By **Al W. King III** & **Pierce H. McDowell III**

# Selecting Modern Trust Structures Based on a Family's Assets

A round-up of the available options

Trusts have grown enormously in popularity since the mid-1990s as a result of the development of modern trust laws, the dramatic increase in wealth and evolving family needs and goals.[1] Modern trust laws promote many key desires of a client's estate planning, such as flexibility, control, tax savings, asset protection, family values, governance, succession, education and privacy.[2] However, when designing and structuring a client's estate plan, these key desires may not be properly coordinated with the selection of trustees, the type of trust and the type of trust administration. The assets funding the trust are another key factor that often gets overlooked.[3]

Assets funding trusts can be quite diverse, particularly as an individual's net worth increases. Generally, the current composition of global wealth transfers is:[4]

- 40 percent privately held businesses
- 27 percent public holdings
- 6 percent real estate and luxury
- 27 percent liquid

This composition varies quite extensively by country (See "Asset Composition," p. 51).

In the United States, the top 10 percent to 12 percent of households own a large percent of illiquid assets, for example, closely held businesses and real estate, which aren't generally viewed as ideal assets for the typical trust.[5] "Popular Trust Assets," p. 53, summarizes many of the more popular client assets that need to be coordinated with a client's trusts. Consequently, given the diverse range of assets held by clients, decisions regarding the selection of the type of trust, trustees and trust administration are extremely important.

## Asset Diversification and Trust Laws

Many sophisticated family offices and investors view asset diversification as a key to both increasing return and reducing risk. This type of investing will typically involve: cash, domestic and international fixed income and equities, hedge funds, real estate, private equity (direct and funds) and natural resources (see "Average Global Family Office," p. 54). Many of these investments may pose issues for trustees based on the type of administration selected.[6]

The Uniform Prudent Investor Act (UPIA), passed in 1994[7] and adopted by most states, requires trustees to pursue an overall investment strategy considering various factors when formulating an investment program, including:

- Size of portfolio
- Nature and likely duration of trust
- Liquidity and distribution requirements
- General economic conditions—inflation/deflation
- Tax consequence of investment/distribution decisions
- Expected total return
- Role of individual investments in portfolio

The UPIA holds professional trustees to an even higher standard. Thus, as a result of both the potential fiduciary liability and lack of required expertise, many individual and professional trustees are reluctant to implement sophisticated asset diversification programs like those previously mentioned.

It's important to note that 70 percent of all wealthy families don't use corporate fiduciaries.[8] Popular trustee

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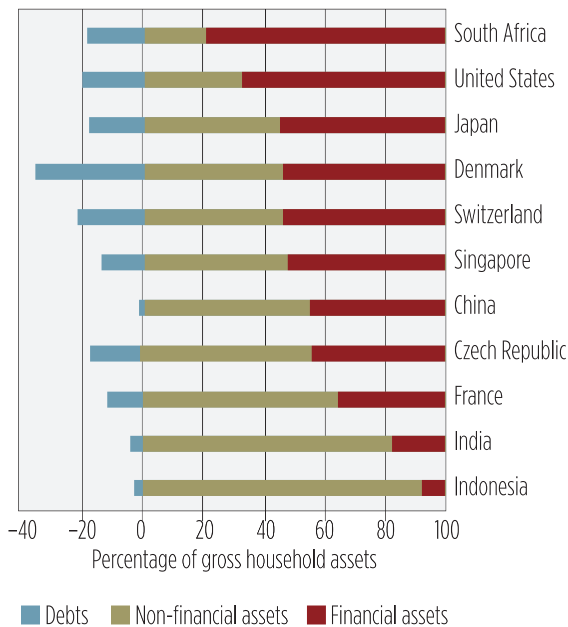
and co-trustee choices are: family members, business colleagues, friends, lawyers, CPAs and other advisors.[9] Most individual trustees don't have the requisite investment advisory and management expertise; consequently, they have to delegate these responsibilities. Moreover, serving as trustee subjects an individual to very high standards of fiduciary liability as well as personal liability.[10] He's able to delegate the duty, but not the risk.[11] Trustees who delegate investment advisory and management responsibilities are required to conduct due diligence on the professionals to whom they're delegating for asset allocation, investment management and monitoring.[12] Consequently, high personal liability standards limit an individual trustee's desire to act as trustee of a non-modern trust. Many of the modern trust states have delegated trust statutes limiting this liability to a gross negligence/willful conduct standard.[13] This liability limitation is effectively buying the individual trustees insurance that they can't otherwise obtain. As such, many clients change the situs of their trusts to garner this added protection.

