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2012 Set To Be Tax Driven For Wealthy Clients, As Fiscal Uncertainty Continues

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After a busy 2011 for trust and estate practitioners, 2012 will be "even more tax-driven," says Dan Lindley, president of The Northern Trust Company in Delaware and chief fiduciary officer of its private client business in Guernsey and Cayman Islands.

"Generally speaking, what we see in Delaware is that clients' planning initiatives are often framed by developments in the US tax code," says Lindley.

Recent efforts got underway in 2010 when the Tax Relief Act ushered in "unprecedented" opportunities to make lifetime gifts – but only within a two-year window set to expire at the end of this year – explains Lindley. "What we are certainly going to see is a steady if not frenzied effort by our clients to use the exemption in this window."

"So far in 2012 what I'm seeing is largely the creation of dynasty trusts," he adds.

The pros of dynasty trusts

One thing clients can do of course is make an outright gift, but this comes with a number of disadvantages, so they are "wisely" using the trust option, says Lindley.

Dynasty trusts "last potentially forever" and avoid all future gift, estate and generation skipping taxes, as long as the assets are left growing inside a trust, which can have "a tremendous impact on wealth accumulation" over generations, he says.

Clients also opt for dynasty trusts to try and retain some control over the assets during the lifetime of those assets. In addition to tax savings, grantors use trusts to control and protect beneficiaries to some degree, he explains, sometimes because the beneficiaries might be infirm, or suffer from addiction, or be too immature to take control of the assets.

Dynasty trusts can also be used to motivate beneficiaries, using incentives to reward positive behavior (in the eyes of the grantor) and methods for deterring behavior such as gambling, criminal activity or addiction. A final aspect of control relates to a family business, where a patriarch or matriarch has built up an enterprise that he or she doesn't want broken up. Where the interests in the business are passed directly to children or more remote descendants they can be transferred directly out of the family, so leaving it in trust can help keep the business together.

On the other hand, one can envision a situation where a grantor tries to impose too strict a set of rules on beneficiaries, sowing the seeds of discontent that may be destructive in other ways. However, Lindley says you can build the necessary flexibility into a trust instrument to ensure that if there are compelling reasons to allow a business to be sold, for example, then it will be.

He says an important aspect of Delaware law in the case of closely-held assets is the ability for trustees to work with investment advisors – not in any strict sense of the word, but an individual or committee made up of family members, or close family advisors, for example. This advisor can be vested with the power to direct the trustee with respect to all investment actions of a trust.

There are two alternatives for managing closely-held assets held in a long-term trust: 1) vest responsibility purely

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with a corporate trustee, such as Northern Trust, to use its experience with closely-held assets and family businesses to make investment decisions, or 2) if someone doesn't feel comfortable with this, appoint an investment advisor to oversee the assets. In the second option the investment advisor can be self-replacing over generations, or a trust protector can appoint successor advisors.

Planning in an uncertain climate

But as clients attempt to make preparations, there is still "great uncertainty about the timing of the two-year window," says Lindley. "There's concern Congress will say 'this is an area where we can pick up revenue' by reducing the lifetime exemption limits."

As readers will no doubt be aware, rumors swirled towards the end of last year that the Super Committee would act, and while this didn't materialize, Lindley, like many of his colleagues in the trusts and estates planning industry, urges action "sooner rather than later."

Luckily, while tax uncertainty abounds, the investment climate has calmed somewhat – when compared to 2008/09, that is.

"In the 2008/09 time I think many clients were paralyzed by what was going on," says Lindley, who doesn't think that's the case anymore. He still sees lingering doubts, though. He hears from clients who see the sense of using the $5 million exemption but are worried that a repeat '08 situation could leave them financially stressed without those assets.

"Typically when you create a trust you've parted with all interests and control but we're seeing use of a technique of retaining a limited ability to get assets back," says Lindley. He explains that this is a trust structured as an asset protection trust where the client is also a beneficiary, but the client's ability to access the assets is limited to the sole discretion of a trustee or distribution advisor.

This arrangement can create "a completed gift, where the assets are out of [the client's] estate" but where the client can get them back, and undo the careful planning, in an extreme situation like financial ruin, he continues. The client can only get these back as a last resort and it will mean the client's exemption is wasted, but this won't matter anyway if these assets are all that is left.

Growing need for asset protection

Another trend Lindley has seen is the growing awareness of asset protection, as distinct from estate planning.

"Domestically, we have had since 1997 asset protection trust statutes. Early on there wasn't great acceptance of them," he says, adding that nowadays "he couldn't even begin to count" the number of clients trusts for asset protection, quite apart from estate planning. In his opinion, it is becoming increasingly popular to protect against unforeseen creditors and other incidents, as well as spousal interests.

Another side of this story is on the international front, as the world has just come to the end of a year mired by political and economic crises in regions as diverse as North America and North Africa.

"We're also seeing international clients, who used to look very favorably on the US, who are starting to feel uncertain about the US tax code," says Lindley. "Some have reached such 'a level of discomfort' about where the US tax code is going that they are turning to Guernsey and other Channel Islands to keep their asset farther removed from the US."

But all these concerns aside, Lindley has one key message he really wants to get across to wealthy clients: "Use the various techniques you have to reduce your estate, and do it sooner rather than later."

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