A "FAST" Solution to Legacy Planning: The Family Advancement Sustainability Trust

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Marvin E. Blum, J.D./CPA
The Blum Firm, P.C.
(817) 334-0066
www.theblumfirm.com
mblum@theblumfirm.com

Ask your clients: **What keeps you awake at night?**

My experience is that most don't say it's their money or their investments. Most say: **"It's my family."**

- What they are most concerned about is having a family that is "successful":
  - Physically and emotionally healthy
  - Productive
  - Connected for generations to come
- "Baby Boomers" are especially reflective and want to preserve a legacy. They are asking themselves: "To what end have I created this wealth?"

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"Shirtsleeves to Shirtsleeves in Three Generations"

- The first generation **creates it**: starts with nothing, works hard, and amasses wealth—without making significant changes to their values, customs, or lifestyle.
- The second generation **saves it**: gets an education, lives well, and saves well.
- The third generation **spends it**: has no work experience or business acumen and spends all the family's wealth.
- The fourth generation is **back to manual work.**

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England – Clogs to clogs is only three generations.

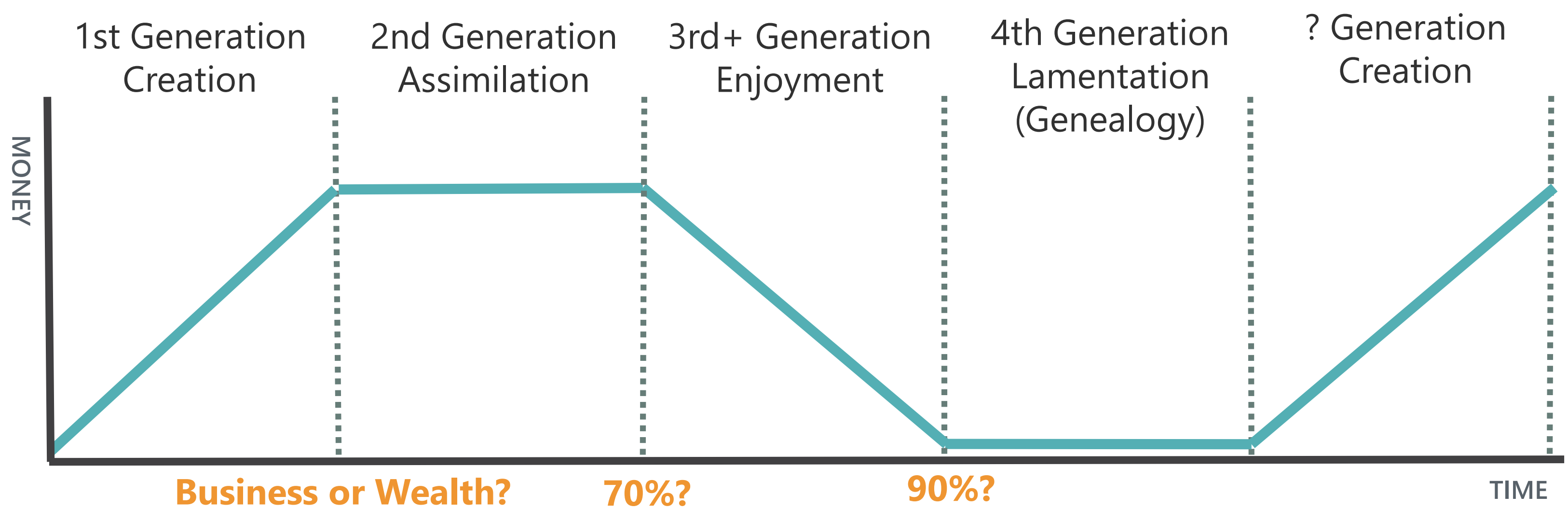
Italy – From stables to stars to stables.

Australia – From goon to Grange to goon.

China – Wealth does not survive three generations.

Japan – The third generation ruins the house.

Asia – Rice paddy to rice paddy in three generations.



