

Danielle Friedman: Welcome to Trust Us Estate Planning Wisdom, the podcast where we unravel the complexities of estates and trusts to empower you with the knowledge needed for effective estate planning.

Max McCauley: This podcast is hosted by seasoned estates and trust attorneys, Danielle Friedman, Herb Fineburg, and Charles Max McCauley.

Herb Fineburg: This podcast is your guide to the intricate landscapes of estate planning, including wills, trusts, and probate.

Danielle Friedman: Thank you for joining us, and we hope you find the discussion informative. But remember, when it comes to legal matters, always consult with a qualified attorney regarding your specific case.

Hello, everyone. Hi, Max. Hi, Herb. Today's topic is an interesting one. It's about how long trust should last.

Sometimes we call these dynasty trusts, and we're gonna talk about what we think an appropriate term for a trust should be. And today's facts that we're gonna discuss are as follows. A family owns some valuable real estate. They own a company that owns this valuable real estate. And mom and dad die, and they leave this company, which just owns real estate, to their son in trust.

The son was in his early thirties when mom and dad passed away, And mom and dad, in their estate planning documents, left the real estate company in trust for the son. But the documents said that when the son reaches age 35, the trust can be terminated at the son's discretion, and he can withdraw all of the property that was held in the trust at age 35. Fast forward, and son is age 50. He hasn't really touched his trust. The the property is is in trust.

He's obviously older than age 35, but he hasn't withdrawn the trust property. And he's in his fifties now, and he's married, and he has kids, and he files for divorce. And the ex wife or soon to be ex wife wants to claim some of the trust property as marital property because her husband could have accessed it at age 35. And the parents did not foresee that giving their son a withdraw right from the trust at age 35 led to the unintended consequence of his suit to be ex wife being able to claim some of the trust assets or really all of the trust assets as marital property and not only receive part of the trust assets as marital property, but also any appreciation on those trust assets from age 35 through the date of divorce as part of the divorce settlement. So Herb and Max, is this something that that you've seen previously, these types of trusts and this type of result when a trust is not a lifetime trust for the beneficiary, but rather terminates at a certain age or where the beneficiary has withdrawal rights at a certain age?

Herb Fineburg: Yes. It it's not uncommon. We don't typically prepare

documents that way. One of the first things that always sets off alarms is giving the beneficiary the unilateral right to withdraw the assets from the trust because the judge, of course, would be able to order him to withdraw the assets since there's nothing prohibiting it. So in most of our trust documents, we would typically say that the trustee has a discretion to distribute it.

So that if the son is in a situation like this, at the minimum, the trustee can defer the distribution rights at the trustee's discretion and keep it in trust, which might help in the divorce proceeding. And Max, this client had a prenuptial agreement, and I'm getting the impression that the prenuptial agreement granted his spouse the right to claim future appreciation after the marriage to these assets, even this asset in trust.

Max McCauley: That's correct. So appreciation after he reached 35. So getting a divorce at 50 would have yielded as part of the equitable distribution about fifteen years worth of appreciation of the real estate. In the past fifteen years, there's been substantial appreciation.

Herb Fineburg: So he didn't have a very good prenuptial agreement too. His parents left it in trust. They had too early withdrawal date. He then compounded the problem by saying that after age 35, and he picked that up because his trust said he got it at 35. And her attorney said, well, you have a right to it at 35.

She had gets all the appreciation after 35.

Max McCauley: Half of the appreciation and equitable distribution of the appreciation past 30 part of the marital estate. And the prenuptial agreement expressly referred to the trust. So it was certainly something somebody had intentionally planned on. Danielle, what are the advantages or disadvantages of 35 versus a lifetime, and how have you seen that change over the years?

Danielle Friedman: Sure. So take that in two parts. As far as advantages to age 35 and allowing a beneficiary to withdraw assets at age 35. I guess the only real advantage there is reduced costs of administering a trust for a beneficiary after age 35, but I don't really see any other advantage, and that so called advantage seems somewhat de minimis compared to the downsides of being able to have that trust property available for distribution in the event of divorce or available to the claims of creditors. There's not a huge advantage to having a trust terminate at any age.

If your state allows a trust to last for a longer period of time, because each state has different rules about how long a trust can last, I go for the longest period possible. And the reason is because allowing a trust asset to stay in play within a trust or, let's say, a

beneficiary's lifetime protects that asset from the beneficiary's creditors. It protects the asset in the event the beneficiary gets divorced. Now, of course, the terms of the trust have to be written a certain way to afford the beneficiary those advantages. But the way that I draft trusts, those assets would be protected.

