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Spotlight on the Inheritor's Trust™

By Robert L. Moshman, Esq.

Are trusts gaining in popularity? Are more people using trusts? Are trusts being used to accomplish new objectives?

A recent increase in the total value of assets held in personal trusts reflects the growth of asset values in general without explaining how many new trusts are being created, what types of provisions they include, or what is motivating the grantors. Even when there is more data to go on (years after the fact), the results will remain debatable.

But there is anecdotal evidence that trusts are very much alive and well. In particular, irrevocable living trusts are capable of implementing the most effective gift transfers for tax purposes. However, a variety of provisions, including "trust protector" clauses, may be used to retain far more flexibility than many people realize.¹

Let's review how classic trusts are being adapted to the rules and circumstances that are now being transformed around us.

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In particular, there has been a great deal of the recent interest focused on the Inheritor's Trust™ over the past two years. One of the principals behind this arrangement, attorney Richard A. Oshins, was most generous in providing insights about the technique as well as its reception. (See the separate interview with Richard Oshins that follows.)

Change in Focus

It might be argued that as we draw closer to the repeal of the estate tax, there is a shift away from trusts which concentrate merely on minimizing transfer taxes and a rise in those arrangements which address long-term asset protection.

As with any trend that evolves over time, it becomes impossible to pinpoint the exact time when things began to change or to identify a specific triggering incident, but there were certainly major changes that were already in motion prior to the enactment of the estate tax repeal in 2001.

For example, the Taxpayer Relief Act of 1997 would have increased the estate tax exemption to shield \$1 million of an estate by 2006. That law also introduced a \$1.3 million exclusion for small-business owners.

Dynasty trusts and other long-term asset protection trusts were becoming increasingly popular. A critical factor of planning was the incorporation of flexibility into long-term irrevocable trusts. In "Making Irrevocable Trusts Flexible," the June, 1997 issue of *The Estate Analyst* recapped the many powers which can be given to trusts:

- Power to invade principal
- Power to amend the trust
- Power to change trustees
- Power to change trust situs
- Power to substitute charitable beneficiaries
- Power to correct drafting errors
- Power to invest in grantor's family business
- Power to invest more aggressively
- Power to protect Medicaid eligibility

"Trust protectors" had come into vogue by then. The trust protector concept had been employed in the United Kingdom and off-shore tax haven jurisdictions for many years. A trust protector could simply be a separate trustee who would be empowered to exercise one or more powers, such as those listed above.

A Change in Context

In 2001, Lawyer's Weekly noted the growing use of trust protectors by trust draftsmen and attorneys in standard, garden-variety trusts. By that time, the likelihood of significant tax reforms, including an estate tax repeal, had made trust flexibility of paramount importance.

If you will indulge a tangential observation concerning the growing reliance on health-care proxies to be used in conjunction with living wills, one may wonder if there has been a crossover effect.

Like a trust protector, a health-care proxy, i.e., an individual holding a power of attorney for health care, is a way of protecting an individual's preferences in the future by appointing a representative who can review changed circumstances and take appropriate action. Whether in the context of living wills or investment trusts, the flexibility of having a "trust protector" or a "health-care proxy" is simple, practical, and effective.

Changes to the Bankruptcy Code which will take effect in October may also play a role in the evolution of trust planning. There will be a 10-year limit on assets transferred to a self-settled domestic asset protection trust (DAPT).

With more restrictions on the bankruptcy solution to creditor problems in general, a variety of alternatives must be considered. Establishing a long-term, beneficiary-controlled trust that will be set up long before any potential bankruptcy (or divorce, or litigation) avoids such worst-case scenarios.

Disclaimer trusts are another useful feature being added to wills in states which may or may not decouple from Federal law and adopt or modify state death taxes or state death tax exemption levels.

Dynasty Planning

A new generation of well-informed estate planning professionals have implemented multi-generational planning in thousands, if not millions, of estates. These may be called "dynasty trusts" in certain respects. And they are well equipped to protect not only against estate and transfer taxation but also creditors and divorce.

