

# **Benefits of Receiving Your Inheritance in a Personal Adult Management (PAM) Trust Over Outright Distributions**

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## **A LOOK AT THE PERSONAL ADULT MANAGEMENT TRUST**



As the beneficiary of a Personal Adult Management Trust (PAM), what does this mean for you? A PAM Trust can protect your inheritance from:

- Most creditor claims
- An ex-spouse
- Frivolous lawsuits
- Excessive income taxes
- Death taxes

Think of your inheritance as a castle and the PAM Trust as the moat filled with alligators to protect that castle. You have the key to the drawbridge, allowing you to enter the castle and benefit from it, but you can also keep out unwanted visitors (see above list).

### **Who Controls the PAM Trust?**

The PAM Trust has two trustees who administer and manage the property within the trust. The administrative trustee (most often this is you, the beneficiary) has most of the power over the trust.

What authority does the Administrative Trustee have?

- Controls the trust assets
- Makes all investment decisions
- Can buy or sell trust assets
- Can invest in almost anything you as an individual can invest in with your own money

The trust is like a fund that you alone control. Generally you can buy anything for the trust that you would buy yourself as an investment, including your own home, a vacation home, artwork, stock, bonds, CDs, etc. The trust can even invest in your business or in a business of a family member.

#### What authority does the Special Trustee have?

- Directs allocation of trust benefits among the named group of potential beneficiaries
- Steps in if you are threatened by a lawsuit, creditor, spouse in a divorce, etc. to help keep your inheritance from being taken away by these parties
- Assists in planning distributions to save taxes

#### What limitations are imposed on the Special Trustee?

- Has no control over or access to trust assets
- Has no control over the investments you make

#### Who can be the Special Trustee?

- Someone who is legally considered independent of you
- Someone you can replace and therefore generally open to listening to your wishes

### **How Does the PAM Trust Function to Protect Your Inheritance?**



The PAM Trust functions much like any trust. All property owned by the trust should be titled in the trust name. You are the prime beneficiary of the trust, but you personally do not own the trust property. The property of the trust is not in your personal name, thus, your creditors generally cannot take the property. As administrative trustee, you control the trust property and can invest the trust property in any investment you want. Why is this important? Your creditors, a spouse in a divorce proceeding, frivolous claimants, or the death-tax collector, can get their hands on the property you own but not property you do not own. The alligators in the moat stand between them and your inheritance. Various state laws may allow them to get their hands on some small part of the property of the trust, but most of it will be protected.

If the PAM Trust is properly administered with a competent active Special Trustee acting as required, the predators may be kept at bay and your inheritance can be protected. The Special Trustee acts as a security guard for your inheritance. When adverse situations arise where any income distributed to you will be taken from you by one of these predators, the Special Trustee, under the discretionary authority given him, can exercise such authority to keep the income of the trust in the trust or to give instructions to distribute income or principal to someone other than you, thus preventing unwanted persons from getting the money.

## How Can You Achieve Income Tax Benefits?

The PAM Trust names you as the primary income beneficiary, and The PAM Trust names you as the primary beneficiary and other parties are named as alternate beneficiaries. Many tax savings opportunities present themselves. For example, you have a child in college who needs \$20,000 a year for school expenses. Your combined federal and state tax brackets are 30%, but your child's effective combined rate is much lower after taking into account the standard deduction exemptions, etc.

If you want to give the child \$20,000 for school, you would need \$28,571 of pre-tax income to do so. If instead the trust distributes \$22,222 directly to the child, the child will have \$20,000 after tax left for school expenses, a savings of \$6,349. With proper planning with a tax advisor, other significant family tax savings can be achieved.