Lyrics to “Diamonds from Sierra Leone” by Kanye West featuring Jay-Z

As long as I'm alive, he's a millionaire
And even if I die, he's in my will somewhere
So he can just kick back and chill somewhere, oh yeah
He don't even have to write rhymes
The Dynasty like my money last three lifetimes

- The statistics aren't good. Recent study showed over 80% of family money was gone within 50 years of founder's death. About 90% of families come unglued and money is gone by the time it's passing to G4.
- Addiction issues are rampant in wealthy heirs who lack self-esteem.
- Most common reason for wealth transfer efforts to fail is **lack of communication and trust.**
- Second most common reason is **unprepared heirs.**

Question: What can we, as planners, do to **help our clients beat the odds** and be one of the successful ten percenters?

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Best Practices for Success

Hold Family Meetings/Retreats to Foster Family Relations/Cohesiveness

- Identifying **shared values**; creating family mission statement
- Preserving family's **history and heritage**
- Family philanthropy
- Encourage family member well-being and wellness
- Teaching and enhancing **communication skills**
- Communicating/sharing **intensions for wealth transfer**

Develop Education Curriculum and Process to Prepare Heirs

- Financial education
- Money management
- Mentoring
- Support for entrepreneurship
- Mentor future heirs on impact of an inheritance

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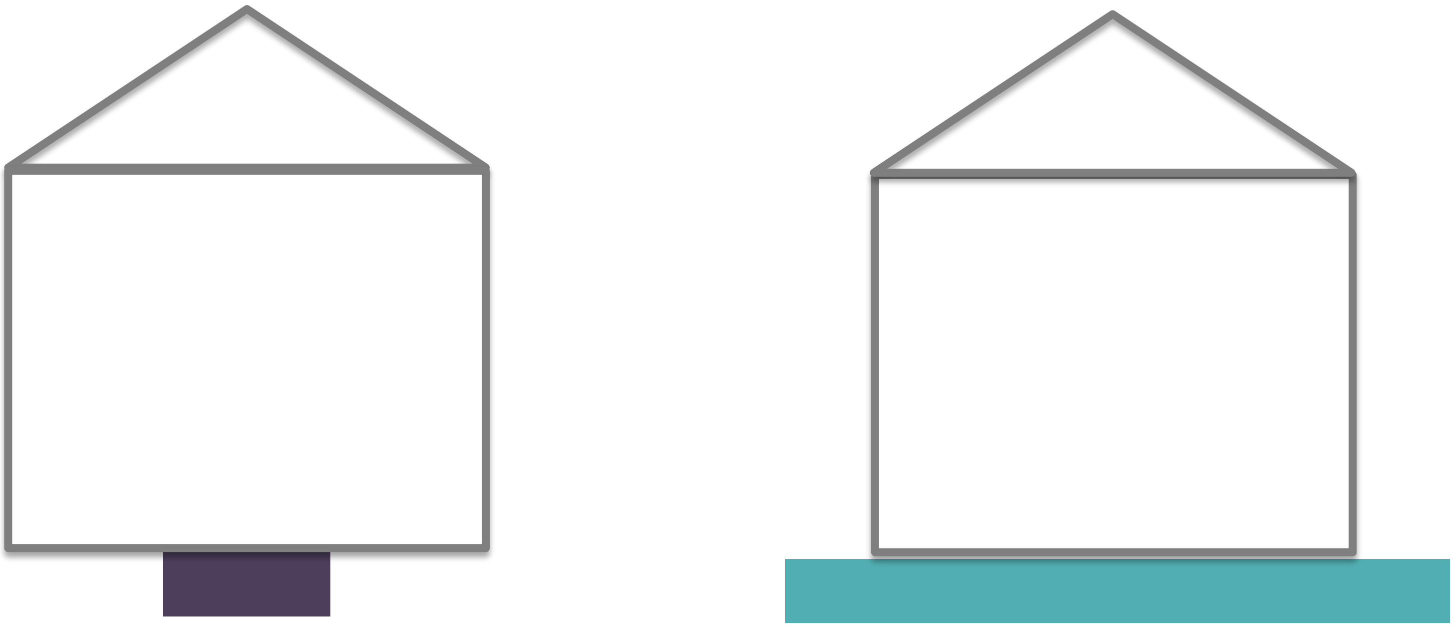
Develop a System of Family Governance

- Family Mission – Serves as guidepost for all decisions/actions
- Family Constitution/Bylaws
- Family Council
  - Determine which family members vote
  - Establish procedure to make decisions
  - Establish procedure to resolve conflicts
- Family Advisory Board – Includes the family's "go to" outside advisors (attorney, CPA, Financial Advisor, etc.)

