

A Primer for the Businessperson: In Trusts We Trust



By George N. Saliba, Managing Editor

Since the average net worth of New Jersey Business magazine's readers is \$1.2 million, it stands that they either already know – or might want to know – something about trust law. While one need not be excessively affluent to establish a trust, it is true they aren't necessary in every case. When appropriate, they can offer an array of benefits, including, for example: accomplishing substantial estate tax savings; allowing protection from creditors; and permitting the person who sets up the trust to control which persons are going to ultimately receive the assets, and when. Among many other uses, trusts can also protect beneficiaries from themselves. For instance, they can prevent an inexperienced 21-year-old from receiving a lump sum of \$500,000.

What Is a Trust?

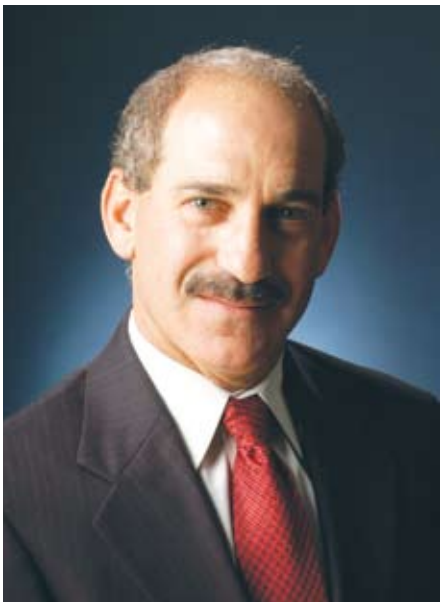
While trust law is extraordinarily complex, it essentially involves giving money or other property to a trustee, who in turn holds property for a beneficiary or beneficiaries (people who will receive the property). Different types of trusts exist, and they can be created either when a person is alive, or established when a person passes away. Also, trusts may have provisions for change, or, on the other hand, they may be irrevocable.

One trust use is for ameliorating estate tax burdens. The federal estate tax exemption is currently \$2 million (it changes to \$3.5 million in January), and in New Jersey the state tax exemption is \$675,000. A hypothetical married couple with children collectively might have \$3 million in assets (\$1.5 million owned by the wife and \$1.5 million by the husband). Then, the wife dies, leaving her \$1.5 million to her husband. A short time later, he dies, with \$3 million in total assets. Absent a trust, the first \$2 million is, of course, exempt from federal taxes, but the next \$1 million would be subject to substantial taxation.



Anthony F. Vitiello, chairman of the tax and estate planning group at the law firm Connell Foley.

However, had the wife put her \$1.5 million in a trust for the benefit of the surviving husband, with the trust assets to go to their children upon his death, then when she died, the money would not become part of his estate. Yes, he might even be the trustee of the trust, but he is *not* the owner and the money would pass free of federal taxes to their children when he dies, since *his* estate is only \$1.5 million (exempt from federal taxes). New Jersey estate taxes, of



Alan H. Zuckerman, a shareholder and tax, trust and estate attorney at the law firm Flaster/Greenberg.

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course, would also be significantly less. The husband could use the trust money prior to his death only under specific circumstances.

James B. Garland is a partner and head of the tax, trust and estate department at Coughlin Duffy LLP (offices in Morristown and Manhattan). He says, "Trust mechanisms are used a lot for purely estate tax savings – and that can be a significant savings down the line."

Meanwhile, a trust with the right language, for say a child, is not subject to creditors and can't be pledged as collateral. A beneficiary can go bankrupt, and the funds may be completely protected. Or, an acrimonious divorce may occur and, again, the trust funds are protected. However, trust assets and the income they generate are considered when determining alimony and child support, since they can generate



Steven C. Levitt, partner and co-chair of the tax and estates department at Fox Rothschild LLP

income.

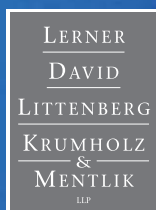
Another trust example: A business owner hopes to someday sell his or her business, and if he thinks it will greatly appreciate, a trust is an effective means to move assets which may appreciate in the future, to children at a very low cost. A business owner might put stock into a trust because the company isn't worth much. Years later, he or she might sell the company at a substantial price; proceeds from the sale are already in trust for the benefit of a child.