## Now That You Have a PAM Trust, What Steps Do You Take?

1. You must title all of the inherited property in the name of the PAM Trust;
2. You must obtain a federal tax I.D. number for the trust;
3. You must keep the assets and income of the trust in its own separate account;
4. You must work with the Special Trustee to develop a plan of operation;
5. You must file tax returns for the PAM Trust and, in certain situations, pay income taxes on income or capital gains retained by the trust;
6. You must distribute the K-1s as prepared by the trust's tax preparer each year to the beneficiaries to inform them what income to report on their personal tax returns; and
7. The Special Trustee must be made aware and kept informed to prove that the Special Trustee was active. If the Administrative Trustee acts alone without utilizing the Special Trustee, then many of the benefits of the PAM Trust will be lost.

A PAM Trust is the strongest asset protection device you can have if you follow the guidelines set forth in the trust document regarding administration and investments and work with the Special Trustee to make the PAM Trust effective. The following is memorandum that explains the administration of the PAM Trust in more detail.



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**MEMORANDUM REGARDING PERSONAL  
ADULT MANAGEMENT TRUSTS**

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**TO:** JOHN J. DOE and JANE E. DOE

**FROM:** JAMES G. KNOLLMILLER, Attorney

**DATE:**

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This memorandum may serve as a guide and instruction to the future beneficiaries and trustees regarding the reasons why a Personal Adult Management Trust (hereafter referred to as PAM Trust) has been chosen to administer your inheritance rather than making an outright bequest of assets to you. This memo outlines the benefits to you and the benefits to succeeding generations. **Please note the provisions of this memorandum are based upon the current general understanding of the law and there may be changes and other interpretations of the law in the future.** First, some background information so that you are better informed as to why such trusts are advantageous to you.

In planning an individual's estate, most estate planners recognize that there are really two tax systems, one for the informed and one for the uninformed. This same rule applies for those who wish to use credit protection strategies as compared to those who do not. There are significant tax, asset and divorce protection benefits that are derived through a well-conceived family estate plan that are not found in using unplanned arrangements. The PAM Trust is one of these planned structures. Your inheritance was placed in a PAM Trust to offer the best opportunity available for you to provide protection of your inherited assets from the claims of creditors and payment of future estate taxes on your inheritance.

Under the tax structure we have in the United States, which is called a transfer tax system, properly structured inherited wealth is much more valuable than wealth that is earned and saved. This memorandum will illustrate how this differential applies in your circumstances. The vehicle chosen to achieve and maintain this difference is what is called an "irrevocable trust," which we are calling in this instance, the PAM Trust. This trust may be created by any family member for someone other than himself or herself and his or her spouse. The trust has as much flexibility built into it as legally can be done for tax and legal purposes. It is of chief benefit to mature competent family members who would otherwise receive property outright except for the benefits that can be derived from the transfer of property into such a trust.

The PAM Trust is designed to give the primary beneficiary almost the functional equivalent of outright ownership, including undisturbed control over the investment of the property. As you carefully read the trust provisions, you will see that as the beneficiary and if you act as administrative trustee of this trust, you have considerable latitude in being able to administer the trust during your lifetime, make investment decisions, and have choices as to the parties who will receive your property either during your lifetime or upon your death. This trust is not the typical trust that you may be aware of. Unlike some trusts, it is not an inflexible vehicle that restricts your enjoyment of the property. You may have heard horror stories of situations where financial institutions have control of a trust and the beneficiary literally needs to beg for more income to no avail. Contrary to that arrangement, this trust is extremely flexible and allows one to cope with the various problems, both those anticipated and those unanticipated, that have occurred or may occur in the future.

One of the prime concerns of a financial institution is the fact that such institutions are governed by state and federal rules regarding investment decisions. These are commonly referred to as the "prudent man rule." Traditional trust language usually precludes the types of investments that you as the beneficiary may wish to make. For example, under the terms of the trust document, the trust may make investments in a closely held family business enterprise no matter in what legal form the enterprise has been set up to function, make loans to your children, or even buy a house for them to occupy.

