

# **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 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 (REIT).

Cf., legal life estate/remainder (p.5, fn).

# **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 included 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.8-9) for non-probate assets (e.g., (1) insurance proceeds and (2) pension benefits), in addition to assets received from the distribution of the residuary part of the decedent's probate estate.

# Intervivos Revocable Trusts/Living Trusts P.10

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

How determine if trust is revocable/irrevocable?

Funded or unfunded (only 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?

*continued*

# **Intervivos Revocable Trusts/Living Trusts P.10**

**Federal income tax status of the revocable trust:  
Grantor trust status during the lifetime of the  
grantor - §676.**

**At death trust becomes irrevocable and, then, a  
“true trust” for federal income tax purposes.**

**Estate tax impact: Inclusion of trust assets in  
the trust grantor’s gross estate - §§2036 &  
2038.**

# Transfer One's Personal Residence to Trust? P.12

FN 26 (P. 12). Transfer one's personal residence to revocable trust? TOD as option?

- 1) Effect on the 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 (for principal residence gain realized)?

# **Other Nontax Reasons for a 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 encourage asset transfers into trust? P.14**

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

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

# **Structure of the Trust Document**

## **P.16**

Transfer of property into the trust

Designation of the trustee & successor trustee(s)

Dispositive provisions (*next slide, p. 17 et. seq.*)

Include a spendthrift clause? P.16. Purpose?

Impact of the “rule against perpetuities”?

Expanded powers clauses (beyond state law)?

Include “distribution to minors” provision?

Performance bond/security waived?

Trustee’s fee – how much?

# Trust Dispositive Provisions – Income P.18

Trust structuring choices - income distributions:

- 1) Mandatory distributions
- 2) Ascertainable standard; HSEM
- 3) “Spray & sprinkle” power
- 4) Discretionary income distributions – who makes the decisions? Use a committee to make this decision; but, a committee, not including the beneficiary? What if a corporate trustee has income distribution discretion?

# **Trust Dispositive Provisions – Corpus P.18**

Trust structuring for corpus distributions:

- 1) Mandatory distributions – multiple distributions at various ages
- 2) Pursuant to an “ascertainable standard”?
- 3) “Spray & sprinkle” power.
- 4) Discretionary distributions – who decides?

Include generation skipping trust structure?

Provide a “power of appointment” p.19 –

If so: 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's Responsibilities**

## **P.22-23**

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

### **Other choices:**

- Special trustee – makes distribution decisions**
- Advisory committee – multiple inputs**
- “Trust Protector”– 3<sup>rd</sup> party protection, p.24**

# **Trust Restructuring – Decanting p.26**

**See Texas Trusts Code §112.071-112.087 –  
provisions enabling “decanting.”**

**What are the limits in transferring from (1)  
Trust one to (2) Trust two? P.27**

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

**No decanting which reduces (federal) tax  
benefits – p. 28; see listing, p. 28.**

# **Note: The “Living Trust” Scam & Advising Clients**

See Texas State Bar materials concerning  
“Living Trust Scams and the Senior Consumer”  
& Ch. 5, p. 27, re “equity trusts.”

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

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