Anthony F. Vitiello, chairman of the tax and estate planning group at Connell Foley (offices in Roseland, Jersey City, Manhattan and Philadelphia), says, "A trust may allow for a consolidation of business ownership and control under one owner (the trust), even though there may be many beneficiaries of that trust (and thus many beneficiaries of the business' profits). Trusts can assist in minimizing estate and gift taxes on the transfer of businesses from one family generation to the next. Trusts can also prevent a beneficiary from creating havoc among the business' operations and other owners since a properly designed trust can provide profits to the beneficiary,



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yet avoid a beneficiary's creditors or divorcing spouse from levying upon the business' assets or ownership."

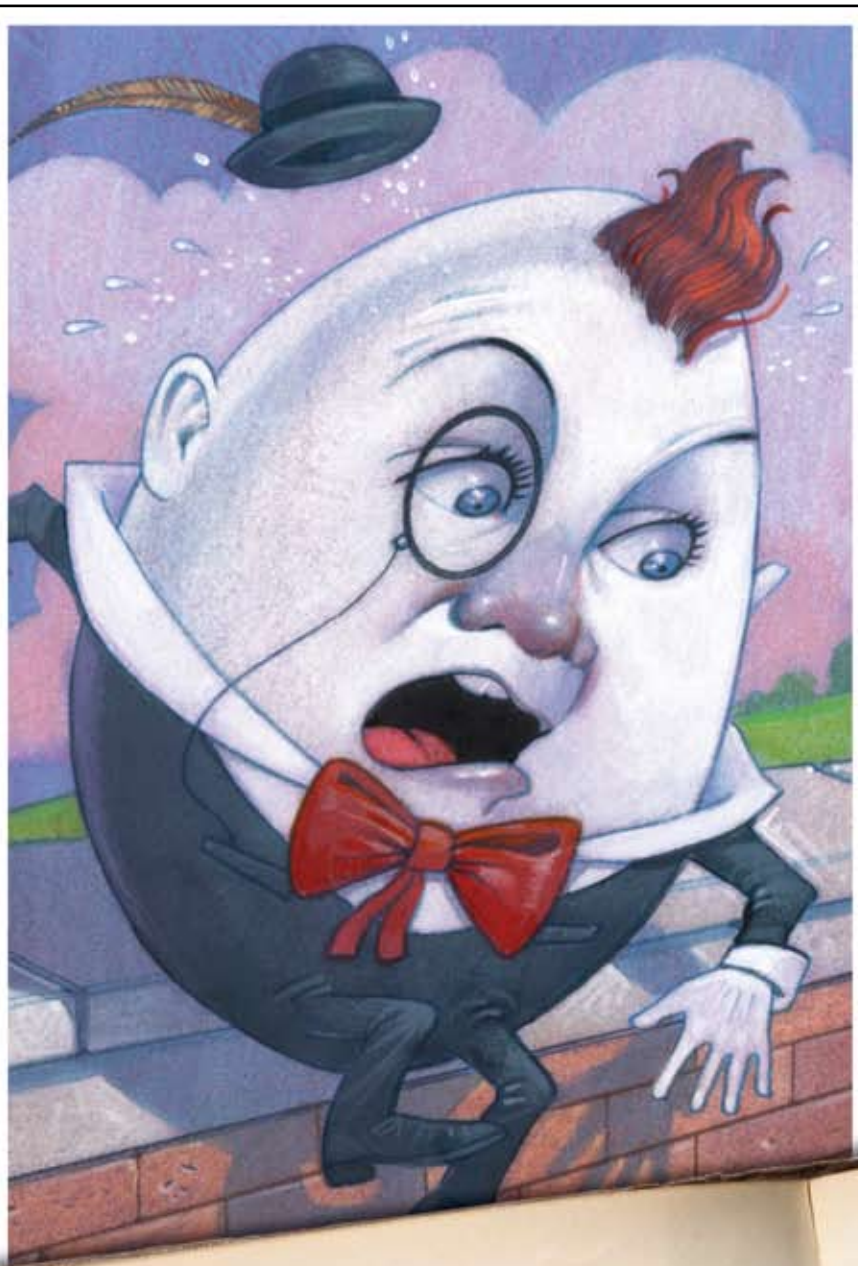
Speaking broadly, Coughlin Duffy's Garland says, "Trusts provide lots of opportunities for asset preservation, asset protection, and for gifting of assets down to other family members." Another trust example is a life insurance trust, which allows, if properly drafted, for life insurance proceeds to be excluded from both the testator's estate and the spouse's estate.