### The Benefits of the PAM Trust

The benefits of the PAM Trust as compared to having the assets distributed outright and free from trust can be summarized as follows:

		<u>Treatment of Bequest</u>	
		<u>Distributed</u>	<u>Held in</u>
		<u>Outright</u>	<u>PAM Trust</u>
1. Beneficiary has right to all income	yes	yes	
2. Beneficiary has right to invest principal any way beneficiary chooses		yes	yes
3. Spouse of beneficiary can attach in divorce proceeding			yes
4. Creditors of beneficiary can attach	yes	no <sup>1</sup>	no <sup>1</sup>
5. Beneficiary can waste principal, give it away to anyone			yes
6. Asset subject to estate taxes at beneficiary's death		yes	no <sup>2</sup>

#### Notes

Note 1: This is true only if the spendthrift status provisions are complied with and is subject to certain restrictions and conditions imposed by the state in which the beneficiary and/or trustee reside.

Note 2: Only true if held in GST-Exempt PAM Trust unless the document divides the PAM Trust into an Exempt and Non-Exempt Trust, the trust established is considered an Exempt PAM Trust and thus is not subject to estate tax at the beneficiary's death.

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This trust has been established after reviewing carefully the goals of estate planning and the desires and goals of most families. There are several primary ingredients that are generally included in most estate plans that are of prime concern to both the party establishing the plan and to the beneficiaries of the trust. These goals are:

1. control
2. estate tax savings
3. income tax savings
4. asset protection
5. valuation and leveraging
6. flexibility
7. liquidity at death

1. **Control.** Generally speaking individuals do not want to give up control over assets during their lifetimes. Parents who have built up wealth typically desire to retain it, and upon their deaths, they wish their children, and secondarily their grandchildren, to have the resources and retain control. This function is achieved in the PAM Trust. In the PAM Trust as set forth in the trust, control is retained by the parents during their lifetimes, and upon their deaths, it is passed on to their designated beneficiaries. Each individual child beneficiary receives his or her interest in a separate trust that he or she alone controls, if provided for by the grantor.

Beneficiaries have a broad special power of appointment that allows them to have control over the disposition of the property during their lifetimes and additional control after their deaths. If so desired you can then pass the benefits down from children to grandchildren. The only limitations are what is called the "Perpetuity Statutes," which simply limit the life of trusts to the listed persons who were alive at the death of the grantor (or last to die of the husband and wife grantors) of the trust plus twenty-one (21) years. Likewise by choice of what state law will govern the trust and the "situs" (place where the trust is a "resident") can offer the opportunity for a trust that can exist for periods of time in excess of the common rule of law of twenty-one (21) years plus lives in being.

May the trust stay in existence for a longer period? Yes, under certain state laws, trusts can be established that will be in existence for hundreds of years or even forever. However, before one embarks upon establishing such a trust one should discuss the full long term ramifications of such a decision. Generally trusts that go on for such long terms create many administrative and legal issues. For example, in five generations the potential number of beneficiaries of such a trust could expand to hundreds.

2. **Estate Tax Savings.** We are all aware of the advantages of reducing, avoiding, or deferring taxes. Generally most of us are concerned with income taxes, but in order to build up wealth for long periods of time, one must also consider the imposition of estate taxes. The Tax Act of 2017 increased the federal applicable exclusion amount to \$11,000,000+ per individual, adjusted yearly for inflation, with every dollar over the exemption amount taxed at 40%. In the normal method of transferring wealth from parent to child, child to next generation, and so forth the Internal Revenue Service gets an opportunity to "bite the apple" each time there is a transfer. It can be clearly seen at these tax rates that they take a very big "bite" out each time. Considering that these generations fall somewhere around the 30-year mark, you can see that it is very simple to compare a sum of money that goes through three generations with a tax bite each time compared to the same sum that does not get a bite taken out. The ability to escape estate taxes at each generation is only available to a PAM Trust that is exempt from generation-skipping taxes. Even if the trust does not grow in value through the various generations the net difference is substantial. However the increased estate tax exemption has caused planners to focus more on income tax benefits and elimination of concerns for estate taxes. See point number 8 that discusses the new provisions added to the PAM Trust that address this issue.