Many large institutional trustees are hired to provide full service (one stop shopping) trust administration. Many of these large institutional trustees may be reluctant to invest in anything but their own previously approved trust investment products that they're familiar with and can easily monitor internally. Consequently, the products offered for trusts are usually more limited due to possible liability concerns. The trustee may view many of the desired asset allocation categories as too risky for a non-modern trust. Additionally, these large full service trustees generally have the ability to delegate investment management for products and services they don't provide, though such institutions are often reluctant to do so as a result of the risk and possible liability associated with such delegation. However, many of these institutions have existing trust administration services available in one of the modern trust jurisdictions providing for modern trust administration (that is, a lower liability standard for a delegated trust or directed trust) that may allow them to diversify more broadly.

## Modern Trusts/Asset Diversification

The directed trust is the most popular type of modern trust administration.[14] Unlike most types of full service and delegated trust administration services, directed trusts aren't available in all states.[15] Many full service trustees also have directed trust capabilities. Some of the more popular directed trust states are: Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming.[16] These directed trust states don't have income taxes on trusts.[17] Other key benefits of having a trust sitused in these states are asset protection, privacy, governance and the promotion of family values, as well as flexibility and control.[18] The directed trust generally trifurcates the traditional trustee role into an investment committee, distribution committee and a directed administrative trustee.[19] The latter is based in one of the directed trust states. Generally, if the trust is properly administered and has a substantial presence in one of the directed trust states, the client's resident state will recognize the trust and the directed trust laws.[20] Additionally, if this is the case, and publicly traded investment assets



are involved, the assets will be deemed located in the directed trust state if the assets are properly titled to the directed trust.[21] A directed administrative trustee has no discretionary investment duties regarding the trust. The selection of asset allocation, monitoring and/or investment management is generally the responsibility of the investment committee (not deemed a co-trustee but instead a co-fiduciary), which is usually run by the family and the family advisors. The investment committee members are typically subject to a gross negligence/willful misconduct standard of liability for serving in this role. This is a much lesser liability standard than serving individually as a delegated trustee in most states.

> Directed trust statutes typically provide for the ability to override the UPIA and, thus, don't require diversification of the trust assets whether public or private securities are involved.

In addition, as previously mentioned, a delegated trust will only allow trustees to delegate the duty, but not the risk.[22] To further protect the investment committee of a directed trust, a trust protector may be added with the power to approve and/or veto trust investments.[23]

## Non-Diversification of Trust Assets

In addition to the possible issues if a broad asset diversification strategy with sophisticated assets is desired for a non-modern trust, there may also be issues if the trust assets aren't properly diversified.[24] The UPIA provides for a general duty to diversify trust assets unless the purpose of the trust is better served without diversification (that is, low cost basis assets (sale would trigger large tax gains) and/or family business interests).[25] Generally, retention language is added to the trust to either "permit," "encourage" or "require" the holding. This language may or may not protect a trustee.[26] There are numerous cases indicating that holding one asset in a non-modern trust, even if mandated to hold the asset, could potentially result in extensive trustee/fiduciary liability.[27] Directed trusts provide significantly more fiduciary protection, as directed trust statutes typically provide for the ability to override the UPIA and, thus, don't require diversification of the trust assets whether public or private securities are involved.[28]

Further, there are few investment limitations with a directed trust as long as the trust investment management language allows for the investments, the investments are legal and they don't have any environmental issues. Typically, advisors will draft trust investment clauses as general powers and generally won't prohibit any specific types of investments.

## Investment Management LLCs/FIPs

Investment management limited liability companies (LLCs) are another modern trust administration concept that can be used in combination with a directed trust.[29] An LLC that's owned by the trust can handle the investment management of a trust, and a family member or family advisor can be named as the manager of the LLC. The investment committee of a directed trust typically directs the administrative trustee in a directed trust state to hold the LLC that will be responsible for the investment management. The trustee/trust generally will be the sole member of the LLC (that is, the owner of the LLC). The LLC manager would report to the investment committee and/or directed administrative trustee as to the underlying investment management taking place within the LLC on behalf of the trust. The investment management LLC owned by the trust doesn't usually have to be established in the same state as the trust situs, but doing so may be an important advantage from an asset protection and/or tax standpoint. Most of the popular directed trust situs states also have sole member LLC statutes allowing for a single owner (that is, the directed trust) as well as LLC sole remedy charging order protection as the exclusive remedy, thus adding another layer of asset protection to the trust.[30]

Many families also use family investment partnerships (FIPs). The investment management for a family is frequently done within one or more of the investment partnerships with the partnership units then allocated to family trusts. Generally, these FIPs also work best with a modern directed trust structure.

