A new era in Connecticut for trusts

Last summer our legislature modernized and codified Connecticut trust law with the adoption of the Uniform Trust Code. Some of the key changes are covered in our feature article this issue. The purpose of the overhaul was to make Connecticut a more welcoming place for establishing a trust for wealth management. Another change that would make our state more hospitable for implementing estate plans might be to join the other 49 states and eliminate our gift tax, or to not be among the last 12 states to levy an estate tax—but that is an argument for another day.

Should estate planners be preparing their clients for the scheduled reduction in the federal estate tax exemption equivalent coming in 2026? Should clients take steps now to “lock in” today’s higher gift tax exemption? See page 2 for a discussion.

If you have ideas for our future coverage in Trusted Insights, we welcome them.

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Connecticut adopts the Uniform Trust Code

One benefit of the federal system is that states may be laboratories for policy experimentation. In recent years, one avenue of such tinkering has been trust law, as states have begun competing to be the most favorable for trust jurisdiction. By a unanimous vote of the legislature last June, Connecticut joined that race with the adoption of a Uniform Trust Code (UTC). The new law should be welcomed by Connecticut estate planners as it provides greater clarity concerning the creation, administration, and termination of trusts in Connecticut, as well as articulating the duties that fiduciaries owe to beneficiaries. Here we cover a few highlights of the new legislation.

Extended rule against perpetuities

Connecticut’s rule for private trusts followed tradition, in that future interests were required to vest within 21 years after the death of a person who was alive when the trust was created, or within 90 years if later. The 90-year measure is expanded by the UTC to 800 years. This change will facilitate the creation of dynasty trusts, which are intended to last for many generations free of transfer taxes.

At least twelve other states have extended their perpetuities period, according to a recent compilation by the Law Offices of Oshins and Associates. Tennessee and Florida chose 360 years, for example. Five states have gone all the way to allowing perpetual private trusts without a time limit, including New Hampshire and Rhode Island.

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The new perpetuities rule applies to Connecticut trusts created after January 1, 2020. It will not apply to trusts created earlier or to trusts moved to Connecticut from other states.

**Directed trusts**

Traditionally, all the duties of trusteeship have been vested equally in all the trustees. There has been a growing trend in some states of dividing responsibilities for trust administration among several fiduciaries. For example, one fiduciary might be tasked with investment management decisions, while another is given responsibility for trust distributions. The UTC provides clarity by explicitly authorizing such divisions of trust management.

Directed trusts may not be cheaper to administer, but they may increase the comfort level of beneficiaries and provide expertise to manage specific assets, such as real estate and closely held business interests.

**Domestic Asset Protection Trusts**

Years ago there was a boomlet in the creation of offshore trusts shielding assets from lawsuits. Then states began permitting self-settled trusts for this purpose, hence the name “Domestic Asset Protection Trust (DAPT).” Connecticut now joins about 17 other states that explicitly allow this strategy, according to Oshins.

A Connecticut DAPT must be irrevocable, and it must have an independent trustee. The grantor of the trust is a permissible beneficiary of the trust, but must not have the power to decide on trust distributions. The DAPT does not protect assets from claims existing at its creation, only against future claims.

**Notice**

Trustees always have had a fiduciary duty to communicate with beneficiaries, and now the UTC describes more explicitly what that duty entails. The UTC requires a trustee of an irrevocable trust to (1) keep the qualified beneficiaries* reasonably informed about the trust’s administration and the material facts necessary for them to protect their interests and (2) promptly respond to their requests for information on the trust’s administration. The bill generally requires, within 60 days after accepting a trusteeship, that the trustee notify the qualified beneficiaries about the trust and provide contact information. Within 60 days after learning that an irrevocable trust has been created, or that a trust became irrevocable, qualified beneficiaries must be notified of the trust’s existence, the settlor’s identity, the right to request a copy of the relevant portions of the trust related to that beneficiary, and the right to the trustee’s reports. The trustee must send a report annually and upon the trust’s termination to the current beneficiaries and to other qualified beneficiaries who request it. The report must include information on the trust property, liabilities, disbursements, trustee compensation, and trust assets (including market values, if feasible). (This requirement, and the foregoing list of requirements, does not apply to irrevocable trusts created before January 1, 2020, or to trusts that became irrevocable before that date.)

