TRUST ARTICLES

Country Club Trust COMPANY

Ask a Trust Officer – Dynasty Trusts

DEAR TRUST OFFICER:

I'm intrigued by something I heard about recently, a "dynasty trust." What is that, and how does it work?

– LEGACY BUILDER

DEAR LEGACY:

Traditionally trusts with private beneficiaries were not permitted to last forever, but had to have a determinable end date. This policy was enforced by the "rule against perpetuities," a complex formulation that was the bane of many law students. As a simplifying rule of thumb, a private trust generally had to end in about 90 years or so. Wholly charitable trusts, in contrast, could last forever.

Recently, some states have amended their trust laws, and one important change has been the lengthening of the permissible life of a private trust to 360 years or more. Some have eliminated the restriction entirely.

The longer life for private trusts has given rise to the multi-generational "dynasty trust."

The other aspect is taxation. There is a federal tax on major gifts, on large estates, and on "generation-skipping" transfers (GSTs) associated with trusts. There is an exemption from the GST tax, and it matches the federal estate tax exempt amount. It is theoretically possible to put assets into a dynasty trust, sheltered by these exemptions, and have those assets provide family financial protection for generations without further transfer taxes. Income taxes still would apply.

Do you have a question concerning wealth management or trusts? Send your inquiry to trust@countryclubtrust.com

Preparing for Incapacity

What should one do after an unfortunate medical diagnosis that suggests he or she will lose mental and physical abilities in the near term? Areas that need addressing are testamentary dispositions, health care preferences, long-term care preferences, and substituted decision making.

Estate planning

Usually, estate planning involves a substantial amount of guesswork and ambiguity. How far into the future will it be before the plan is needed? What family circumstances might change in the interim? What will the assets be? What will the tax laws be like?

Many of these uncertainties may be swept away when someone is on the verge of incapacity, because this could be the

final review of testamentary documents. Beneficiaries need to be reviewed. A statement of intent in the will or trust is advisable, so as to aid in the understanding of that intent.

This is also a good time to determine if any of the probable beneficiaries has a disability. If so, care needs to be taken so that their inheritance does not compromise their access to government benefits.

Revocable living trusts

A revocable living trust is a superior tool for asset management in case of incapacity, because a trustee typically will have an easier time dealing with brokers and banks than would an attorney-in-fact. The trust document also needs to be reviewed carefully if an onset of incapacity is expected.

For example, should the trustee be empowered to make distributions to heirs before the trust creator's death? Or is the trust to be for the sole benefit of the trust creator and perhaps spouse? The trust needs to be crystal clear on this point.

If individuals will serve as trustee instead of a corporate trustee, when should they be removed for incapacity? What standard should be used? Should the opinon of a physician be required?

Consideration should be given to giving someone other than the trust creator the power to amend the trust after incapacity sets in. This might be the trustee, a trust protector, or the attorney-in-fact. If more than one person is granted the power, there should be a hierarchy of priority and a process for resolving conflicts.

Health care at the end of life

Typically, we expect heroic medical procedures for those who have a long and productive life ahead of them. The specter of incapacity may change this calculus. How aggressive does the individual want treatments to be? Are there treatments that should be avoided?

Does the individual want a durable power of attorney for health care decisions? Who should be the power holder? The power will need to comply with the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

An advance medical directive is also advisable for setting out expectations for medical treatment. What artificial means of extending life should be used? What should be avoided? These issues need to be discussed with family members to minimize future misunderstandings and conflicts.

Long-term care

A diagnosis of impending incapacity makes the need for planning for long-term care urgent. Step one is to determine how long someone may be able to stay in the home. Does the design of the house present obstacles to remaining there? Can they be fixed?

Who will provide the long-term care? Most such care is provided without charge by family members, such as a spouse or adult children. However, as dementia sets in, professional help may be required.

Will the person's income be sufficient to cover the costs of a nursing home? Is long-term care insurance part of this picture? The analysis can be daunting. If the income will not be sufficient, a plan may be needed for the orderly liquidation of assets to cover those costs.

Substituted decision making

Who will make decisions when the individual loses the capacity to do so? For asset management, the trustee of a living trust may handle those duties. For legal, medical, and personal issues, the durable power of attorney will be used. In general, a family member will be given this responsibility.

Should the power of attorney include the power to make gifts? If so, how broad should the power to make gifts be? Should the class of recipients be limited or unlimited? Should the amounts of the gifts be limited to the annual federal gift tax exclusion ($15,000 this year)?