And it's really kind of an old fashioned methodology to permit the beneficiary to have withdrawal rights at certain ages. And it's sort of a cookie cutter approach that was really popular back in the day, and my outlook on trust drafting has evolved when I see that the benefits to leaving trust property in trust for a beneficiary's lifetime, the advantages greatly outweigh any sort of administrative considerations in allowing a trust to terminate or giving a beneficiary withdrawal rights at a certain age. And moreover, in this scenario where you had parents die and leaving assets to their son in trust, If there are any death tax consequences to doing that, those death taxes, whether it's the federal estate tax or state inheritance tax, they're paid one time at the death of the surviving parent, and then that's it. They're not paid again because, hopefully, the tax has been paid or there's been enough exemption that covers any future taxes that might be due. And if you have a trust that terminates at age 35, you are bringing all of those assets back into the beneficiary's taxable estate, and then what you're doing by having that term is triggering estate taxes again.

So when the son dies and let's say he leaves the assets to his children, they're gonna have to pay inheritance tax again. They're gonna have to pay federal estate tax again. If you had a lifetime trust, you only pay the tax once, and you eliminate the tax being triggered for future generations.

Herb Fineburg: So that's a a very interesting point. The longevity of the trust is important for saving on estate taxes. So if the a trust continues and assuming there's no generation skipping transfer tax applicable, if the trust is an exempt trust for GST purposes, generation skipping transfer tax, When that person pulls it out of the trust into his name, that beneficiary, my guess is there's going to be a federal estate tax of about 40%.

Danielle Friedman: Yeah. I mean, in this case where you have super valuable real estate that I think it was worth around a hundred million dollars at the time that client was getting divorced, so in his fifties. Let's say he dies around this time if something horrible happens and he dies with this hundred million dollar asset that he has access to, he's gonna have a federal estate tax. He has his exemption of currently \$14,000,000, and then you have \$86,000,000 subject to federal estate tax, and 40% of that is gonna be subject to federal estate tax.

Herb Fineburg: So round numbers, by taking it out of the trust, he's

changed his estate plan unintentionally by allowing the government to be a beneficiary of 40% or \$32,000,000, his kids getting the balance as opposed to his kids getting all of it.

Danielle Friedman: Exactly. And the unfortunate thing about these types of trust is that the beneficiary can't really do anything about taking out the assets. You know? Let's say he's sophisticated, and he's in his fifties, and he has this highly valuable asset and trust, and he says, well, I have the right to withdraw at age 35, but I didn't exercise that right. So I'm leaving it in trust.

Will that save me from federal estate tax? I'm not gonna touch the trust. And, unfortunately, the answer is no because he has the right to withdraw at age 35. The IRS and other taxing authorities don't really care if you exercise your right to withdraw. If you have that right, the way the IRS looks at it, it's your asset whether you withdrew it or not.

So even taking the position of, well, I'm not gonna touch my trust. I'm gonna make the decision to just leave the money in there. Doesn't matter because the trust says it's yours at age 35.

Herb Fineburg: So that's a good reason to have the discretion to withdraw, eliminate it, and give the trustee a discretion to distribute.

Danielle Friedman: Yeah. I mean, in the in the trust we create for our clients, rather than giving beneficiaries withdrawal rights, the trust assets are in trust for the beneficiary for their lifetimes, and then the trustee has a purely discretionary power whether to distribute trust property or not. And what that does is protect the assets from the beneficiary's creditors, including divorcing spouses, and it prevents the assets from being included in the beneficiary's taxable estate when the beneficiary dies. So when the IRS looks at that trust, that is purely discretionary and held for the beneficiary's lifetime, the IRS can't make the argument that those assets were in the beneficiary's taxable estate. Instead, they are outside the beneficiary's taxable estate, and they're not subject to death tax.

Herb Fineburg: So one one of the things is when you prepare documents such as what was done here where you have a right to a troll at age 35, you were in essence voluntarily agreeing to be subject to an additional tax.

Max McCauley: And when you said additional tax, this isn't income tax. This is some other tax. Correct?

Herb Fineburg: Yes.

When we we talk about saving on federal state taxes, death taxes,

sometimes people get that confused with income taxes. We're still paying income taxes. So, there's a profit in the business, still have to pay the profit in the business, but we don't have to pay what we call a surcharge or a transfer tax applicable when the asset passes from one person to another. That's a transfer tax.

Max McCauley: Danielle and Herb, so how does this lifetime trust differ from another kind of trust I've heard called a dynasty trust, or is it the state of tech?