**Comparison of estate tax bite of 50% for three generations to no estate tax bite**

	<u>Tax Bite</u>	<u>No Tax Bite</u>
Initial fund	\$100,000	\$100,000
1 <sup>st</sup> generation bite	<u>(50,000)</u>	<u>-0-</u>
Left for 2 <sup>nd</sup> generation	50,000	100,000
2 <sup>nd</sup> generation bite	<u>(25,000)</u>	<u>-0-</u>
Left for 3 <sup>rd</sup> generation	25,000	100,000
3 <sup>rd</sup> generation bite	<u>(12,500)</u>	<u>-0-</u>
Remainder	\$12,500	\$100,000

The above comparison illustrates that, even without any growth in the value of the assets, the big winner after a few generations is the government. If you throw in a modest growth factor, the difference becomes even more pronounced. Without going into the mathematical details, if a modest growth rate is selected (6%), by the time the third bite is taken, the difference will be more than thirty (30) times greater with the no tax bite trust than with the tax bite each time. Thus, the family with no tax bite will have \$30 for every \$1 the family with a tax bite.

Since the estate tax exemption has dramatically increased in recent years, an option is now included to allow the beneficiary to make an election that will result in having all or part of the trust property included in said beneficiary's estate at death, and thus obtain a date of death value for basis purposes for the heirs while still preserving the other benefits outlined for PAM Trusts.

3. **Income Tax Savings.** By proper use of the special trustee's ability to spread income, significant income tax savings can be obtained. For example, assume the following case facts:

**FACTS:** Couple with three children over the age of 18 have \$175,000 adjusted gross income, \$25,000 in itemized deductions and potential income of \$60,000 from the PAM Trust. Assume the three children are in school and have no other income. Taxes are computed for federal and state rates imposed in 2002.

Alternative I: Distribute the \$60,000 income to the parents.

Alternative II: Distribute \$20,000 of income to each child instead. Under this alternative, because the children have too much income, the parents may not get the exemption allowance, however each child gets the exemption plus standard deduction.

### **Results**

Alternative I:

Parents' federal and state income taxes	\$60,460
Children's federal and state income taxes	-0-
Total tax bill	<u>\$60,460</u>

Alternative II:

Parents' federal and state income taxes	\$39,569
Children's federal and state income taxes	<u>5,877</u>
Total tax bill	<u>\$45,446</u>

Alternative II tax savings to family:	<u>\$15,014</u>
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4. **Asset Protection Planning.** Asset protection and liability planning has always been a consideration, but given the more litigious nature of our society coupled with the proliferation of divorces, creditor protection is often a very motivating factor. Certainly no one wants to pay any more taxes than necessary, and judgment creditor problems and divorce settlements are also situations for which one does not want to pay excessive amounts. The PAM Trust will offer a significant degree of protection in this area. When an irrevocable trust is established by someone other than the party who is the beneficiary, it provides what most planners consider the ultimate in creditor protection. The asset protection maxim is: "If you don't own it, nobody can take it away from you."

The general rule in trust law is that unless trust property is distributed to a beneficiary, it is protected from the beneficiary's creditors. There have been inroads in this area by legislation and cases; however, the PAM Trust offers the most protection of any legal devices available, if state

spendthrift statutes and cases are adhered to. Please note new statutes and cases may make inroads into the ability of such trusts to limit the spendthrift limitation advantage. One only has to look at some famous situations in which wealthy individuals have been sued and are able to fend off creditors' claims against trust assets. In Arizona, former Gov. Fife Symington's ongoing battle with the union pension fund regarding his liability on a mortgage is a typical example. One of his chief "assets" was a trust in which he is the income beneficiary, but the principal could not be reached by his creditors.