## Popular Trust **Assets**

*They comprise a diverse range*

| Investments | Life Insurance | Private Securities | Real Estate | Other Assets |
|---|---|---|---|---|
| Cash | PPLI* | Closely held businesses | REITs | Pets |
| Publicly traded securities: domestic and foreign | Term | LLCs*, ** | Residential real estate | Gravesites |
| Fixed income: domestic and foreign | AD&D | LPs* | Commercial real estate | Antiques |
| Hedge funds | Whole | Other | Land | Cars |
| Alternative investments | Universal | | Buildings | Art |
| Direct private equity | Variable universal | | | Jewelry |
| Private equity funds | Other | | | Memorabilia |
| Natural resources | | | | Royalties |
| Other | | | | Digital assets |
| | | | | Other property |

Key
PPLI—private placement life insurance
AD&D—accidental death and dismemberment
LLC—limited liability company
LP—limited partnership
REIT—real estate investment trust

* Please note: Also serves as a wrapper for investments
** Please note: Also serves as a wrapper for PPLI and real estate

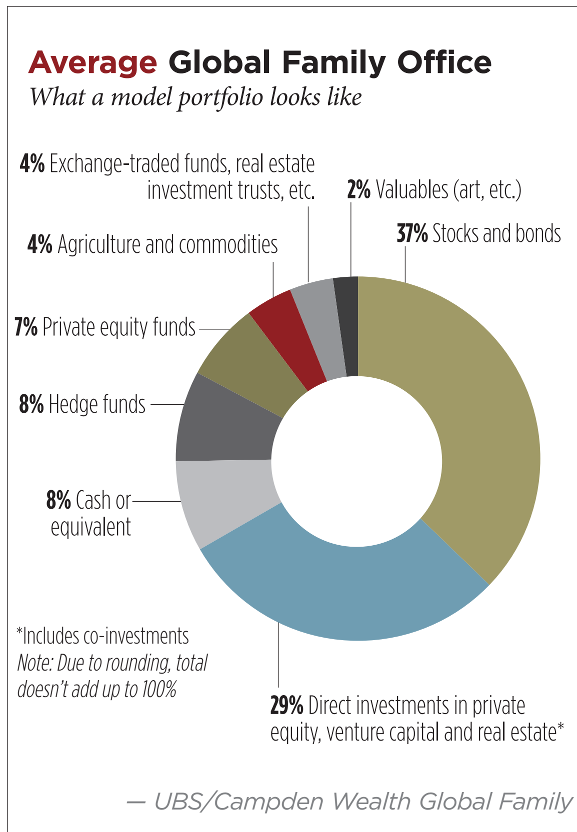
*— South Dakota Trust Company LLC*

Many families use separate investment management LLCs and/or FIPs for each type of asset class. Additionally, the investment management LLC may be of interest to families desiring an administratively convenient account to do their own trading within a trust. Generally, this isn't recommended, but sometimes required (due to the family dynamic or circumstances).

### Life Insurance

Life insurance is another popular trust asset. There are several trust-owned life insurance (TOLI) services and programs to provide for monitoring of insurance companies and policies. Consequently, life insurance is frequently purchased by both full service trustees and delegated trustees of both non-modern and modern trusts generally within an irrevocable life insurance trust. With a directed trust, the investment committee typically uses these TOLI services. As previously discussed, directed trusts may result in less trustee/fiduciary liability as compared with delegated trustees. Whole life, universal life, variable life and term insurance are frequently purchased for the payment of estate taxes and debts, survivor income, the purchase of key person insurance and the funding of buy/sell agreements. Generally, these types of insurance policies are structured to maximize death benefits and minimize cash value and require both upfront due diligence on the insurance company and policy, as well as ongoing monitoring by the trustee or investment committee.

Alternatively, private placement life insurance (PPLI) is generally structured to minimize death benefit and maximize cash value. PPLI is purchased to provide a tax-efficient wrapper for sophisticated investments such as publicly traded securities, alternative investments, hedge funds and private equity, many of which are tax inefficient.[31] Consequently, the modern PPLI policy provides an insurance wrapper for investments, thus eliminating federal and state income taxes on the investment capital gains and income. If the policy isn't structured as a modified endowment contract,[32] then tax-free policy loans may also be made from the cash value of the policy, which may be beneficial to trust




beneficiaries residing in high tax states. Many trustees will purchase insurance in trust and/or an LLC with situs in a modern trust state with low premium taxes and/or favorable insurance laws.[33] Insurance laws in certain low premium tax states also allow for in-kind distributions of cash value during life or death benefits, so if underlying assets are subject to an investment lock-up, it doesn't pose a problem.[34] Consequently, directed trusts and/or LLCs are usually the ideal choices for the purchase and administration of PPLI policies.

