For our final Tax Notes column, in this last edition of *ABA Trust Letter*, we reflect on the evolution of trusts and trust planning options over our careers and especially over the last 16 years of writing this column. Much has changed in our 30+ years of practice.

Trusts, especially under current law, are incredibly flexible vehicles for wealth planning. When clients are first introduced in a serious way to trust planning, they often will ask, “What can I do?” Our response is usually some form of “What would you like to do?”

**Trusts as Protectors of Wealth**

Trusts are first and foremost a vehicle for managing and preserving assets for a beneficiary, often to protect the beneficiary in ways that cannot be achieved if the beneficiary owned the assets directly. When the goal is to preserve assets for a beneficiary who is a spendthrift or makes poor decisions, the trustee can be empowered, or directed, to limit distributions and thereby preserve the trust assets over the long term to help provide for the beneficiary’s basic needs.

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ABA Professional Certifications has created quizzes for wealth management certification holders (CTTS, CISP, CRSP, CSOP, CTFA) worth 6.0 CE credits each year. This replaces the *ABA Trust Letter* quiz and provides the same number of credits annually. New quizzes will be posted every other month. More details can be found at:

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Trusts Cannot Do Everything — But They Can Do a Lot

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But a trust will not prevent or rehabilitate the “trust fund baby.” The concern that so many parents express — that they do not want their children to be spoiled by wealth or grow up with a lack of drive or inability to support themselves — is not something that the estate plan will fix. Trusts will help, primarily in the ways just described, but it is the parents, the family, and their advisors who have to educate and prepare the child to receive and be a responsible steward of wealth.

Trusts have evolved over the past three decades as increasingly effective protectors of wealth. Dating back to English common law, the spendthrift rule has operated to protect irrevocable trusts created by third parties from the reach of creditors of trust beneficiaries. The evolution of domestic asset protection trusts has created similar protections for self-settled trusts. There are currently 17 states that have some form of domestic asset protection trust statute. Many of the flexible powers that now exist, such as trust protector provisions, nonjudicial settlements, and decanting (all discussed below) can enhance these protections by allowing the trustee and beneficiaries to better address unforeseen circumstances that may threaten the protective trust shell.

One area, however, where trusts have become less effective protectors of wealth is divorce. There has been a trend in some states toward courts increasingly reaching in indirect ways into trusts as part of divorce settlements. The spendthrift rule remains sacrosanct almost everywhere. A divorce court cannot order the trustee of a third-party trust to turn over assets to the non-beneficiary spouse. However, in several states, the irrevocable trust assets available to one spouse are considered property of that spouse in the division of trust assets. In some states, such as Colorado, increases in value of the trust during the marriage are treated as marital property. See Colo. Rev. Stat. §14-0-113(4). As a result, a large share of the directly owned marital estate may be awarded to the non-beneficiary spouse.

Even more shocking are the cases where the court orders the beneficiary to pay the other spouse additional amounts when the trust terminates. See, e.g., In re Marriage of Dale, 87 P.3d 219 (Colo. Ct. App. 2003); Zuger v. Zuger, 563 N.W.2d 804 (N.D. 1997). In Becker v. Becker, 858 P.2d 480 (Ore. Ct. App. 1993), the court determined that the wife’s interests in several trusts were subject to division. The court awarded the husband a share of the interests in the form of a promissory note payable in installments and a balloon payment payable when one trust ended. Id. at 480-82.

Trusts Are Living, Changing Entities

Many years ago, we wrote a paper on administering irrevocable trusts that started with the proposition that clients often have trouble with the concept of irrevocable. The client would tell the lawyer she wishes to change the trust. The lawyer would respond, “But it is irrevocable.” The client would reply, “I know, but I can still change it, right?”

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Trusts have evolved over the past three decades as increasingly effective protectors of wealth.

trust severance and merger statutes, which supplement the increasing inclusion of these powers in trust agreements. Often a desired change in an irrevocable trust can be addressed by merging the trust into a new or existing separate trust with similar provisions.

Finally, the emergence of the concept of decanting provides a completely new platform for changing irrevocable trusts. The trustee can exercise its distribution power to distribute the trust property to an entirely new trust, with substantially different terms. Twenty-six states now have decanting statutes. In 2015, the Uniform Law Commission completed a Uniform Trust Decanting Act that, hopefully, will bring more consistency to the decanting law. It has been adopted in one form or another in five states.

Decanting is a double-edged sword. It creates the impression that a trust can be changed in many ways at any time. That is not the case, as a close reading of any decanting statute will reveal. More importantly, a trustee must keep a careful eye on the tax implications of trust decanting. The Internal Revenue Service (IRS) has made clear, for example, that it would view certain decantings as “un-grandfathering” a grandfathered generation-skipping transfer (GST) trust.

