



# Weatherby & Associates, PC

## Counselors at Law

Helping Families Preserve and Protect Assets and Values

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# The Wealth Counselor

A monthly newsletter for wealth planning professionals

## UPCOMING EVENTS & SEMINARS

### VA Benefits Seminar

9/20/2011

5:30 PM

101 Bickford Extension  
Avon, CT

10/3/2011

5:00 PM

1060 Main Street  
South Windsor, CT

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You have received this newsletter because I believe you will find its content valuable, and I hope that it will help you to provide better service to you clients.

Please feel free to [contact me](#) if you have any questions about this or any matters relating to estate or wealth planning.

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Our firm focuses our practice on Estate Planning, Business Planning, Trust Administration, Probate, Elder Law and Life Care Planning. We help families preserve and protect assets and values; we help business owners maximize their businesses' value.

## Niche Trusts

Revocable Living, Irrevocable Life Insurance, Charitable Lead, and Grantor Retained Annuity - these are trust descriptors that are familiar to estate planning professionals. However, there are many less well-known types of trusts that clients may ask about or benefit from having. Some of those other types of trusts will fill an estate planning need like no other arrangement can. Some arrangements called "trusts" do not fit the traditional trust definition. Still other things called "trusts" are outright shams.

As professionals, we need to know about the lesser-known trusts, when to use them, when to avoid them, and when to warn our clients to get out of them.

In this issue of *The Wealth Counselor*, we review some trust basics and then provide an introduction to a number of these lesser-known trusts and things called "trusts."

### What Is a Trust?

Almost always, when someone says "trust," they mean what is called an "express trust" - a tri-party

relationship intentionally established by a grantor (who is the owner of property), a trustee (who receives and agrees to hold and manage the property), and a beneficiary or beneficiaries (for whose benefit and enjoyment the property is to be held). In this discussion, "trust" means "express trust" unless the contrary is stated.

A trust is a fiduciary relationship between the trustee and the beneficiary and between the trustee and the grantor. It involves two distinct elements of ownership of an asset: 1) legal (transferred by the grantor to the trustee) and 2) beneficial (vested in the beneficiaries to the extent specified in the trust agreement).

Although a trust is a relationship, for IRS purposes, it is treated as an entity. Under the Treasury Regulations, the key distinguishing factor of a trust is that it exists to protect and conserve property for the benefit of beneficiaries "who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit."

**Planning Tip:** An entity that is *not* classified as a trust under Treas. Reg. 301.7701-4 is a business entity.

### **Private Trusts**

Most trusts are private trusts. In addition to those commonly encountered, there are many that have very special purposes. Some of them are:

*Health and Education Exclusions Trust (HEET):* The HEET is a multi-generational or "dynasty" trust. Through a HEET, a wealthy grantor can confer even more benefit on grandchildren and generations beyond than the amount that is exempt from the Generation Skipping Transfer (GST) Tax. The HEET does this by limiting

distributions for the benefit of "skip persons" to direct payments of their medical and higher education tuition expenses. A skip person is someone two or more generations younger than the grantor. A HEET also prohibits direct payments to skip persons or for purposes that are not exempted from gift, estate, and GST tax. The HEET must have a least one beneficiary with a substantial present economic interest who is a non-skip-person. Typically, the non-skip beneficiary chosen is a charity so that the HEET can continue in existence for as long as the charity exists.

**Planning Tip:** A HEET is frequently created by a taxpayer who has already used their GST exemption, has charitable goals and wishes to create an education and health care safety net for future generations.

*Delaware Incomplete-gift Non-Grantor (DING) Trust.* A DING is a non-grantor self-settled irrevocable trust that gives the grantor creditor protection and avoids state income tax on undistributed ordinary income and capital gains. Delaware was the first state to allow self-settled asset protection trusts. Now, however, DINGs are not limited to Delaware. States where domestic asset protection trusts can be established now include Alaska, Nevada, New Hampshire, Rhode Island, South Dakota, Tennessee, Utah and Wyoming.

Assets placed in a DING get a step up in basis on the grantor's death and are included in the grantor's estate for estate tax purposes. A DING must require the consent of an adverse party for any trust distribution (typically a committee composed of two beneficiaries of the trust other than the grantor).