## Closely Held Business

Another popular trust asset is closely held operating businesses that typically take the form of LLCs, C corporations, S corporations and partnerships. A business may be either the main asset or a substantial asset of the trust. As previously mentioned, the UPIA requires a duty to diversify, which may or may not prove problematic. Generally, you can override the UPIA when family considerations outweigh fiduciary considerations so that the trust purpose is better served without diversifying (for example, retain family business and/or low basis securities).[35] In addition to diversification, other potential issues with a closely held business asset may be lack of yield, speculative investment, fiduciary conflict and fiduciary liability.[36] Mandatory retention language is popular within trusts, and if the facts change, the trustee can usually petition a court to sell the stock if the stock drops in value or other issues arise. Even with mandatory retention language, however, monitoring may still be required, and an exculpation clause may not waive the duty to diversify (this may depend on other supporting trust language).[37] As such, it may be helpful to assign the monitoring of the family business to a co-trustee with the appropriate knowledge of the business. The monitoring trustee may also want to coordinate with the board and/or officers of the business for updates to know when to sell. Another option is to coordinate the retention of the closely held business asset with a buy/sell agreement limiting the trustee's ability to sell the closely held business asset to the buy/sell agreement.[38] A directed modern trust eliminates many of these issues. Diversification isn't generally required with a typical directed trust so that the family business can be the sole or a substantial asset of the trust without a problem. Additionally, the ability to override the UPIA is much easier. The investment committee of a directed trust would be responsible for making decisions regarding the business interest held by the trust subject to a lower liability standard (that is, gross negligence/willful misconduct).[39]

Issues may also arise with both non-modern as well as modern directed trust structures when any trustee, co-trustee or fiduciary is also an officer and/or owner of the business. This usually results in a fiduciary conflict because he's serving both as a fiduciary of the trust as well as a fiduciary of the business. Fiduciary conflict language should generally be added to the trust and any other related documents to hopefully alleviate this problem.[40]

## Residential Real Estate

Qualified personal residence trusts (QPRTs) are popular estate-planning vehicles for residential real estate (primary and secondary homes). A great alternative to the QPRT is the promissory note sale of a residence to a defective grantor dynasty trust, which can provide many added benefits not available with the QPRT,

such as generation skipping as well as the ability for the grantor to receive the house back if desired or needed.[41] Additionally, many families use trust funds to purchase residential real estate for the beneficiaries. The beneficiaries can use the home tax-free, and the home is protected from creditors.[42] If the home is going to remain in trust for several generations of family use, families may consider establishing a family time share. Revocable trusts are also used for privacy purposes as well as to avoid ancillary probate.[43] Directed trusts and trust-owned LLCs can also be advantageous structures to administer trusts holding residential real estate.

## Commercial Real Estate

Commercial real estate is also an important asset for many family trusts. Typically, commercial real estate is held by closely held business structures, LLCs or limited partnerships. As a result of diversification, asset protection, and possible environmental and trustee/fiduciary liability issues, directed trusts are also a very popular alternative for commercial real estate.[44]

Potential issues may arise in the event that the commercial real estate held by the trust doesn't generate sufficient income for the income beneficiaries of the trust. This result can be accentuated if the trust isn't directed and if the commercial real estate is the sole or a substantial asset of the trust. Possible solutions may be an Internal Revenue Code Section 1031 exchange and/or debt/mortgage, but with a non-directed trust, these may require court approval.[45] Generally, both alternatives are also available with a directed trust, but with the added benefit of not needing court approval or possibly even not needing to pay or increase income.[46]

## Other Assets

Many other types of family assets, such as pets, gravesites, antiques, cars, art, jewelry, memorabilia, royalties, digital assets, land, property and buildings, may be best suited for a purpose trust. Purpose trusts first gained popularity with pets, which are considered "property."[47] Purpose trusts don't have beneficiaries. They have a trust enforcer to enforce the purpose, as well as a trust protector to oversee the trust and directed administrative trustee. Their sole purpose is to care, protect and/or preserve an asset such as those previously mentioned. The trust protector can convert the trust to a beneficiary trust at some point in the future after the trust's purpose is served. Also, family members can use the assets of a purpose trust if structured properly.[48]