- Adopt Family Governance Policies
  - Procedure for when to tell young about wealth and when they get to vote.
  - Procedure for when people enter the family, there is an orientation to family history and values. They are made to feel a part of the family.
  - Clear rules on when entering family members join the family and join the retreat (must be engaged to go on retreat, must be married to join family?).
  - Are step-kids family members? What’s the proper role for them?

Bottom Line: Don’t just prepare the money for the family.
Prepare the family for the money.



- Who will **keep best practices going** after matriarch and patriarch pass away?
- Who will **pay** for it?
- It takes more than G1's hopes and dreams for G2/G3/G4, etc. to succeed. Don't leave it to chance. G1 needs to be intentional and implement a practical solution.

The Solution: Family Advancement Sustainability Trust

(Jointly developed by Marvin Blum and Tom Rogerson)

1) The FAST provides FUNDS

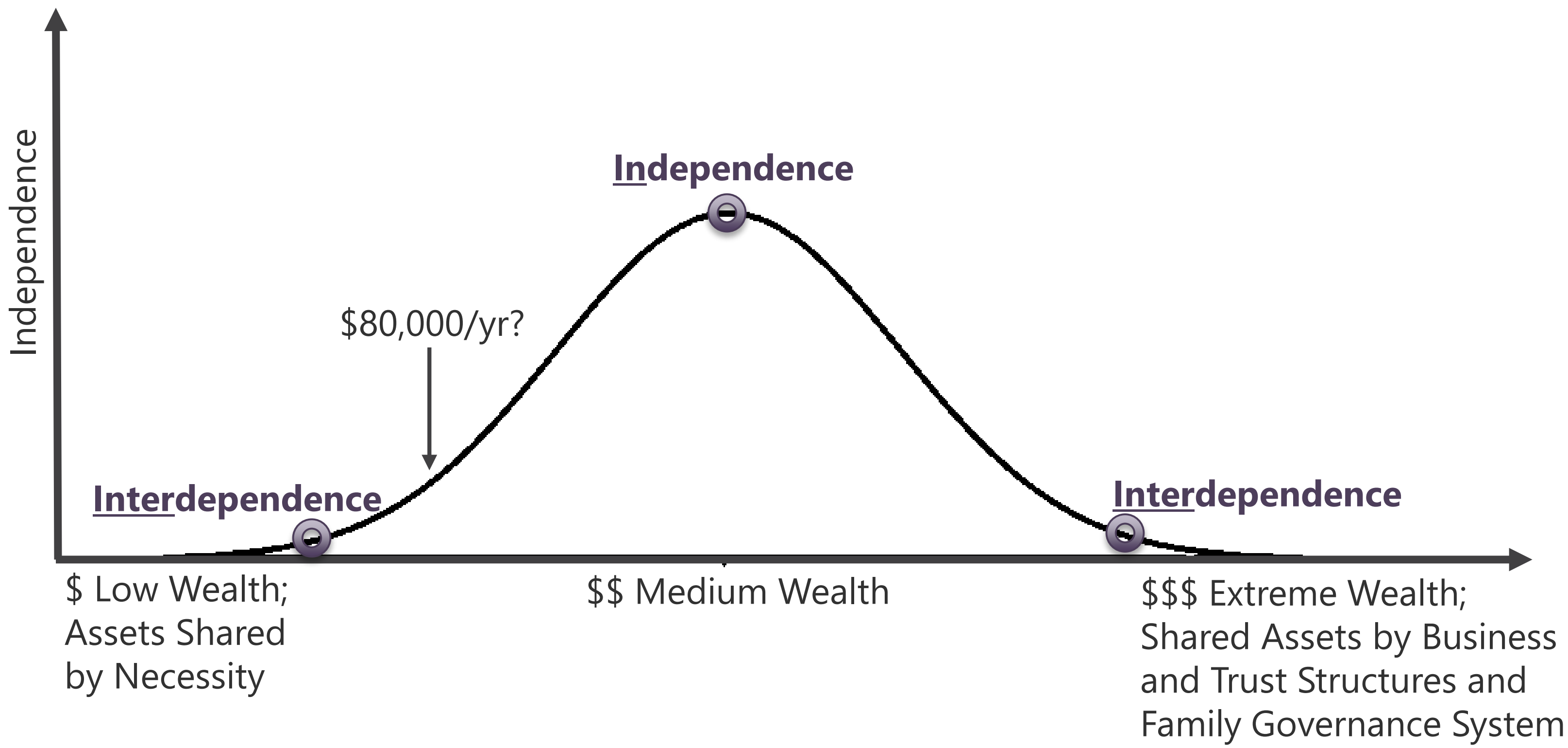
- For future generations to use to **prepare heirs** to be able to successfully manage inheritance.
- Funds family endeavors to keep family together after elder generation dies, such as **family retreats** and family meetings.
- To train future generations on concepts like **philanthropy** and being **responsible stewards.**
- To encourage family members to **be intentional** about being an active part of the family today, while growing more active family participation for generations to come.

