

9 Questions Wealthy Families Should Be Asking in 2018

Here we are passing through February into March already and settling in to a new year. Often, the new year means change to many making resolutions or setting goals, both personal and business.

For wealthy families, a new year brings renewed focus on investments, trends, and opportunities—and for those who have trusts—attention to how the trusts are currently being maintained, and how they will be protected and grow over the coming years.

One hidden truth with families is the wide-ranging experience and education levels with regard to the financial details and laws related to trusts. If you're one of those family members and are reading this—be honest, your knowledge of intricate trust laws is probably limited at best. It's probably not your background. But, make no mistake, it is a topic of interest to you—and you certainly want to know, and deserve to know, what's happening to the family trust at a very detailed level.

As a company that routinely helps wealthy families and their trusted advisors find the answers and guidance they need to ensure that their trusts are being well-managed and well-maintained, we offer the following list of common questions that families should be asking their trust officers, legal and investment advisors about their trusts as we settle into 2018:

1. Is our trust's wealth growing?

Most families set up their trusts to preserve wealth by growing principal prudently over time and taking income distributions when needed in order to allow the trust to grow. Unlike individuals, most trusts have long time horizons meaning it doesn't typically have a finite end such as a person saving for retirement at which point you may become more conservative in your investment approach and start spending down income and principal. In order to achieve this most trustees take a balanced portfolio approach diversified amongst many asset classes to ensure slow steady growth over time. Therefore, portfolios should see little turnover during the year unless investment advisor is rebalancing if certain asset allocations have gotten out of whack.

2. Are the assets in my trust protected from creditors?

Trusts do provide a layer of asset protection. However not all creditor protection is equal. The South Dakota creditor protection statute is the most powerful in the U.S. Under South Dakota law, a discretionary interest in a trust is not a property interest nor an entitlement. Additionally, limited powers of appointment and remainder interests are also not property interests. This can become extremely advantageous from an asset protection standpoint. In layman's terms, in a correctly drafted trust in South Dakota, although you may have a beneficial interest in a trust a creditor can't attach a claim to it because its not a property interest. Secondly, once assets have sat in the trust for two years it becomes creditor-proof.

3. What taxes are we paying—and are the state and federal taxes being addressed as part of management of the trust?

All good trustees should be managing trust assets in order to minimize taxes in order to grow the principal of the trust more effectively. In South Dakota, there is no state income, capital gain,

dividend or interest tax, meaning clients in high tax states can grow the principal of their trusts' assets more efficiently by deferring the payment of state income taxes until they distributed back into the home state of the beneficiary. This allows the untaxed income and capital to compound on a year over year basis allowing the principal of the trust to grow faster if managed correctly. To the extent families are distributing all the income out on an annual basis using municipal bonds that are state and federal tax free can help minimize tax on an annual basis.

4. **What privacy is in place to conceal our wealth from anyone outside our family circle?**

South Dakota has some unique privacy rules that allow families to not only protect family members from knowing about existence of a trust and the wealth inside but also protect families from any outside party ever learning about the existence of the trust. Most states follow the uniform trust code that says at the age of 18 any beneficiary must be notified about the existence of any trust for which they are a beneficiary and are also entitled to receive statements or accountings of its assets. South Dakota does not follow the UTC and is therefore silent as to the notification of beneficiaries. In addition if a trust is ever made part of lawsuit, it can be completely sealed in South Dakota so no one ever has access to it.

5. **I'm worried my kids may squander wealth I have created, what is the best way to protect them?**

Creating a trust with dispositive provisions that control the amount of income and principal that can be distributed to your kids is the best way to go. Setting specific standards such as education and health are items you should focus on. Other distribution controls could be for starting a new business or charitable endeavors in order to teach your kids about the value of money. Most importantly trust assets should be passed down along bloodlines and should never include spouses of children in order to protect the assets from being part of marital property in a divorce.

6. **With the estate tax exemption rising to \$22 million combined between husband and wife, do I still need to have a trust when I die?**

There are multiple purposes for the creation of trusts. The most obvious purpose is to eliminate estate taxes to the maximum extent. However, many people setting up trusts want to ensure that future generations don't squander wealth that was created to fund trusts and so things such as asset protection and privacy are important issues the rise to the creation of trusts. So, although there are additional costs associated with potentially setting up a trust as well as annual trustee fees if you are using a third party trustee vs a family member, the benefits and peace of mind knowing assets are protected in trust far outweigh the drag of these costs.

7. **How do I know whether the investment advisor I am working with is looking out for my family's best interests when managing trust assets?**

The most important things an investment advisor should be doing can be summarized in two key areas. First, they should be completely transparent when it comes to pricing and how they get paid for their services. And second, they should be willing to sit down with family on at least a quarterly basis and review the performance on both absolute and relative terms compared to similar indexes. They should be candid about allocation decisions they made that worked and didn't work and whether managers or particular stocks they picked to fill an allocation worked out to their expectations. As a client being able to monitor their decision-making process will lead you to more accurately determine whether your advisor is working for your best interests.

8. I am nervous about naming one of my siblings as trustee as I don't want to create any family friction. Are there any better trustee solutions out there?

One of the biggest mistakes families make when creating an estate plan is naming a family member to serve without thinking of the ramifications when they are no longer around. This often creates conflicts with the children of the grantor who may have to go to a sibling who is named as the trustee and ask for a distribution. Over the last 20 years a new breed of trust company has entered the market: mainly independent trust companies that will serve purely as trustee and eliminate the conflict of interest that exists at most banks today where they are acting as both trustee and investment manager along with custodying all the assets. These smaller, nimbler trust companies allow families to develop relationships with their trust officers, ensuring that the wishes of the trust instrument are carried out without any conflict with the investment management. It also eliminates any family issues by having a third party making distribution decisions.

9. What information should my trustee be providing me with on a monthly, quarterly and annual basis?


At a minimum, your trustee should be providing you with a monthly statement showing cost and market values of the various holdings in your trust along with performance data to measure how accurately trust is performing. Secondly they should be detailing any cash transactions in or out of the trust to see where trustees are spending and distributing income and principal of the trust. At year end trustee should provide beneficiaries with a summary statement and K-1 to the extent they have taken distributions from the trust.

Read this list carefully. Share it with other family members. Call a meeting and ask these questions of your trust administrator and/or advisors. And make sure you're getting complete, clear and satisfactory answers.

And let us know if you're interested in exploring some of these in more detail. We'd be happy to participate in a call to share additional insight, answer other questions you might have, and explain why companies like Sterling Trustees exist to help family members stay well-informed about the details of their trust's health and management.

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