Halliday Private Trust
Integrated Trust Solutions for Clients

Trust Connection

A Monthly Report of Trust News and Information September 2016

Welcome to *Trust Connection,* our monthly newsletter highlighting Trust news and information. Each month we will feature timely articles of interest.

About Us

At Halliday Private Trust, it is our mission to assist our clients in the process of providing solutions, specifically through a wide range of financial advice.

Since 1982, we have utilized a full spectrum of financial services to help our clients navigate every major hurdle in their financial lives. Because we are an independent financial services firm, we utilize an open architecture approach to locating the most suitable investment options for our clients.

Our role is to help clients make smart decisions about their money. We understand that each client has unique needs and requires personalized solutions based on their goals, objectives and concerns.

Show Me The Money: Investing for Different Types of Trusts

Fiduciaries have an important responsibility because a client has placed the utmost trust and confidence in this person to manage and protect property or money. Fiduciaries have the power to invest the money and property they've been tasked to protect, and they must put their client's interests above their own. Below are some things to keep in mind when using a fiduciary to invest in different types of trusts.

Important to fiduciary investing are its common law rules, expansion or limitation by the document, and changes under state law, from which one can glean insight into issues affecting the investment decisions, documentation, and areas of liability. The Uniform Prudent Investor Act (UPIA) serves as a helpful guide to examine the thought process, considerations, documentation and ongoing review of challenging investment decisions that must take place, including concentrations, initial assets, delegation, and specific factors to consider.

Investing is central to the role of a fiduciary. Regulation 9 defines fiduciary roles largely using the investment discretion as the central tenet. Without a fiduciary relationship, investments fall to the transactional caveat emptor brokerage model. Neither model is better nor worse, but each is decidedly different.

Investing for trusts is similar to investing for people. People or charities are the beneficiaries of trusts and thus the objectives, risks, and taxation issues are similar. Trusts are entity-like, however, and potentially have multiple taxpayers, multiple and sometimes conflicting interests complicating the objective, and are held to fiduciary standards of conduct that are far higher than for an individual's own account. (This discussion will focus on irrevocable trusts, not revocable living trust. A revocable trust, during the competent life of the grantor is much like an investment management account, considering only the needs of the present beneficiary, without regard to the future beneficiaries.)

The grantor's intent with regard to the beneficiaries is paramount in determining the appropriate investment policy. It informs their property interests, the tax consequences of investments, whether accumulated in the trust or automatically distributed, as well as the enhancements proper investments play in the transfer tax side of the plan. All of this must be done with the care of a fiduciary rather than one's own assets. The fiduciary standard of care can be a bit more conservative, comparable to the prudence exercised while driving a friend's car or caring for children that are not one's own. The asset will not be placed at risk beyond what is necessary.

There are three essential elements to consider outside the investment marketplace: principal and income accounting, fiduciary income tax and transfer tax rules, and fiduciary responsibility.

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To begin with fiduciary accounting, the trust document dictates the relationship of the parties. The grantor creates the relationship and defines the role of the trustee as well as the manner in which this individual intends to benefit the beneficiaries. This creates a further relationship of the trustee in serving the needs of the beneficiaries within the boundaries of the document. Additionally, it establishes a relationship and ongoing need for communication between the trustee and beneficiaries as to goals and objectives, risk tolerance, distribution expectations, and total wealth and income picture in order to optimize the value of the trust in carrying out the grantor's objectives.

Whether the trust is required to pay income or not is central to determination of the need for cash flow and of the determination of who the tax payer will be: the trust or the beneficiary. This understanding is key for allowing the trustee to invest properly. The dual set of beneficiaries also creates an unavoidable conflict in the irrevocable trust, no matter how subtle or pronounced, as to who the client is. Classically, the income beneficiary will want income and the remainder beneficiary will want growth. The language of the trust tells the trustee whether to pay all income annually or whether income is discretionary. So language, as well as the needs of the beneficiary, are central to every distribution, which in turn drives taxation of the income of the trust.

Fiduciary income taxation basically starts with the trust as the default taxpayer and shifts that burden to the beneficiary in certain situations, namely the required or actual distribution of funds. In general, distributions carry out the income tax consequences of the trust up to the taxable income for the year. It is critical, then, that the trustee understand how to interpret the document terms, understand their implications, discuss in advance with the beneficiaries the expectation of distribution for the year, and invest accordingly. Even more dramatic is the grantor trust, wherein the trust is a disregarded entity for income tax purposes, leading to all manner of potential benefits to the beneficiaries and the ability to legally pay their beneficiaries income taxes without it being considered a gift to them.

In addition to income taxation, many plans have multiple trusts, such as a bypass and marital trust, or an exempt and non-exempt trust for generation-skipping transfer tax, which can be enhanced dramatically by appropriate allocation between multiple accounts for the same beneficiaries. Having a growth objective in one account and an income objective in another account may save the taxpayer a high level of estate tax at the death of the beneficiaries and even help determine from which trust it would make the most sense to take distributions. This ability to play the duality of investment professional with an understanding of the unique property law and tax law characteristics of trusts is critical. Without this, a competent investment advisor may invest in a very appropriate manner for the market, yet lose gains to taxes rather than for benefit of the beneficiary.

Finally, fiduciaries' responsibilities provide certain special situations, which are dealt with in the UPIA. It puts clear emphasis on modern portfolio theory, including the importance of diversification. There are also all the factors one would expect in investing criteria, such as general economic conditions, the possible effect of inflation or deflation, expected tax consequences of investment decisions, the role each investment plays in the overall trust portfolio, the expected total return from income and appreciation of capital, and needs for liquidity, regularity of income, and preservation or appreciation of capital. In addition, the UPIA specifically mentions two points that may not come directly to mind for a fiduciary novice: other resources of the beneficiary, and an asset's special relationship or value to the purposes of the trust or the beneficiary.

Other resources are important in the fiduciary investment world as trusts often hold assets that are concentrated and may not appear to be properly diversified without the consideration of all assets available to the beneficiary. A family business, for

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Call us today at (800) 786-1598 to learn more about working with Halliday Private Trust.

For information and assistance, please feel free to contact one of our Trust Advisors:

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example, may not appear to be the best investment when held in concentration, but in combination with outside wealth amassed by members of the family it may make perfect sense. This issue also often informs the second point, which is an asset's special relationship or value to the purposes of the trust or the beneficiary. Again, the desire to keep a business in the family may be the very reason the trust was created in the first place. To use another example, a lake house or beach house may not appear to be the most appropriate investment to retain in a trust; however, its special relationship to the family as a gathering place and for lifestyle support may make its place in a trust portfolio completely justified.

Summary

Keeping in mind that the investment marketplace and considerations are complex enough, adding a fiduciary's insight and understanding raises fiduciary investing to a much more important and personal place. An investment advisor lacking deep knowledge of fiduciary accounts may invest perfectly well on the surface but inappropriately for the type of account, causing unnecessary income tax or transfer tax, to say nothing of the proper administration of the trust to be diminished. Contact a professional trustee to learn more about fiduciary investing.

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