2) The FAST provides LEADERSHIP

- It creates the leadership structure to **make sure it happens**, using a system of **trustees and committees** who are paid to run the FAST and are charged with the responsibility for carrying out these tasks.

- The FAST is an **add-on to a traditional estate plan**. The traditional plan is still needed to provide for:
  - Health, education, maintenance, and support (HEMS)
  - Investment management
  - Tax savings
  - Asset protection (creditors/divorces)
- The FAST bolts on top of the existing plan and invests in the family rather than distributing to it.
- The FAST recognizes the phenomenon of **family interdependence** as wealth grows.

Interdependence to Independence to Interdependence



Structure of a FAST

- Dynasty Trust created in state with **Directed Trust** laws. Allows decision-making authority to be split up. Decisions regarding administrative matters, trust investments, and trust distributions may be assigned to separate co-trustees, advisors, or trust protectors.
- Distinction between **delegation** (where trustee delegates to an advisor, but trustee remains liable for advisor's performance vs. **direction** (where a trust names advisors who direct the trustee on discretionary decisions, relieving the trustee from liability (except for willful misconduct) for decisions directed by an advisor.
- Delaware leads the way on directed trusts. The body of law for Texas directed trusts is not as well developed.

- **Four separate decision-making bodies.** Allows family members and family advisors to **directly participate** in governance of trust.
- Individuals may serve on more than one committee. Grantors would likely desire to be on each committee. Non-family committee members receive compensation for serving on committee.

Common Law Trust

TRUSTEE
Controls investment and distribution decisions

TRUST BENEFICIARIES/ FAMILY MEMBERS

Under a typical common law trust, the family is governed by the trustee.

Directed Trust

Grantor Appoints:

TRUST PROTECTOR COMMITTEE

INVESTMENT COMMITTEE

DISTRIBUTION COMMITTEE

ADMINISTRATIVE TRUSTEE
No control over investment and distribution decisions

A Directed Trust allows families and their trusted advisors to be involved in the trust governance.

Administrative Trustee

- Typically, a corporate trustee.
- **No control** over investment or distribution decisions.
- Record keeping, tax filings, maintain custody of trust assets.

Investment Committee

- Commonly comprised of three members: **two family members** and **one professional** advisor.
- The advisor could be a peer (such as family investment advisor or some other type of fiduciary) or could be a hired investment advisor.
- Charged with making **all decisions relating to investment of trust assets.**
- Coordinates with Distribution Committee to make sure the FAST generates the cash needed to pay for activities.

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Distribution Committee

- Comprised of several members:
  - **Two family members**
  - Family legacy planning consultant
  - Like-minded peer to grantor(s)
  - Professional advisor who brings knowledge of family
- Charged with spending trust assets to **preserve and strengthen family institution**, rather than distributing assets to trust beneficiaries.

TRUST PROTECTOR COMMITTEE

- **Three professional members** such as family's attorney, CPA, financial advisor and/or trusted fiduciary.
- **Family members could serve as consultants** to Trust Protector Committee. (Avoid family members serving on the committee to prevent inadvertent general power of appointment.)
- Charged with **playing role of grantor** once grantor no longer able.
  - Removing or appointing trustees, committee members, or other advisors.
  - Amending governing instrument of trust to efficiently administer the trust or to address unforeseen circumstances that adversely affect accomplishment of trust purpose.