The attorney-in-fact will not automatically be able to handle tax matters. The IRS requires the filing of Form 2848 for this purpose. Similarly, the Social Security Administration requires a person to be appointed Representative Payee to be able to affect a third party's benefits. The law recently has been changed in this area. The Strengthening Protections for Social Security Beneficiaries Act of 2018 included a provision for designating representative payees, and the Commissioner of Social Security was directed to come up with a procedure for implementation. The change in law becomes effective April 13, 2020, and the procedure is due six months before that date.

Mistaken Identities

A new study suggests "investor confusion" may be responsible for about 5% of trading. The confusion comes from ticker symbols that are very similar, leading to execution errors.

- The ticker for the Ford Motor Company is F; FORD is the symbol for Forward Industries, Inc.
- HP stands for Helmerich & Paynes, Inc., not Hewlett Packard Co. which is HPQ.
- The symbol for MCI Communications is MCIC, not MCI, which was a closed-end mutual fund, Massmutual Corporate Investors.
- On October 3, 2013, Twitter, Inc., filed papers for a $1 billion initial public offering. The proposed ticker symbol was TWTR. On October 4, 2013, the stock of Tweeter Home Entertainment Group, an unrelated company, soared 1,400%. It's ticker was TWTRQ. The spike was almost certainly a case of investor confusion.

The study identified 254 pairs of symbols with sufficient similarity as to cause investor confusion. The price changes and turnover co-movements of 31 pairs showed statistically significant parallels sufficient to imply investor confusion.

Interestingly, the confusion was not limited to individual investors. Abnormal trading was identified in institutional investors as well. "On average, trades by mistakes involve 8.2M shares and $1.1M in transaction costs per pair per year." What's more, the 31 pairs studied likely do not exhaust the pool of investor confusion.

It is possible that some sort of technical solution might be implemented for ticker symbols that are similar, something akin to a spell checker in word processing. Until that day arrives, the authors recommend that individuals "always double-check before you trade."

Billionaire Mobility

Do the rich change domiciles in order to save taxes? Intuitively, one would think that taxes are a factor in choosing a state of residence, though perhaps not the most important one. The question has been studied more rigorously by

economists at the National Bureau of Economic Research (NBER).

A bit of background is in order. For decades the federal government allowed a credit for state death taxes in the determination of federal estate tax obligations. This was a dollar-for-dollar credit, subject to a cap at 16%. The practical effect of this structure was that every state imposed an estate tax at least equal to the amount of the allowable federal credit. Should any state not have an estate tax, their citizens would be no better off, as the IRS would keep the money that the state left on the table.

That structure was changed in 2001, when the credit was converted to a deduction for state death taxes. The nominal reason for the change was to offset the costs of tax benefits enacted in the same legislation. But the effect was that states that repealed their inheritance and/or estate taxes would provide a real tax benefit to their residents. Federalism allows the states to be diverse policy laboratories. A few states killed their death taxes, then many more followed, until today only 12 states impose taxes related to death time transfers.

The NBER researchers wanted to know how billionaires responded to this new incentive to relocate to an estate tax-free state. They used the Forbes 400 list to track that movement. The basic results were not surprising:

- The number of billionaires in state with estate taxes fell by 35% after 2001.
- Billionaires' sensitivity to estate taxes increases with age.
- When a billionaire dies in a state that has an estate tax, the average contribution to state tax revenue is $165 million.
- In looking at the distribution of billionaires in 2001 and in 2010, nine years later, 21.4% of those in states with estate taxes had moved to a state without death taxes, while only 1.2% had done the reverse.

However, the authors' conclusions were much more surprising. They compared the lost income taxes when a billionaire moves away to the lost estate taxes when a billionaire dies resident in the state, and concluded that in most cases the state will be better off keeping the estate tax! This analysis was done on a state-by-state basis. The only state that is better off without a death tax, they determined is California. That is because income taxes are so high in that state.

There is a huge caveat in this analysis, which the authors concede. When a billionaire moves out of a state, much more is lost than the stream of income tax revenue. The study "does not include potential indirect effects on states if billionaire relocation causes relocation of firms and investments as well as a reduction of donations to local charities." Those intangibles are much harder to measure.

Country Club Trust COMPANY

1 Ward Parkway, Kansas City, MO 64112 | www.CountryClubTrust.com