## Additional Administration Structures

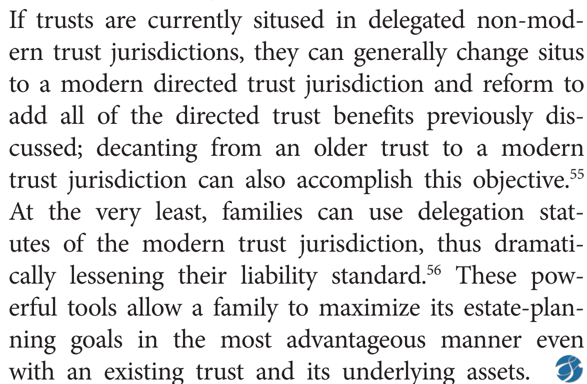
Many families like to supplement their directed or delegated family trusts with a more formalized structure for investment and distribution decisions. Consequently, they'll establish special purpose entities (SPEs), trust protector companies (TPCs) and/or a private family trust company (PFTC) to provide more formality, governance, mentoring, succession and education to the trust investment and distribution committees.[49] Instead of just focusing on the client, these modern trust structures allow for the focus to shift to the entire family and their goals. The participation and mentoring of children, grandchildren, siblings, nieces and nephews can be very important to many families. Additionally, family advisors may be brought in to assist with asset allocation and provide consulting services regarding fiscal and social responsibility.[50] These structures are generally LLCs, thereby providing a wrapper around the investment committee, distribution committee and trust protector functions, while also allowing the family to obtain directors and officers insurance as well as errors and omission insurance while serving in these roles.[51] Also, these structures are usually established in states other than their resident states, with meetings typically held outside their resident states, which may provide added asset protection, tax breaks and other advantages.[52] Additionally, a

More formalized structures are usually established in states other than their resident states, with meetings typically held outside their resident states, which may provide added asset protection, tax breaks and other advantages.

properly established, operated and administered regulated PFTC may allow for a family to establish common trust funds (CTFs) and/or business trusts (BTs), which may be useful alternatives to FIPs.[53] Unlike FIPs, CTFs and BTs are both Securities and Exchange Commission exempt, and therefore, not subject to the "99 investor" limitation (that is, the SEC limit of 99 investors for an LLC). Families can hire various investment managers to be the subadvisors of the CTFs and/or BTs. Lastly, these SPEs, TPCs and PFTCs are also generally owned by purpose trusts.[54]

## Reformation/Modifications

If trusts are currently sitused in delegated non-modern trust jurisdictions, they can generally change situs to a modern directed trust jurisdiction and reform to add all of the directed trust benefits previously discussed; decanting from an older trust to a modern trust jurisdiction can also accomplish this objective.[55] At the very least, families can use delegation statutes of the modern trust jurisdiction, thus dramatically lessening their liability standard.[56] These powerful tools allow a family to maximize its estate-planning goals in the most advantageous manner even with an existing trust and its underlying assets.



