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The "burden" of wealth

The *New York Times* has an ethics columnist who answers questions posed by readers. Here are excerpts from two inquiries published on November 23, 2021:

One: *When my father died, I inherited a large trust fund and sole ownership of a family business. I was young and woefully unprepared, so I put my inheritance on the back burner and lived my life as if I was financially "normal." However, since the pandemic, my portfolio has hit a new high. I am utterly distraught. I feel that I should have never gotten so wealthy when people are suffering so much. . . .*

Two: *. . . my grandmother bought a large amount of stock in a fossil-fuel company, which she left to my father. I find it heartbreaking that the investment she made and that my father has maintained to provide safety and security is one of the things that is actively moving the planet toward terrible destruction. . . . I hope my father will live for many more years, but when that stock—and the associated wealth—come to me, what is the ethical thing for me to do with the money?*

Reader reaction to these inquiries fell into two camps. One group responded, essentially, "I should be so lucky to have such problems." The other group sympathized, and offered a range of suggestions regarding philanthropy and "socially responsible" investing. The sympathizers were numerous enough to imply that the burden of inherited wealth is not an

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Why use a trust?

A trust is a wonderfully flexible property management tool. A **living trust** is established during life, typically for one's own benefit. A **testamentary trust** is established by will for the benefit of others.

A trust beneficiary might naturally wonder, why shouldn't I simply receive my inheritance outright? Are there advantages to receiving property in trust instead? There are many advantages, including:

- **Professional asset management.** Portfolio management is not a trivial undertaking. When a corporate fiduciary is asked to handle the investments, the beneficiary gets all the benefits and none of the burdens of wealth.
- **Protection from creditors.** An irrevocable trust is an independent legal entity. Trust assets can provide for the financial support and protection of several beneficiaries without becoming subject to the claims of creditors of any beneficiary.
- **Potential transfer tax savings.** Estate or gift taxes may be due when a trust is created (depending upon the size of the trust and the total amount of taxable transfers the grantor has made). Such taxes are no more than would be imposed upon an outright transfer of the same amount. However, the trust can provide for many beneficiaries, sometimes in different generations, without triggering additional taxes.
- **Income tax benefits.** Income tax deductions are available for creation of charitable trusts that meet tax requirements. Trusts may also shift income to family members who are in lower tax brackets, to lower the family's overall tax burden.

What must a trustee do?

Every day, the trustee provides these services to the beneficiaries:

Asset management. Personal portfolio management is not the same as trust management. The trustee must balance the needs of current beneficiaries against the interest of the future beneficiaries—both must be satisfied. An understanding of the purposes of the trust is vital to shaping an investment policy for it. And when the investment plan is designed, it needs to take a long-term approach, one that is matched to the expected life of the trust itself.

Trust administration. There are many routine-sounding chores that are, in fact, vital to the smooth operation of a trust. Your trustee will need to title and safeguard trust assets properly, collect trust income, and disburse or invest collected income in accordance with the directions in the trust document.

Tax and accounting services. The trustee needs to keep detailed, accurate records of the trust assets and transactions. Tax returns will need to be filed. Regular reports must be provided to the beneficiaries.

Make impartial decisions. Very often a trust will provide for the distribution of principal in certain specified circumstances, such as a medical emergency or other unexpected financial need. The trustee has to decide if those conditions have been met. One beneficiary or another may ask for an invasion of the trust, and the trustee must decide whether the request is reasonable and within the spirit of the trust. "Grandfather would have wanted me to have a Tesla" is not likely to be received favorably by most trustees.

The "burden" of wealth *. . . continued*

isolated problem. Evidently, too many wealthy parents do not adequately prepare their children for their eventual inheritance.

Communication is vital

For many families, talking about money is even more uncomfortable than discussing religion, politics or sex. But advance communication about wealth, estate plans, and aspirations for the family fortune can go a long way toward alleviating concerns and insecurities such as those expressed in the *Times* column.

Bringing up the subject. A parent can arrange for a family meeting to discuss the family fortunes. Often children have no conception of the wealth of their parents, and the family meeting is a fine time for an education. Future needs, expectations, and hopes may be aired. It may be wise to have the family lawyer or trust officer present to handle questions as they come up. When a trust will be involved in the wealth management plan, heirs should meet and become comfortable with the trustee.

Setting realistic expectations. Some children are hoping for a larger inheritance than they are likely to receive. Others may expect too little. Either misconception can lead to unwise planning choices by the heirs in their personal financial management. A reality check is another benefit of the family conference on inheritance.

Investing for more than strong financial returns

For the beneficiary who dislikes certain investments, consider a new type of "social investing." Three categories of factors are involved: environmental, social, and governance (ESG). An environmental focus may look at carbon emissions, water stress, renewable energy, or pollution. Social factors might be diversity, inclusion, labor, employee welfare, or data security. Governance issues might touch upon independent directors, audit standards, women in leadership, and executive compensation.

Companies may be scored for their ESG performance. These scores may be combined with traditional financial analysis tools in determining which companies are likely to have the desired impact while still providing satisfactory returns to shareholders.