Establishing a Trust

Echoing the sentiments of several attorneys, Steven C. Levitt, partner and co-chair of the tax and estates department at Fox Rothschild LLP (offices in Atlantic City, Princeton, Roseland and 11 other locales) underscores the complexity of trust law. He says, "There are many lawyers who feel they are in a position to prepare a trust for a client. We who specialize in this area regard it as a specialized area of practice, and feel that mistakes happen when generalists try to do things that are beyond their skill level."

He adds, "The average client should respect the specialization that is needed and not simply go to the attorney who closed on their house."

In broad strokes, attorneys say when a trust is considered, they should learn about the client's assets. In addition, a review of client's existing estate planning documents is needed to ensure the new trust doesn't conflict with these documents. Also, if the person establishing the trust is in business, an attorney should see if business agreements exist which would affect the use of implementing trusts in an estate plan. Attorneys also want to determine whether the trusts should be revocable or irrevocable, depending upon income, gift and estate tax



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Trustees

Of key importance is the selection of a trustee, which could be a spouse, relative or a financial institution (such as a bank).

John R. Blasi, president and a member of the executive committee at Lindabury, McCormick, Estabrook & Cooper, PC (offices in Westfield, Summit, Rumson, Manhattan and Philadelphia), says, "Somebody you name today as a trustee might fall out of favor with you. So is there mechanism in the document to allow the trustee to be removed and replaced with a successor? Because you might pick your friend Harry today, but in a year, or six months, Harry is not your friend anymore. Have you made a provision in the document to get him out and replace him with somebody that is right, to fill that position? That's something I see. Some people don't



James B. Garland is a partner and head of the tax, trust and estate department at Coughlin Duffy LLP.

have that safety valve in there."

Blasi adds that a person does not want to be too narrow in the direction of how money for the beneficiary may be used and thought should be given as to

when to ultimately distribute the trust.

"What levels of maturity do you think your child will reach, at certain points, and when should they receive assets free of trust? What if there is a circumstance present with the child, even though the trust says, 'Distribute it at age 30'? If a circumstance exists with the child (such as substance abuse) and they are 30, have you built in a mechanism to protect those assets and maybe not distribute it at age 30? There has to be built-in flexibility to the many areas of the trust: a document that is drafted now, but might have to address situations 10 or 15 years down the road."

As for trustees, they must be willing to do the job, must be reliable and honest, and should have the financial acumen and presence of mind to handle advisors and make sound decisions regarding trust administration.

Strategically

Is it better to win today, yet potentially lose five moves down the board? Or settle today and focus on winning eight moves later? And in either case, how will your adversaries counter? The right law firm will take the long view. Do more than react. Weigh tactics against benefits, gains against repercussions. And that's how Pepper works. Not so much a business partner thinking in our best interests, but an ally thinking in yours. Strategically, in all directions.

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Alan H. Zuckerman, a shareholder and tax, trust and estate attorney at Flaster/Greenberg (offices in Cherry Hill, Linwood, Morristown, Philadelphia, Trenton, Vineland and Wilmington), says, "I usually advise my clients who are looking for a trustee that they want somebody – or a combination of somebodies – that have integrity and are financially astute. Financially astute doesn't mean that they have to necessarily be an investment advisor or a stock broker, but they should be able to seek advice from professionals, understand it, and then act on it. Also, you want somebody who has something more than just a financial interest in the beneficiaries of the trust that you have set up. That's why when somebody sets up a trust, they will pick a professional trustee, like perhaps a bank or trust company, but *also* make another family member a co-trustee, to try to get that balance."



John R. Blasi, president and a member of the executive committee at Lindabury, McCormick, Estabrook & Cooper, P.C.

Conclusion

Even people with, say, \$500,000 often wish to establish a trust under their will, because if they die and have children, \$500,000 isn't something they want given to the

children in one lump sum.

Zuckerman says, "It is very, very common to see trusts set up and it is becoming even more common for high-wealth individuals to set-up these *inter vivos* trusts (a trust established when one is living), to take advantage of different tax planning."

Blasi, at Lindabury, finds it surprising how many people lack adequate estate plans, including a simple will, power of attorney and a medical directive.

He concludes, "Sometimes people think that because they don't have large assets, they don't need those documents. They do. Whether it is \$100, or \$100 million, there is a core set of documents everyone should have ... which includes trusts, if appropriate."

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