Directed Trust – Grantor Appoints:

TRUST PROTECTOR COMMITTEE
3 Members

3 Professionals
- (Family's Atty, CPA, Financial Advisor, Other Fiduciary?)

INVESTMENT COMMITTEE
3 Members

2 Family (G1 & G2?)
1 Professional
- (Investment Advisor, Other Fiduciary?)

DISTRIBUTION COMMITTEE
5 Members

2 Family (G1 & G2?)
3 Professionals
- 1 Like-Minded Peer
- 1 Consultant
- 1 Fiduciary (Atty or CPA?)

ADMINISTRATIVE TRUSTEE
A Trust Company in a Directed Trust Jurisdiction

Peer Review

- Include peer review to ensure trustees and committee members are **accountable** to carry out the tasks that have been assigned to them.
- A "check-up" on how well the trust is continuing to meet the patriarch's and matriarch's original objectives. Begins on the 5th anniversary and occurs **every 5th year** thereafter.
- Administered by Trust Protector Committee. Objective and unbiased reviewers. Receive reasonable compensation for efforts and expenses. No enforcement authority. The peer reviewers make recommendations to the trust protectors, who can then take action (example: remove and replace).
- **Provides clients assurance** that as younger generations become committee members, they'll receive continued guidance.

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Funding the FAST

- **Create during patriarch's and matriarch's lifetimes** to allow G1 to mold trust to reflect the ideals and values of family, guide family members and advisors, and establish direction of FAST for future generations.
- May be minimally funded with lifetime gifts, but the main funding **pours-over upon death of G1** (either fixed amount or percentage of estate).
- While G1 is alive, G1 usually pays for the FAST activities out of G1's pocket (which is more estate tax efficient).
- Funding amount will vary from family to family according to means and FAST's agenda.
- A FAST can work for a family of any size. This is **not just for the mega-wealthy.**

- In addition to funding the FAST with liquid assets, the FAST can also be the ideal owner of a family's **legacy real estate** (such as the family ranch or lake house).
  - FAST provides funds to maintain the property.
  - FAST establishes rules for shared use.
  - Segregate the real estate in a separate entity (such as an LLC owned by the FAST) to insulate other FAST assets from liability exposure related to the real estate.

Options for Additional Funding at G1's Death

- Testamentary Gifts
  - Pour-over from G1's will or living trust
  - Funding amount limited to remaining estate tax/GST exemptions in order to avoid estate tax and GST tax implications

678 Trust (Beneficiary Defective Irrevocable Trust)

- Upon death of G1 (who serve as primary beneficiaries of 678 trust), GST-exempt assets from 678 trust pour-over to FAST.
- Pour-over can be achieved by G1 exercising special power of appointment directing assets into FAST. Allows G1 to adjust the amount of pour-over from time to time.

Special Purpose ILIT

- Stand-alone ILIT holds life insurance policy on patriarch, matriarch, or second-to-die.
- Funnels additional funds into FAST at death of G1.
- Preserves family's assets for distributions (a traditional inheritance).
- Leverages the lifetime estate/gift tax exemption so there's no estate tax cost.
- Leverages the GST exemption so the FAST is fully GST exempt.

GST NONEXEMPT FAST

- For a FAST that is not allocated GST exemption, additional factors must be considered:
  - When the last G2 member passes away, there would be a "taxable termination" for GST purposes, triggering a GST tax, because there would be no beneficiaries remaining at that time other than "skip persons."
  - To avoid a taxable termination, include a charity as a beneficiary. The charity would receive an annual payment (such as 5% of the trust's assets), beginning on the date that the last surviving G2 passes away.
  - Because the charity is a "non-skip person," a taxable termination would be avoided.

  - To the extent that the FAST makes distributions, directly or indirectly, to a G3 or more remote descendant, the distribution will be treated as a "taxable distribution" for GST purposes and a GST tax will be owed by the recipient. The FAST could be drafted to provide for the distribution to be grossed up to provide the recipient with sufficient cash to pay the GST tax.