## Endnotes

1. *See* Al W. King III, "Drafting Modern Trusts" *Trusts & Estates* (December 2015) at p. 12; Al W. King III, "Selecting Modern Trust Structures Based Upon a Family's Assets," Boston Estate Planning Council (April 2017); Al W. King III, "So You Want to be a Trustee," Hofstra University—Private Wealth & Taxation Institute (May 2017).
2. *Ibid.*
3. *Ibid.*
4. *See* Andrew Soergel, "World's Super Wealthy to Transfer $16 Trillion in Inheritance Over Next 30 Years," *U.S. News & World Report* (Jan. 14, 2015).
5. *See* Edward N. Wolff, "The Asset Price Meltdown and the Wealth of the Middle Class," New York University (January 2013), *https://s4.ad.brown.edu/Projects/Diversity/Data/Report/report05012013.pdf.*
6. *See supra* note 1.
7. Uniform Prudent Investor Act (UPIA) (1994); *see also* Charles D. Fox IV and Thomas W. Abendroth, "Trustee Liability for Investments: A Review of the Current State of the Prudent Investor Rule; Delegation; and Direction," American Bankers Association (April 6, 2017).
8. Al W. King III, "Modern Trusts Ease the Worries Of The Wealthy" (June 16, 2015), *http://insurancenewsnet.com/conference-post/modern-trusts-ease-the-worries-of-the-wealthy.*
9. *Ibid. See also* King, "So You Want to be a Trustee," *supra* note 1.
10. *See* Cal. Prob. Code Section 16040, 16014, Cmts to 16014, 16047; NY CLS EPTL Section 11-1.7, 11-2.3; *see also Matter of Shore,* 19 Misc.3d 663 (N.Y. Sur. Ct. March 19, 2008).
11. *See* Fox and Abendroth, *supra* note 7.
12. *See* King, *supra* note 1; NY EPTL 11-2.3(c); Cal. Prob. Code Section 16052.
13. For example, *see* S.D.C.L. Section 55-5-16.
14. *See* King, "Drafting Modern Trusts," *supra* note 1; Al W. King III and Pierce H. McDowell III, "Delegated vs. Directed Trusts," *Trusts & Estates* (July 2006), at p. 26.
15. *See supra* note 11.
16. Selected state directed trust statutes include: Alaska Stat. Section 13.36.375; Del. Code Ann. tit. 12 Section 3313; Nev. Rev. Stat. Section 163.5549; N.H. Rev. Stat. Ann. Section 564-B:8-808(b); SDCL 55-1B; Wy. Stat. Ann. Section 4-10-712; Wy. Stat. Ann. Section 4-10-712.
17. *See* Wolters Kluwer CCH, *2016 State Tax Handbook* (2015).
18. *See* King, *supra* note 1.
19. *Ibid.*
20. *See generally Restatement (Second) of Conflict of Laws* Sections 270, 272 and 273 (1971); Jeffrey A. Schoenblum "Governing Law Clauses for Trusts," 53rd Annual NAEPC Advanced Estate Planning Strategies Conference (November 2016).
21. *See* Philip J. Michaels and Laura M. Twomey "How, Why, and When to Transfer the Situs of a Trust," *Estate Planning* (January 2004); Margaret E.W. Sager and Bradley D. Terebelo, "Down the Rabbit Hole and Through the Looking Glass: The Wonderland of Trust Situs and Governing Law," South Arizona Estate Planning Council (November 2013); Advisory Opinion of the State of New York Department of Taxation and Finance, 1994 N.Y. Tax LEXIS 310, at *7 (April 8, 1994) (*citing Safe Deposit & Trust Co. v. Virginia,* 280 U.S. 83 (1929)).
22. *See supra* note 14.
23. Alaska Stat. Ann. 13.36.370; Del. Code Ann. tit. 12, 3313; N.H. Rev. Stat. Ann. 564-B:12-1201; S.D.C.L. Section 55-1B-6; Wyo. Stat. Ann. Sections 4-10-710, 711. A trust protector is generally an individual (though a committee of individuals or an entity may serve) with specified powers over the trust. The typical purpose of a trust protector is to provide flexibility to an irrevocable trust. Common trust protector powers include: the power to remove or to replace trustees; the power to veto or direct trust distributions; the power to add or remove beneficiaries; the power to change situs and the governing law of the trust; the power to approve, veto or direct investment decisions; the right to consent to exercise power of appointment; the power to amend the trust as to the administrative and dispositive provisions; the power to approve trustee accounts; the power to add a grantor as a beneficiary from a class of beneficiaries; and the power to terminate the trust. Trust protector statutes vary by state. Some state statutes simply reference the position, while other states also list the powers that may be exercised. Advisors also draft the trust protector functions into trust documents even in states without specific statutes; however, this may not be as strong as drafting trust protector functions pursuant to a specific statute. Ideally,

the trust would be sitused in a modern trust jurisdiction to benefit not only from the broad trust protector statutes, but also from the state's other powerful asset protection, privacy, tax and trust laws.

