

CHAPTER FOUR

Trust Structuring

Primary objectives for using a trust:

- 1) Conserve assets for profligate beneficiaries**
- 2) Protect the beneficiaries from creditors, ex-spouses, and other “vultures,” etc.**
- 3) Multi-generational transfers, “dynasty trust”**
- 4) Federal income tax reduction planning**
- 5) Coordinated money/investment management**
- 6) Choice of law – move a trust to another jurisdiction (e.g., to avoid the Rule Against Perpetuities)? Trust can be established by contract and governed by local law.**

Governing Law for Trusts – State and/or Federal?

Personal/family trusts:

- 1) Texas Property Code, §112.001 – specifies the methods for creating a trust. P.6.**
- 2) Trust as defined for federal tax purposes – Reg. §301.7701-4(a); cf., trust could be alternatively classified as a business entity.**

Cf., other special types of trusts: pension trusts, equipment leasing trusts, special needs trusts, real estate investment trusts.

Cf., legal life estate/remainder.

Other Trust Purposes

P.7

- 1) **“Protective trust” – to protect the trust grantor against himself.**
- 2) **Supplant guardianship during lifetime – enables another to assist the trust grantor.**
- 3) **Minimize probate costs – no assets in the probate estate.**
- 4) **Privacy – no disclosure of trust assets/purpose in the probate proceeding.**
- 5) **Minimize transfer & income taxes.**

Testamentary Trusts

p.8

Created under the decedent's “last will & testament.” Often subject to continuing probate court jurisdiction.

Only activated for federal income tax purposes when trust is actually funded with assets.

Also a possible receptacle (see p.8) for non-probate assets (e.g., insurance proceeds and pension benefits), in addition to assets received from the distribution of the residuary part of the decedent's probate estate.

Intervivos Revocable Trusts/Living Trust P.9

Is a revocable trust even essential in Texas as a probate alternative? Cf., the probate/estate administration process.

Funded or unfunded (only a minimum corpus)?

Trust enables privacy to the extent funded with assets prior to death. But, must transfer assets!

“Seasoning” of the trust during lifetime?

Also, a receptacle for further assets after death?

Grantor trust status during life - §676.

Inclusion of assets in the gross estate - §§2036 & 2038.

Transfer One's Personal Residence to Trust? P.11

Transfer personal residence to revocable trust?

- 1) Effect on title insurance policy?
- 2) Texas Property Code, § 41.0021 (re not losing creditor protection).
- 3) Texas property taxation – not losing homestead status for real estate property tax homestead reduction? Texas Property Tax Code, §11.13.
- 4) Loss of federal income tax exclusion under §121?

Other Nontax Reasons for Trust

P.13

- 1) **Uninterrupted administration and management**
- 2) **Avoid elective share rights?**
- 3) **Less exposure to undue influence, i.e. seasoning of the trust.**

How contribute to taxes/other expenses imposed on the probate estate?

How encourage asset transfers into trust? P.14

See (p. 14) Code §645 re income tax status in conjunction with the estate.

Structure of the Trust Document

P.15-16

Transfer of property into the trust

Designation of the trustee & successor trustee(s)

Dispositive provisions (*next slide*)

Include a spendthrift clause? P.16. Purpose?

Impact of the “rule against perpetuities”?

Expanded powers clauses (beyond state law)?

Include distribution to minors provisions - why?

Performance bond/security waived?

Trustee’s fee – how much?

Trust Dispositive Provisions – Income P.17

Trust structuring for income distributions:

- **Mandatory distributions**
- **Ascertainable standard; how defined? HSEM**
- **Spray & sprinkle power**
- **Discretionary income distributions – who makes the decisions? Use a committee to make decision, not including the beneficiary?**
- **What if a corporate trustee has income distribution discretion?**

Trust Dispositive Provisions – Corpus P.18

Trust structuring for corpus distributions:

- **Mandatory distributions – multiple distributions at various ages**
- **Pursuant to an “ascertainable standard”?**
- **“Spray & sprinkle” power.**
- **Discretionary distributions – who decides?**
- **Generation skipping trust structure?**
- **Provide a “power of appointment” p.19 – (1) special P/A, or (2) general P/A?**

Trust as a Source of the Estate Tax Payment p.20

Cf., revocable (estate tax inclusion of assets) vs. irrevocable (i.e., no estate tax inclusion?)

Trust as a source of liquidity for probate estate (e.g., to pay debts, expenses, taxes (if any)).

Possible options for funding the probate estate:

- 1) Trust buys illiquid assets from the probate estate (enabling estate liquidity), or
- 2) Trust loans funds to probate estate to enable payment of expenses and to pay bequests.

Trustee Responsibilities

P.22

- 1) **Exercise of discretion concerning income/corpus distributions**
- 2) **Investment management of the assets/prudent investor**
- 3) **Record-keeping/tax returns, etc.**

Other choices:

- **Special trustee – makes distribution decision**
- **Advisory committee – multiple inputs**
- **“Trust Protector”– 3rd party surveillance p.23**

Trust Restructuring – Decanting p.24

**See Texas Trusts Code §112.071-112.087
enabling decanting.**

**What are the limits in transferring from (1)
Trust one to (2) Trust two? P.26**

**Cf. full discretion vs. limited discretion granted
to the trustee of the original trust.**

No decanting which reduces tax benefits – p. 27

The “Living Trust” Scam & Advising Clients

See Texas State Bar materials concerning “Living Trust Scams and the Senior Consumer”

Who sells/buys “living trust” packages?

Does this really enable “avoiding all taxes”?

The probable exposure of the estate planning advisor to this gimmick: helping the client extract himself (and his assets) from this arrangement. What if an irrevocable trust?

Are the property transfers into the trust completed for local property law purposes?

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