Trusts Are Not Income Tax Shelters

In the 1960’s, 70’s, and early 80’s, trusts were often used as vehicles for sheltering income. The Internal Revenue Code contained a wide range of brackets that applied to both individuals and trusts, and a top bracket that exceeded 50 percent — in fact 70 percent or 90 percent at times. High-income taxpayers would move income-producing assets to trusts, sometimes many trusts each holding a small interest, to take advantage of the bracket run-up. There was a creature called a Clifford Trust. It did not hold a large red dog. Rather, it was a statutorily authorized way to shift income to a lower bracket trust beneficiary for a 10-year period. Congress significantly compressed the trust tax brackets in 1993, and Clifford Trusts were eliminated in 1987.

Income-shifting for state income tax purposes remains an active part of trust planning. A trust that is considered a resident taxpayer in Delaware, Florida, Texas, Wyoming, Washington, Nevada, South Dakota, or Alaska will pay no state income tax on its income (excluding, of course, income from business activity or tangible assets located in another state).

At the federal level, the income tax planning opportunity has evolved into a transfer tax planning opportunity with grantor trust planning. The ability to transfer assets to an irrevocable trust and accomplish transfer tax savings, but leave the grantor responsible for the tax on trust income under the grantor trust rules, is one of the most significant benefits in trust planning.

Trusts Can Last a Long Time

The earliest conception of trusts was that they were anti-competitive. Laws were created to prevent someone from taking assets (especially land) out of commerce for too long. A trust for
private beneficiaries could not be perpetual. The rule against perpetuities prohibited it. If one thinks about it, the initial rule did allow trusts to last for quite some time — but it was a much shorter period than now.

Lives in being plus 21 years probably was no more than 60 to 90 years in most cases in the 1600’s or 1700’s. With longer life expectancies, it now routinely is 100 to 120 years. We currently are approaching the end of the perpetuities period for trusts that were created in the early 1900’s. The lives in being have died and the 21-year period is running.

Many trusts created in the last 25 years will last forever. Nineteen states and the District of Columbia have either eliminated the rule against perpetuities or made it optional. Many other states have provided for a set number of years that is the functional equivalent of forever. Florida’s rule against perpetuities is 360 years. Think about a trust created 360 years ago — 1658. Colorado, Utah, and Wyoming have a 1,000-year rule against perpetuities. Will trusts created today still be around in 2378 or in 3017?

We know we will not be here to answer that question. But we still plan a good long run of continuing to serve the trust industry through our affiliation with the American Bankers Association.

Thank you to our readers, our listeners for our telephone briefings, and our students from our many decades at Trust School.

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Leadership Shifts at the Banking Agencies

For the time being, Martin J. Gruenberg remains the Chairman of the Federal Deposit Insurance Corporation (FDIC), but the top leadership at the other two prudential regulators — the Office of the Comptroller of the Currency (OCC) and Federal Reserve Board (FRB) — is changing.

Comptroller Otting Assumes Office

On November 27, 2017, Joseph M. Otting became the 31st Comptroller of the United States, replacing Thomas J. Curry, who served as Comptroller between April 2012 and May 2017. The Comptroller is the chief officer of the OCC and administers the federal banking system, which encompasses national banks, federal savings associations, and federal branches and agencies of foreign banks in the United States. Together, these institutions comprise nearly two-thirds of the assets of the commercial banking system.

After Comptroller Curry completed his five-year term and left the agency in May 2017, President Trump nominated Mr. Otting for the top post at the OCC. Upon his confirmation by the Senate in November, Otting took over from Keith A. Noreika, who had been serving as Acting Comptroller since Curry’s departure seven months earlier.

Before becoming the U.S. Comptroller, Otting was a banking industry executive, having served most recently as President of CIT Bank and Co-President of CIT Group. He was also president, CEO, and board member of OneWest Bank, and before that, served in a variety of leadership roles at U.S. Bank and Union Bank. He began his career in branch management, preferred lending, and commercial lending for Bank of America.

Powell Nominated to Fed Chairmanship

Janet L. Yellen, the Chair of the Board of Governors of the Federal Reserve System since 2013, is leaving the Fed when her term expires in February. Nominated to be the Fed’s first female chair by President Obama, Yellen is popular among both Democrats and Republicans. However, rather than asking Yellen to serve a second term — as has been the practice of recent presidents — President Trump nominated current Fed board member Jerome H. “Jay” Powell to replace her. If confirmed, Powell will begin serving in February and Yellen will step down.

Powell, a moderate Republican, began serving on the Board of Governors in 2012, having been nominated by President Obama. He was also an official at the Department of the Treasury under the George H.W. Bush administration. Powell is known for his non-partisanship, consensus-building, and strong advocacy to Congress against defaulting on the federal debt. He is a lawyer and former partner with the private equity firm The Carlyle Group.