- This is similar to a HEET (Health and Education Exclusion Trust). Note that distributions for educational and medical expenses that would qualify for the exclusion pursuant to Section 2503(e) would not be subject to GST tax.

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Income Tax Implications

- There may be income tax implications from the FAST paying out expenses for things such as family retreats. In the event a FAST expenditure is considered to be a distribution to a beneficiary, and if such distribution carries out DNI (distributable net income) causing the beneficiary to owe income tax, the FAST should be drafted so as to allow it to make additional "tax" distributions to cover the tax imposed on the beneficiary.
- It is not clear what expenditures would be categorized as trust administration expenses, deductible on the FAST's Form 1041 income tax return. To the extent expenditures are not tax deductible, the FAST needs to reserve cash to cover its income tax liability.

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The FAST is Created. Now What?

First Family Meeting: Focus **More on Values than on Valuables**

- Start meeting by asking:
  - What is your vision for the family?
  - How does wealth impact your life?
  - How do you see wealth filtering down to your kids?
  - What do you want for your life?
  - What do you want collectively for the family as a whole?
  - Where do you see the family in 25 years?

- **Lay the foundation** of why legacy planning is important.
- Begin to develop shared family values and family mission statement, vision for family's future.
- **Get buy-in** from G1, G2, and G3 (if practical).
- G1 should not lead it. Utilize a facilitator so G1 can participate, not dominate.

TOPICS FOR FAMILY RETREATS

- Include discussions on **health and wellness.** Learn what the family can do to improve each member's physical health and emotional well-being.
- Include sessions related to **faith or spirituality** at retreats.
- Begin to share estate plans and how wealth will transfer as appropriate. Slowly (over period of years) move away from culture of secrecy to **culture of openness.**

- Family philanthropy – Example: mobilize family to conduct study on how to best utilize its charitable dollars to fund medical research for a certain disease impacting family members.
- The FAST can fund family enrichment activities such as family travel abroad.
- The FAST can fund endeavors to learn and appreciate family’s history and culture. Maybe one year hold retreat near where ancestors grew up.

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Create a Family Education Program

- Assess family needs and establish family objectives. If different ages and sophistication levels, plan separate programs for different groups.
- A good educational program aims to provide heirs with:
  - Understanding of family's virtues, values, and history (not just about finances; preserve stories of ancestors who overcame obstacles).
  - Basic financial education and skills to make competent decisions in coordination with financial advisors.
  - Ability to read and understand legal duties.
  - Understanding the role of outside investors to a family.

- Incorporate a variety of formats: reading materials, games, teleconferences, outside speakers.
- Find a **balance** between finance and fun.
- Important to identify who will be responsible for ultimate implementation of education system. Could be the family office, independent advisor, or learning committee formed within family.
- Remember **education is an evolving process.** As family members grow and learn, education programs should change. Modify methods and materials to continue to achieve family goals.

Family Philanthropy

- A Family Foundation or Donor-Advised Fund can serve as **training grounds** for younger generations to learn how to handle money, how to give to others, and how to collaborate with family members.
- Teaching the importance of philanthropy helps instill a healthy attitude toward money.
- Statistics show that the use of family philanthropy as a teaching tool is a determining factor in whether or not a **family remains united**. Intentionally using philanthropy to educate and influence the next generation can make a huge impact on the long-term success of the family.
- The FAST provides training and makes recommendations, but no funds are distributed directly from the FAST for charitable purposes. The actual funds come from the Family Foundation or Donor-Advised Fund.

A Family Bank

- Instead of handing money over to a child to start a business, pay for school, or buy a home, create a family bank.
- Child gains business and money management skills in real-world borrowing experience.
- Family bank can be as formal or informal as family prefers. Most are structured as a trust or limited liability company and can be led by family member or board of members. Family bank's protocols would outline process for borrowing money. For example, child must submit lending request summarizing purpose of loan, proposed loan terms, and how child plans to repay.
- FAST Distribution Committee's Role: Helps guide and mentor the child; reviews lending request and recommends to the Family Bank whether or not the loan should be made.

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Conclusion

A FAST can act as **replacement "glue"** to help bind the family together after G1 is gone.

"If you want to go fast, go alone. If you want to go far, go together."
- African Proverb

"If you want to go fast and far, go FAST together."
- Tom Rogerson