*Rabbi Trust.* The first Rabbi Trust was set up for

a rabbi; hence, the name. They are used with various nonqualified deferred compensation arrangements for highly compensated executives who wish to defer the receipt of some of their compensation in order to minimize current income taxes. The Rabbi Trust can be revocable or irrevocable and funded or unfunded. A funded Rabbi Trust provides the executive more security; however it must be carefully structured to prevent the employee from being taxed now. The trustee must be an independent third party and the assets must be held separate from the employer's other funds.

**Planning Tip:** Assets held in a Rabbi Trust are subject to the claims of the employer's general creditors, so it is important to use this technique only with a financially solid company. The fact that the executive will be an unsecured creditor of the company should the company become insolvent is not especially reassuring, but is necessary in order to prevent the executive from being taxed currently on the deferred compensation.

*Oral Trust:* Although trusts are usually written documents, that is not always required. The Uniform Trust Code (UTC) does acknowledge that under certain circumstances a trust may be created orally. However, oral trusts of real property are not permitted in some states. The biggest problems with an oral trust, of course, are interpretation and enforcement. Disputes about the terms or even the very existence of an oral trust are common.

*Alimony and Maintenance Trust:* These are also called "Section 682" trusts. They are an exception to the general grantor trust rules in that the income paid from these trusts to an ex-spouse under a dissolution or separation decree/agreement will be taxed to the payee (the

ex-spouse) and not to the grantor. Typically the trust's income is paid to the former spouse for a specified term or amount or until the spouse dies. After the former spouse's interest has ended, the trust can continue for the benefit of the grantor's designated successor beneficiaries, typically the children.

**Planning Tip:** An alimony trust may be useful if a business owner cannot or does not want to sell an interest in the family business to make payments to his former spouse or if the business lacks the liquidity to redeem the stock of the former spouse. It can protect the payee in the event the payor should die or become financially insolvent before all payments have been made. Also, the trustee can be a neutral third-party who can act as an intermediary between the former spouses. One downside is that the trust can become under- or over-funded, so care should be taken when drafting the document and funding the trust.

### **Commercial Trusts**

Also known as a business trust, the commercial trust is an unincorporated business organization. It is created by a written agreement under which assets are managed by a trustee for the benefit and profit of its beneficial owners. It is typically funded in a bargained-for exchange and shares of beneficial ownership are issued to the participants. The trustee can make risky investments for entrepreneurial gain and share that risk of loss with the beneficial owners. This arrangement is different from the traditional grantor/trustee/beneficiary relationship and the trustee does not have the same kinds of fiduciary duties and protections as in a conventional trust arrangement. It is not clear that these trusts would have as much asset protection as a conventional corporation or an LLC, or how they would be recognized in bankruptcy. Specific

commercial/business trusts include:

*Investment Trust.* This trust is used by multiple individuals to pool funds for common investments. One common type of Investment Trust is the Real Estate Investment Trust (REIT). The trust may provide that beneficial interests in the trust may be bought and sold.

*Environmental Remediation Trust.* These are established to collect and disburse funds for environmental remediation of an existing waste site when the ultimate cost of remediation is uncertain. They are used in sales of contaminated real property.

*Statutory Land Trust.* These private non-charitable trusts are used to hold title to real property while keeping the identity of the beneficiary confidential, and are used to maintain privacy in the transfer of real estate (acquisition or sale). They can avoid probate, but do not provide asset protection.

*Liquidating Trust.* These relate primarily to income tax and bankruptcy. In bankruptcy, they are used to liquidate assets under Chapter 11. Outside bankruptcy, they are used to facilitate a sale.

*Voting Trust.* These allow voting rights in a business entity to be transferred to a trustee, usually for a specified period of time or for a specific event. They are useful in resolving conflicts of interest, in securing continuity, for corporate reorganization, and in divorce when it is necessary to divide an LLC or corporation owned by a divorcing couple.

### **Specific Purpose Trusts**

There are some trusts created for specific purposes rather than for the benefit of individual

beneficiaries. Non-charitable purposes include pets, artwork, aircraft; charitable purposes include private foundations organized as trusts and charitable land banks. Specific examples include:

*Funeral and Cemetery Trust.* A funeral trust is an arrangement between the grantor and funeral home or cemetery involving prepayment of funeral expenses. An endowment cemetery trust is a pooled income fund held in the name of the cemetery for ongoing maintenance of cemetery grounds. A service and merchandise cemetery trust, similar to a funeral trust, is for merchandise like a gravesite marker or mausoleum and for burial service.