24. Advisors typically categorize directed trust statutes into one of three categories: 1) states that follow Section 185 of the *Restatement (Second) of Trusts;* 2) states that follow Section 808 of the Uniform Trust Code; and 3) states that have enacted more protective statutory protection for directed trustees. *See supra* note 11. Some of the better protective statutory state statutes include: Alaska Stat. Section 13.36.375; Del. Code Ann. tit. 12 Section 3313; Nev. Rev. Stat. Section 163.5549; N.H. Rev. Stat. Ann. Section 564-B:8-808(b); S.D.C.L. Section 55-1B; Wy. Stat. Ann. Section 4-10-712 (2015).
25. UPIA Section 3 and cmts; *see supra* note 11.
26. *See supra* note 11; C. Raymond Radigan and John G. Farinacci,"'*Knox*', the Prudent Investor and Fiduciary Duties," *New York Law Journal* (September 2012); David A. Baker, Lauren M. Papenhause, et al., "Current Issues in Trust and Fiduciary Litigation," McDermott Will & Emery (June 2013); Illene S. Cooper and Robert M. Harper, "Incomplete Protection: Exoneration Clauses in New York Trusts and Powers of Attorney," *Touro Law Review,* Vol 28: No 2, Article 4 (2012); Illene S. Cooper and Robert M. Harper, "Exoneration Clauses—Not All They're Cracked Up to Be," *NYSBA Journal* (October 2009).
27. *See Wood v. U.S. Bank,* 160 Ohio App.3d 831 (2005); *Goddard v. Cont. Ill. Nat'l Bk,* 177 Ill. App.3d 504 (Ill. App. Ct. 1988). *See also Mazzola v. Myers,* 296 N.E.2d 481 (Mass. 1973) (court set high threshold for trustee to not diversify—if document waives duty, if there's no reason to fear for the safety of the investment and if there's no change in circumstances, then there's no obligation to sell trust assets to diversify).
28. *See supra* note 14; Al W. King III, "Myths About Trusts and Investment Management: The Glass is Half Full!" *Trusts & Estates* (December 2014), at p. 12.
29. *Ibid.*
30. Selected sole remedy charging order protection statutes: Alaska Stat. Section 10.50.380, 6 DEL. C. Section 18-703, Nev. Rev. Stat. Ann. Section 86.401, S.D.C.L. Section 47-34A-504 and Wyo. Stat. Section 17-29-503. A charging order only gives a creditor the rights of a partnership or limited liability company (LLC) interest, and it doesn't give a creditor any voting rights. A charging order is simply a right to a distribution (if and when one is ever made), and it leaves a creditor without any means to force a distribution. *See* Al W. King III, "The Trust Spendthrift Provision—Does it Really Protect?" *Trusts & Estates* (December 2016), at p. 8; Al W. King III, "Defend Against Attacks on DAPTs?" *Trusts & Estates* (October 2014), at p. 11; Mark Merric, "Forum Shopping for Favorable FLP and LLC Legislation," Leimberg Information Services (Aug. 8, 2007).
31. Al W. King III and Pierce H. McDowell III, "Powerful Private Placement Life Insurance Strategies With Trusts" *Trusts & Estates* (April 2016), at p. 42; Al W. King III and Pierce H. McDowell III, "State Premium Tax Planning?" *Trusts & Estates* (June 2011), at p. 25.
32. *Ibid.* A private placement life insurance (PPLI) policy is typically a privately issued variable universal life insurance policy that has both a cash value and death benefit component. Investors in PPLI must be "accredited investors" who are "qualified purchasers." The accredited investor rules state that natural persons must have a net worth of over $1 million, not including the value of the investor's permanent residence or an annual income over $200,000 in the last two years. Generally, individuals or trusts that have at least $5 million in investment assets are considered qualified purchasers. *See* 115 U.S.C. Section 77(b)(15); 17 CFR Section 230.501(a); 15 U.S.C. Section 80a-2(a)(51). PPLI is usually designed as a non-modified endowment contract (non-MEC) policy, with four to five premiums versus a single premium policy. MEC policies (single premium) are subject to additional taxation of withdrawals and loans from policy cash value usually based on premium funding levels and timing of premium payouts. A non-MEC policy allows for tax-free withdrawals up to basis and tax-free loans against the balance of the account. Withdrawals in excess of basis are taxed as ordinary income, though a client can access the policy's cash value without triggering a tax liability by taking a loan against the policy. Contrast with a MEC, in which accumulation within is tax-deferred, but withdrawals and loans are taxed as ordinary income first, and recovery of basis second. Consequently, the policy owner can only withdraw the initial premium tax-free after all of the accumulated gain has been withdrawn and taxed, so the policy owner can't access the cash value in a tax-efficient manner.
33. *See supra* note 31. Please note if a client has an existing trust in a high premium tax state and the client wishes to acquire PPLI in a low premium tax state, a potential solution is for the client to form an LLC with a resident co-managing member in the low premium tax state. The resident co-managing member of the LLC in the low premium tax state can then purchase PPLI within the LLC and allocate the LLC units to the out-of-state trust, thereby allowing the existing out-of-state trust to benefit from the low state premium tax. Also, if the existing trust doesn't qualify as an accredited investor who's a qualified purchaser (for example, holds less than $5 million), then the grantor (assuming that individually the grantor qualifies as an accredited investor who's a qualified purchaser) can form an LLC in a low premium tax state to take advantage of the low premiums.
34. *See supra* note 31. The ability to pay in-kind distribution of cash value and/or death benefits is particularly important in the event that the underlying PPLI investments are in hedge funds, private equity and/or alternative investments, as such assets may have lock-up periods (typically three to five years or more). Certain states also allow for in-kind premiums on a case-by-case basis if approved by the insurance carrier as well as the state's Division of Insurance. Please note there may be negative tax consequences if appreciated property is contributed as premium. As such, this isn't a very common strategy domestically.
35. *See supra* note 11.
36. *See supra* notes 1 and 29. Please note if not a grantor trust, and if an S-corporation is involved, special trust language will be required.