But the Inheritor's Trust™, has added an extra dimension to dynasty trusts. It moves the starting point from the plan back from the client's estate to the previous generation, i.e., to assets that have not yet been inherited.²

We are talking about the largest bulge of wealth to be transferred in history. It is the life savings of "the greatest generation" which are about to pass to "the baby boomer" generation.

The Inheritor's Trust™

Any hope of long-term planning depends squarely on the positioning of the influx of wealth in the system that is about to embark on an inter-generational journey. Will those funds simply travel one single generation in a direct outright transfer? Or will they transcend multiple generations and remain flexible for many years into the future?³

With these goals in mind, the Inheritor's Trust™ is just in time and may end up becoming the paradigm of 21st century planning.

Until now, dynasty-style planning has taken a client's estate as a starting point and looked prospectively, as far into the future as possible, to exploit the dependable growth of assets that are unfettered by transfer taxation and shielded from liability and serious threats over many years.

The Inheritor's Trust™ takes a step back in time. It looks "upstream" to take better advantage of assets that the client has not yet inherited.

Intercepting an inheritance and directing it into a separate trust before the assets can be received by the client's estate has impressive advantages.

The funds are directed in anticipation of what the client would have done. The client exercises great influence over the funds under the terms of the trust. Yet the assets, having never belonged outright to the client, avoid exposure to debts and liabilities. Consider the other benefits:

- Even if the inherited assets are relatively small, they can have a major role if they remain in a separate trust that can continue for many years and remain out of the reach of creditors.

- Having a separate pool of assets to use as "seed money" in several contexts. Wealth-earning opportunities can be shifted to the trust at their inception so that future earnings are kept out of the client's estate.

- A separately funded trust can also purchase life insurance, the benefits of which will not be included in the client's gross estate.

- The Inheritor's Trust™ can become the 1% general partner of an FLP. A relatively small amount of assets is needed, and if the funds are derived from a

separate source, i.e., anyone other than the client, the trust will retain the controlling interest. The client could retain control over the FLP in a fiduciary capacity on behalf of the trust, yet his estate would only possess non-controlling interests in the FLP.

- The trust can be designed to be "intentionally defective," i.e., in violation of grantor trust rules. Trust income can be accumulated, but if paid to beneficiaries is taxed to the grantor, allowing him to further reduce his estate.

Positioning a client as an "inheritor" and setting up a trust that keeps inheritable assets separate is a strategy with potential benefits for any estate. It can be coordinated with a generation-skipping GRAT, a buy-sell arrangement for buying out a business, state-income tax strategies, and many other techniques in an array of useful variations.

Looking Ahead

A trust for an inheritor/client certainly gets a long-term estate plan off to an excellent start. It is dynastic in its durability, yet practical enough to benefit a moderately sized estate.

In many respects, it creates the same trust arrangement that the estate owner could have set up for his heirs, yet because it is set up by the estate owner's parents, the assets can be protected far earlier, and far longer.

Technical References

1. See, e.g., Jennings, *Flexible giving through the use of irrevocable gift trusts*, 31 *Estate Planning* 7, p. 328 (July, 2004); and Moshman, *Making irrevocable trusts flexible*, *The Estate Analyst* (June, 1997).
2. The inheritor's trust concept arrived in Oshins and Ice, *The Inheritor's Trust™: The Art of Properly Inheriting Property*, 30 *Estate Planning* (WG&L) 9, p. 419 (Sept., 2003) and *The Inheritor's Trust™: Preserves Wealth as Well as Flexibility*, 30 *Estate Planning* 9, p. 475 (Oct., 2003), a 17-page, 51-footnote, two-part work which incorporates the best of modern estate- and asset-protection planning into a comprehensive vision.
3. Portions of this article were adapted from, Moshman, *New Strategies, 2004*, *The Estate Analyst* (March, 2004). A stream of other publications took interest as well. (See, e.g., Rachel Emma Silverman, *How to ask (nicely) for your inheritance*, *The Wall Street Journal*, May 11, 2005.)