A family tradition of philanthropy

Very often parents are as concerned about passing their values to their children as they are about financial security. Family philanthropy can be an excellent mechanism for sharing those values. A variety of strategies are available, from private foundations to charitable trusts.

May we be of service to you?

Wealth and inheritance management are core parts of our daily business. Because we are neutral professionals, we can normally command the respect of all the heirs for the recommendations that we make. Over the years, we have worked closely with many successful families on the implementation of their wealth management plans.

Can we tell you more? We look forward to meeting with you at your earliest convenience to discuss your goals and objectives. ☐

What do the rich own?

The IRS has released a report of the 2020 federal estate tax filings. There were 3,441 estate tax returns filed that year, reporting some $122 billion in assets. However, only 1,275 of those estates were taxable, thanks largely to the unlimited marital and charitable deductions! Of the 2,166 nontaxable estates, 1,523 were less than $20 million. Many of these were likely filed to secure the Deceased Spouse's Unused Exemption Amount, an election that may only be made on a timely filed estate tax return. Net estate tax collections came to $9.3 billion.

As one might expect, publicly traded stocks were the largest asset category of the taxable estates, at $13.7 billion. In second position was closely held stock, $10 billion. Personal residences came in at $1.69 billion. Perhaps surprisingly, the taxable estates reported $3 billion worth of art, a figure larger than the combined value of Treasury bonds, corporate bonds, bond funds, and net life insurance! Details of the asset breakdown are shown in the chart at right.

Estate planners have long recommended making lifetime gifts to reduce the eventual sting of estate taxes. Up to $16,000 may be given to donees in 2022 without the need for even a gift tax return filing, under the annual gift tax exclusion. Larger gifts, such as transfers to irrevocable trusts, will reduce the amount of transfer tax credit at death, but they save overall taxes in two ways. First, they "freeze" the value of the gifted assets, and second, they are taxed on a tax-exclusive basis. With the federal estate tax, the tax applies to the tax itself as well as to what beneficiaries receive.

The advice to make substantial lifetime gifts has been heeded by those with sufficient assets to worry about federal estate taxes, according to the report. The taxable estates, with assets of $63.5 billion, reported total lifetime transfers of $24.3 billion. ☐

Composition of 2020 taxable estates

Category	Billions of dollars
Personal residence	1.69
Other real estate	3.38
Real estate partnerships	2.71
Closely held stock	10.0
Publicly traded stock	13.7
State and local bonds	4.2
Federal bonds	0.9
Corporate and foreign bonds	0.6
Bond funds	0.2
Other mutual funds	0.2
Unallocated investments	0.7
Cash	3.5
Net life insurance	0.3
Farm assets	0.8
Private equity	0.8
Other limited partnerships	3.1
Other noncorporate business assets	8.9
Mortgages and notes	2.2
Retirement assets	1.3
Depletables/intangibles	0.2
Art	3.0
Other assets	0.6

Source: IRS, November 2021

Important reminder to non-itemizers

In early November the IRS reminded the 90% of taxpayers who do not itemize their deductions that they still have access to an above-the-line deduction for charitable gifts in 2021. The extra deduction was created by the CARES Act in 2020 and extended to the 2021 tax year by the Taxpayer Certainty and Disaster Relief Act of 2020—enacted last December. Single taxpayers are permitted a deduction of up to $300, marrieds filing jointly up to $600—for cash gifts to qualified charities [*IR-2021-190]*.

When the standard deduction was doubled with TCJA 2017, making itemizing unnecessary for the large majority of taxpayers, there was a fear that the loss of the tax benefit might reduce American generosity. That does not appear to have happened. According to Giving USA, charitable giving by individuals rose by 2.2% in 2020, reaching $324.1 billion. That was the year of the economic hardships of the pandemic, but those who could do so still opened their wallets wide.

Inflation adjustments to estate and gift taxes

In 2022, the federal estate tax for individuals will begin to kick in at $12,060,000. Married couples can routinely double that exemption, to $24,120,000. Note that state death tax exemptions are generally lower than this. The annual federal gift tax exclusion is bumped up to $16,000, from $15,000 in 2021.

Trust tax review

The release of the "Pandora Papers" has stimulated an interest at the House Ways and Means Committee in the taxation of trusts. The Pandora Papers purport to document how the wealthy have been able to hide their wealth from government authorities, sometimes using the US as a tax haven. Interestingly, to date no Americans have been publicly identified in the Papers. There has been no allegation of a loss of revenue to the IRS.

Nevertheless, the Joint Committee on Taxation prepared "Present Law and Background on the Federal Taxation of Domestic Trusts" [*JCX-49-21*] for a December hearing of the Ways and Means Oversight Subcommittee. Key observations:

- intentionally defective grantor trusts are being used as "estate freezing" strategies;
- grantor-retained annuity trusts have been used to successfully reduce estate and gift tax obligations;
- the generation-skipping transfer tax (GSTT) may be avoided when the GSTT exemption is applied to a perpetual dynasty trust.

The report also provides interesting data on the income taxation of trusts and estates, as well as the reporting requirements of domestic trusts. ☐