37. *See supra* note 11.
38. *See supra* note 1.
39. *See supra* note 14.
40. *See supra* note 1.
41. *See* Al W. King III, "Trust Options for Residential Real Estate," *Trusts & Estates* (August 2015), at p. 14; Kenneth A. Ziskin,"The Home Security Trust—Better than a QPRT On Steroids," *Trusts & Estates* (October 2000), at p. 66.
42. *See* King, *ibid.*
43. *Ibid.*
44. *See supra* note 1.
45. *See supra* note 11.
46. *See supra* notes 1 and 14.
47. *See* Al W. King III, "Trusts without Beneficiaries—What's the Purpose?" *Trusts & Estates* (February 2015), at p. 11; Alexander A. Bove, Jr., "The Purpose of Purpose Trusts," *Asset Protection Strategies Volume II: Planning With Domestic and Offshore Entities*, Chapter 9 (2005); Alexander A. Bove, Jr., "Rise of the Purpose Trust," *Trusts & Estates* (August 2005), at p. 18; Alexander A. Bove, Jr., "The Purpose of Purpose Trusts," *Probate & Property* (May/June 2004); Alexander A. Bove, Jr., "Trusts Without Beneficiaries: Planning With Purpose Trusts," Boston Bar Association (Oct. 21, 2014).
48. *Ibid;* Alexander A. Bove, Jr. and Ruth Mattison, "The Purpose Trust Becomes a Work of Art," *Estate Planning* (October 2016).
49. A private family trust company (PFTC) is generally an LLC or corporate entity that's typically 100 percent owned by the family and qualified to do business in the PFTC jurisdiction, usually after acceptance by the jurisdiction's Division of Banking. PFTCs may be regulated or unregulated. Popular regulated states are South Dakota and New Hampshire, and popular unregulated states are Nevada and Wyoming. Special purpose entities (SPEs)/trust protector companies (TPCs) generally are LLCs or some other form of corporation that houses the trust protector, as well as the investment and distribution committees or advisors of a directed trust. These entities must work with a qualified trustee, and their sole purpose is to direct the administrative trustee as to the trust investments, distributions and trust protector functions of a directed trust. *See* Al W. King III, "The Private Family Trust Company and Powerful Alternatives," *Trusts & Estates* (February 2016), at p. 9, Comparative Chart, *www.wealthmanagement.com/sites/wealthmanagement.com/files/king-table-final.pdf;* Al W. King III, "Another Look at Private Trust Companies," Fam. Office Ass'n Podcast (Jan. 28, 2016); Al W. King III, "Unique Modern Trust Structures for Family Offices," Advisors Roundtable, San Francisco, IPI (September 2014); Matt Tobin, "Making Sense of Situs for Private Family Trust Companies," Family Office Exchange Webinar (March 2017); Al W. King III, Pierce McDowell III and Matthew Tobin, "Private Family Trust Companies and Other Modern Trust Structures," Family Office Exchange Member Event, New York City (September 2012).
50. *See supra* note 1.
51. *See supra* note 49.
52. *Ibid.*
53. *Ibid.*
54. *See* King, *supra* note 47. Typically, when the purpose trust owns the SPE, TPC or PFTC, the sole purpose of the trust is to maintain and perpetuate the entity.
55. *See supra* note 1; Al W. King III, "Are Irrevocable Trusts Truly Irrevocable?—Reformation, Modification, Decanting and Trust Protectors," address at the Berks County Estate Planning Council (March 16, 2016); Al W. King III, "Are Irrevocable Trusts Truly Irrevocable?—Reformation, Modification, Decanting and Trust Protectors," Inland Empire Estate Planning Seminar (Nov. 6, 2013); Al W. King III, "Are Irrevocable Trusts Truly Irrevocable?—Reformation, Modification, Decanting and Trust Protectors," Southern Nevada Estate Planning Council (March 7, 2013); Thomas E. Simmons, "Decanting and Its Alternatives: Remodeling and Revamping Irrevocable Trusts," 55 *S.D. L. Rev.* 253, 263 (2010); Mary Akkerman, "Decanting: A Practical Roadmap for Modernizing Trusts in South Dakota," 61 *S.D. L. Rev.* 413 (2016).
56. *See supra* notes 1 and 13.

**SPOT LIGHT**

**Country Living**
*La Table Villageoise, Gerberoy* by Henri le Sidaner sold for $1.12 million at Sotheby's Impressionist & Modern Art Day Sale in New York City on May 17, 2017. Sidaner's personal country home and garden in Gerberoy, France was purposefully designed by him to serve as inspiration for his paintings, as illustrated above.

## CONTACT INFORMATION

If you have any questions or would like any additional information, please do not hesitate to call or e-mail us at the numbers and addresses listed below. We also invite you to visit our website at www.sdtrustco.com. We hope to have the opportunity to work with you!

*Photo courtesy of the South Dakota Department of Tourism*

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