*(beneficiaries who have or could have an interest in income or principal of the trust currently or upon termination)
Will history repeat itself?

In 2012 the amount exempt from the federal estate and gift tax was scheduled for a precipitous drop from $3.5 million to $1 million. At that time some planners recommended making substantial gifts to “lock in” the larger exemption. Congress instead enlarged the federal exempt amount to $5 million, added automatic inflation adjustments, and made the change permanent.

The lock-in question is raised again, because the doubling of the federal exemption in TCJA 2017 will expire in 2026 unless further action is taken by Congress to extend it. The federal estate tax exempt amount never has been reduced in the past, but there is a first time for everything.


Tactics

A wide variety of strategies were offered in the webinar:

• For married couples, have only one spouse make irrevocable transfers to use the transfer tax credit so as to minimize the chance of “buyer’s remorse.”

• Domestic Asset Protection Trusts (DAPTs) have been authorized in 19 states, and so have gone “mainstream.”

• Spousal Lifetime Access Trusts (SLATs) may be used to consume the transfer tax credit while keeping access to the assets.

• A Special Power of Appointment Trust (SPAT) may permit the fiduciary to appoint property back to the trust grantor.

• Some Democrats have proposed cutting back on the annual gift tax exclusion. This threat suggests that Irrevocable Life Insurance Trusts (ILITs) should be funded sooner rather than later.

• Credit shelter trusts may seem unnecessary for many with today’s high exemption, but the better course is to keep those trusts against the possibility of more stringent future taxes.

• GRATs are not recommended if one expects the tax environment to become less accommodating to certain planning techniques in the near future.

Timing

Although 2026 seems a long way off, the webinar participants highlighted the political controversies that recently have engulfed Washington, D.C. There is a possibility that Democrats could regain control before 2026, and if they do, the parameters of the estate tax might change quickly. The issue was framed in this way: Is it prudent to assume now that Democrats can’t come to power in 2020? Even if the probability is low, now may be the time to raise the possibility with clients to get them considering what actions might be undertaken.

The Regulations confirmed that under existing law, there will be no clawback of the tax benefit for taxpayers who make large gifts before 2026. That’s a relief. However, when one considers the expansive nature of the wealth taxes that some Democrats have proposed, caution is required. New legislation to increase estate taxes might well include a provision reversing the clawback rule.

Staying abreast

When the exemption was doubled in 2017, there was some thought that estate planning would fade in importance. The webinar made clear that there is still plenty to talk about with clients, and that estate planning will remain vital for some years to come.
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Briefly noted
Cryptocurrency crackdown

In Notice 2014-21 the IRS made clear that bitcoin and similar cryptocurrencies are not money for tax purposes; they are property. As such, they have a tax basis, and the transfer of cryptocurrency for value may generate taxable gain or loss. It’s not clear whether the cryptocurrency owners have been complying with the tax laws.

The IRS obtained a court order for the customer data held by Coinbase, a cryptocurrency exchange. Data was provided on all customers who had transactions worth $20,000 or more from 2013 through 2015. About 13,000 customer accounts were documented.

That data may have been the source for a series of warning letters that the IRS began sending to some 10,000 cryptocurrency owners in July. Three versions of the letter were made public. The mildest one outlines the tax requirements for owning and exchanging cryptocurrency. The most severe one (letter 6173) asks the recipients to declare under penalty of perjury that they are in compliance with all tax law requirements. At the time IRS Commissioner Chuck Rettig said: “Taxpayers should take these letters very seriously. The IRS is expanding efforts involving virtual currency.”

IRS Chief Counsel Michael J. Desmond has stated that cryptocurrency transactions should be reported on about 12 million tax returns each year. They are getting nowhere near that level of reporting.

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