Editor's Note: The Inheritor's Trust™ is a trademark of Richard A. Oshins, Steven J. Oshins, and Noel C. Ice. This publication is not endorsing any product or attorney or providing specific legal or tax advice. It is merely making readers aware of a potentially useful strategy.

An Interview with Richard A. Oshins

Background: The Inheritor's Trust™ concept has received considerable attention since it was introduced in late 2003. Was this the right idea at the right time based on demographics, changing tax laws, and other factors? To find out, we tracked down attorney Richard A. Oshins, (pronounced "Oceans") a Las Vegas, Nevada, practitioner who has been a prolific lecturer and writer for more than 30 years. Oshins has collaborated with the A-list of figures in the estate planning industry, not the least of whom has been his own son, attorney Steven Oshins, who regularly authors outstanding articles.

We caught up with Mr. Oshins in a phone interview which took place in late June between this editor (in New Jersey) and Mr. Oshins (in his Nevada office) (and which resulted in a phone bill which the editor's wife remains skeptical about). The responses are paraphrased from that hour-long conversation.

Editor: The Estate Analyst took an early interest in the Inheritor's Trust concept. Which other publications have provided coverage?

Oshins: Most recently, The Wall Street Journal, which led to several additional interviews. It has also been covered in Bloomberg's Wealth Manager, Lawyer's Weekly, Bottom Line/Personal, Commerce Clearing House, Journal of Financial Planning, etc. In my opinion, yours was one of the best. Your analysis really grasped the whole concept.

Editor: Thanks! You've published numerous articles with cutting-edge ideas, particularly long-term dynastic trust arrangements, for many years. Why do you think this particular concept has generated so much interest?

Oshins: I have been saying many of the same things for the past 30 years. I first wrote about GST trusts in 1973, years before the original statute on point was enacted. But once I gave this particular concept a name, it was a different world. It became a real thing instead of an abstract concept.

Editor: Do you think that this is also the right time for an Inheritor's Trust concept based on demographics and changes in the tax system?

Oshins: It's always been the right time. When I worked for the Office of Tax Legislative Counsel years ago, we looked at various types of GST trusts as

"abuses." Once I joined the private sector out in the free market, those areas became "planning opportunities."

Editor: Why the trademark? Is that for marketing?

Oshins: No. Years ago I had written about another concept and had come up with a name for it...and then someone else trademarked it and stopped me from using my own concept!

Editor: Self-settled asset protection trusts are coming under greater scrutiny. Does this vindicate the Inheritor's Trust approach?

Oshins: Others are jumping on the self-settled trust bandwagon but it is extremely important to protect assets from creditors. I look at every client with a business opportunity as the next Bill Gates and his enterprise. If that business is created within the protective environs of a trust, it will be far more secure and can do far more good. And it is not necessary to sacrifice beneficiary control.

Editor: Is there a minimum size for assets in a trust? What about a gift of \$1 million that a parent could give a child using the lifetime gift tax exclusion?

Oshins: Even a small trust can have benefits. This is especially true if the money is being used to fund a business opportunity.

Editor: What's been your experience with clients and their reaction to the Inheritor's Trust so far? Is this a harder sell?

Oshins: Clients have been extremely receptive. People seem to grasp this concept and understand how much it can benefit them. The result is still a beneficiary-controlled trust, but it is far more secure.

Editor: What motivates trusts today?

Oshins: The four greatest ways to lose money in the United States include bad investments, taxes, divorce, and litigation. I can't do much about people who have already made a bad investment that can change that outcome. But taxes, divorce, and litigation all can be mitigated with trust protections, and future investment mismanagement can be avoided. And what's the big difficulty in doing so? Filing an extra tax return? It simply makes sense to protect the family assets using a protective trust arrangement.