Danielle Friedman: So those terms can be interchangeable. Dynasty trust refer typically referred to trust that last multiple generations. If you have a lifetime trust, hopefully, it will also last multiple generations. It really depends on the value of the property and the trust and if it's going to sustain multiple generations of beneficiaries. That being said, you're not stuck with a lifetime trust if, for example, the trust assets have diminished to a point where it doesn't make sense to keep them in trust.

Let's say, over the years that you've spent down the trust, beneficiaries have expended trust principal and income, and now let's say there's \$50,000 left in the trust. All trust agreements or most trust agreements usually have provisions in there that say that if a trust is diminished to a point where it's no longer administratively practical to keep the assets in the trust, the trust can be terminated. So your hands are not tied, and you're not beholden to to the trust document. But I would say, generally, dynasty trust and lifetime trust are used interchangeably.

Herb Fineburg: So if you look at trust and let's just take a simple example. You have a trust that has 10,000,000 in it, and you're trying to decide whether to take the money out of the trust and reintroduce it to the federal state tax system and therefore pay 40% to the government when you die. And that trust, it's gonna cost \$4,000,000 federal state taxes to take that money out of the trust. If you leave it in the trust and you don't die for another twenty years, that 10,000,000 might be 20,000,000. And 40% of that will be 8,000,000 of tax savings.

That's a lot of money for children and grandchildren. And the cost of administering the trust is, generally speaking, the cost of preparing the tax returns and the time associated with keeping track of the trust money. Oftentimes, the trustee is a member of the family and they don't charge a very large fee or they don't charge a fee at all. Or if it's a bank, they charge approximately 1% of the corpus each year, which might include tax returns. So even 1% a year is never gonna get you to the 40% surcharge you're going to pay when the next generation passes away.

Danielle Friedman: So in this case, what I would have done differently

had the parents of this this divorcing fifty year old man been my clients, their estate planning documents would have said that everything passes in trust to their son for his lifetime. And they would have said, well, why? You know, he's gonna be financially mature at age 35. I I don't need him to have a trust that lasts forever. I want him to be able to access the money because that that's a comment I hear a lot.

And I say to them, listen. At age 35, he's probably gonna be married. He might be in a profession. Because when they were doing this planning, their son was probably young, didn't know exactly what what his future held. And I like to tell people that at age 35, you're concerned about him accessing the money.

Well, at age 35, you should also be concerned about divorce either at that age or in the future. And if he's in a high risk profession, you should also be concerned about the fact that there might be creditors that may go after your son. So leave the property and trust for his lifetime. He can still benefit from it. He can still use the money if needed.

The trust is solely for his benefit, but you get these added freebies. Really, it's a freebie. They're that you're paying for the estate planning. You might as well get the trust that protects your children and your beneficiaries the the most that it can and have it in trust for their lifetime. And here you have another unintended consequence, which is now the son is getting divorced.

His ex wife is going to receive a portion of the property that they wanted to keep in trust for their son. Now it's possible that the ex wife gets remarried, maybe has children in the future, and leaves a part of that property to her new spouse or her children, which are not the children of her ex husband. And then you have property passing to individuals that the original owners could have never dreamed of, certainly would not have desired to have owned that property.

Herb Fineburg: So on that point, we've been talking about this this particular individual's divorce. After he withdrew the property from the trust, he also could have died and left it to his wife. And for the reasons Danielle has just described, it may never reach the hands of the the parents' grandchildren. And and in our next episode, we'll go over an illustration of that children. They could be terminated at any time.

Not only can they be terminated at any time, they can be attacked and litigated as to whether they're not they're enforceable for a whole list of things that I won't go into now. While the trust will continue to be respected by the courts, the courts protect wills and trusts and don't let beneficiaries generally disturb the terms of trust.

Danielle Friedman: Well, I think we covered everything that we could today when it comes to lifetime trusts or dynasty trusts. And I think the consensus is if you have the option, have the trust last for the beneficiary as long as possible. Max Herb anything else you wanna add?

Herb Fineburg: I I agree. Everlast for the for as long as possible as state law permits under the perpetuities clause. And we are sort of leaning towards dynasty provisions, so it would be for the life of the the children, potentially the life of the grandchildren for the same reason. It might it might even reach great grandchildren. Material wealth can be passed on for many, many generations as we know all the wealthy families in America have trusts that go on and on and on.

Wow. Great topic and we brought up a lot of very interesting issues, which they may be hard to digest at one time. But as we go through our podcast, these issues will come up over and over again, and it it will begin to resonate with our listeners.

Danielle Friedman: Alright, everyone. Until next time.

Herb Fineburg: Be well. Take care.

Max McCauley: You too.