*Pet Trust.* Many pet owners want to provide for the continuing care of their pets after their own deaths. As a result, many states have adopted some form of pet trust legislation. It is important to specifically identify the animal the trust is to benefit, especially if the pet is valuable or a large sum of money is involved. Special considerations include: how long the trust will need to last, what kind of care is needed and who will provide it, whether to name a separate trustee to manage funds in addition to a caretaker, successor fiduciaries and caretakers, a sanctuary or shelter of last resort if the pet outlives the caretakers or those named cannot serve, liability insurance for potential damage caused by the pet, a trust protector, and reimbursement of taxes if the payee is subject to additional income taxes. Also consider how much money will be required to fund the trust and what will happen to any funds that remain after the pet has died.

*Gun Trust.* Federal, state and local firearms laws strictly regulate possession and transfer of certain weapons and bar certain persons from owning or having access to firearms. When an estate has



firearms, the executor must be careful to avoid violating these laws. Transferring a weapon to an heir to fulfill a bequest could subject the executor and/or the heir to criminal penalties. Just having a weapon appraised could result in its seizure.

A trust designed specifically for the ownership, transfer and possession of a firearm (known as a gun trust or firearm trust) can avoid some of the rules that regulate such transfers. The trust, which must be carefully drafted to account for the different types of firearms held and comply with firearms laws, establishes a trustee as the owner of the firearms. The trust can name several trustees, each of whom may lawfully possess the weapon without triggering transfer requirements. Once a weapon becomes a trust asset, any beneficiary (including a minor child) may use it.

**Marketing Tip:** There are four million members of the National Rifle Association (NRA) and an estimated 240 million firearms in this country. That means millions of American own guns. Many families also have guns as heirlooms. Providing guns trusts (and pet trusts, for that matter) is an excellent way to reach out to potential clients for estate planning.

### **Other Trusts**

*Blind Trust:* These are used by higher net worth clients who are involved in public companies or politics and who need to strictly limit their knowledge of how their assets are being managed in order to avoid any conflict of interest or even the appearance of one. Investments are transferred to an independent trustee who is permitted to sell or dispose of any assets transferred to the trust, and then reinvest in assets that are unknown to the grantor.

*Coogan Trust:* This is a statutory trust account required in some states to protect a part of the

earnings of child actors. It is named after the child actor, Jackie Coogan, who learned on becoming an adult that his parents had saved very little of his earnings.

*Totten Trust.* This is a pay-on-death account that, until the death of the depositor, is treated as an informal revocable living trust. While living, the depositor may be the grantor, trustee and beneficiary. Upon the depositor's death, the proceeds in the account will be paid to the beneficiary previously designated on a signature card by the depositor (who can change the designation any time before his/her death).

### **Sham Trusts**

These are so-called trusts marketed by hucksters that violate public policy and are not recognized by state or federal income tax authorities or the courts. The document may claim to create a trust and promise tax benefits, but makes no actual change in ownership or control of the grantor's property or beneficial interests. They may be complex, involving multiple foreign and domestic trusts, and entities holding interests in other trusts. Funds may flow from one trust to another by various agreements, fees and distributions; often there are no named beneficiaries. They may claim that paying taxes is entirely voluntary. Names include Constitutional Trusts, Pure Trusts, Pure Equity Trusts, Contract Trusts, and Freedom Trusts.

**Planning Tip:** If your client has one of these sham trusts, the risk of an IRS audit with accompanying penalties - civil and criminal - is high. They thus provide the advisor an opportunity to un-do a great harm, providing the client is willing.

### **Constructive Trusts**

A constructive trust is not a trust, but it resembles

one. It is an equitable remedy imposed by a court to transfer the benefit of property to the rightful party when someone else has unjustly received it. A court may impose a constructive trust to remedy fraud, misrepresentation, bad faith, overreaching, undue influence, duress and mistake. Courts may also use the constructive trust doctrine creatively when a wrong has been committed but no legal remedy is available.

### **Conclusion**

There are many kinds of trusts and trust-like arrangements that estate planners may not routinely use in their practices. It's good to be aware of them, and to understand when one might be useful for a client and when one might be dangerous, or possibly even criminal. Each represents an opportunity for the professional to enhance their role as trusted advisor.

If you have any suggestions, comments, or questions regarding the content of this newsletter, please contact us at (860) 769-6938 or by email: [haley.r@weatherby-associates.com](mailto:haley.r@weatherby-associates.com)

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