They can replace the contract with a new contract if the grantor's health permits and it makes economic sense to do so, or the grantor can sell their policy on the secondary market as a Life Settlement. Point is that the message needs to be aired that it's no longer acceptable for a client to call their stock broker/wealth manager several times a week or month to go over the performance of their \$500,000 Investment portfolio, but not even think of evaluating the performance of their \$1-\$2 Million life Insurance portfolio. In addition a performance evaluation allows a trustee to consider and perhaps take advantage of any new features and benefits that may have only recently been made available, i.e.: Pension Protection Act, Chronic Care Riders, which allow a grantor to withdraw up to \$119,000 of tax free proceeds from a Life Insurance contract to pay for various qualifying long term care expenses. Consideration should also be given to protecting the assets of the trust from being depleted in the event a protracted long term illness by considering the purchase of 1 or 2 long term care Insurance policies. Once a contract's performance is initially evaluated, it should be reviewed every 2-3 years to allow an individual to make sure they're still getting maximum value and compare what they have to what may be available.

A useful tool I use in my practice to record all of the available options, is a Letter Of Intent Statement, (LOIS) that has the Grantor meet with the Trustee to

discuss in plain simple language, the grantors intent under various circumstances which I then turn into an informal letter given to the trustee by the grantor. This letter should periodically be updated to keep current with a grantor's wishes as to beneficiaries, duties and percentages of desired proceeds

To summarize a typical client with an ILIT needs to make certain that their crummy administration letters are sent out annually, and that their gift tax returns are completed and properly allocated as to the GST. Someone must make certain that their Life Insurance company is still healthy and more importantly that their individual life Insurance contract will be there beyond an Insured's life expectancy. In short someone needs to advocate for the grantor's beneficiaries and coordinate all of the above to make certain that the next generation's future inheritance and well-being is not endangered as a result of neglect. There is perhaps no better way to initiate a conversation with the children of your clients than to let them know that you're interested in discussing the best way to protect and preserve those assets earmarked for them and their children. Especially since No one else is advocating for them.

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He has lectured extensively and has had articles published regarding protecting and preserving business interests and personal assets, to organizations such as The New York State Bar Association, The New York State Society of CPAs, The National Conference of CPA Practitioners. He has developed an understanding of the overall coordination of a client's goals assets and their objectives in their Closely Held Businesses.

As a source for the media he has been quoted in The Wall Street Journal, Investors Business Daily, Newsday Long Island Business News etc, and has appeared as a guest on Fox News, News 12 & FIOS Money & Main Street.

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