Generally, trust assets in a PAM Trust are not considered property subject to division between the beneficiary and the beneficiary's spouse, in the event of the dissolution of their marriage. However, nationwide erosion has occurred in recent years concerning the impact of trusts on a divorcing spouse. For example, some states consider spouses and ex-spouses of a trust beneficiary to be "exception creditors" outside the otherwise applicable protection of a spendthrift provision when it comes to satisfying a beneficiary's alimony or separate maintenance obligation. We have included language in the PAM Trust that the trustee shall not use trust assets for spousal maintenance or alimony that a beneficiary may owe to his or her spouse or ex-spouse. However, local law or the courts may override this restriction.

We have incorporated into the PAM Trust as much flexibility with regard to the use and enjoyment of the trust funds while offering the highest degree of creditor and divorce protection possible. You must know, however, that certain claims may be made against you as a beneficiary. For example, in some states such assets may not be exempt from child support claims. This area is one that will of necessity be changed in the future as laws and cases are written, but at the present time there is a high degree of protection already in this vehicle against all types of creditors, higher than almost any other device available.

We have made provisions for what is termed the "special trustee." The special trustee has authority to redirect the income from the named income beneficiary to some other party named in the trust. Furthermore, the special trustee also has authority to authorize distribution of principal to various beneficiaries. The independence of the special trustee and the terms of the trust must be adhered to if tax and legal benefits are to be secured. Only if considered independent can the special trustee make such decisions and help provide the income tax benefits and creditor protection required that someone who is not independent of the beneficiary cannot provide. The trust names JAMES G. KNOLLMILLER, an attorney with the law firm of KNOLLMILLER & ARENOFSKY, LLP or his successor in that firm, as the special trustee, who is considered independent of the beneficiary. Thus, we can make such decisions and help provide the income tax benefits and creditor protection required that someone who is not independent of the beneficiary cannot provide. Our current charge for this service is a minimum of Two Hundred Fifty Dollars (\$250) for each PAM Trust, or one-tenth of one percent (.001%) of the value of the assets in the PAM Trust on an annual basis. For larger trusts, the total fee will be negotiated to take into account the actual work involved. The beneficiaries and the special trustee need to realize that state governing statutes, case law and tax law may change over time and such changes will require the special trustee to modify provisions in the trust to maintain its spendthrift nature. Therefore, periodic reviews need to be done by competent tax and legal authority to be sure that proper modifications are made to the trust and it is being administered properly.

***Caveat:*** *Some states have statutes to the effect that a restraint on voluntary or involuntary transfer is invalid if the sole beneficiary of the trust is also the sole trustee of the trust. Therefore, a spendthrift trust with a sole trustee who is also the sole beneficiary may not be an effective device to offer creditor protection of the trust assets from a creditor of the beneficiary. A recent case, In Re Pugh, 274 B.R. 833 (2002 Arizona) held a trust in which a co-trustee was named is not a valid spendthrift trust. However, the facts of the case were that the co-trustee was the sister of the beneficiary. She did not know she was a trustee nor did she act in any capacity as a trustee. The court concluded that the beneficiary was in reality the sole trustee and, thus, the trust did not qualify*

*as a spendthrift trust. Thus it is critical that the trust have an independent third party involved. Therefore, we advise that upon funding of the PAM Trust you determine what the spendthrift law is for that particular jurisdiction and operate the trust as such to comply with the local law requirements at that time, in order to have an opportunity to benefit from the spendthrift provisions.*

5. **Valuation and Leveraging.** By utilizing the trust to make certain types of investments, the ability to leverage growth of assets in an estate tax-sheltered environment is possible. By utilization of various devices, including valuation discounts and leveraging techniques, there is the ability to multiply the value of this trust several fold for future generations.

6. **Flexibility.** One essential ingredient in all estate plans is to provide maximum flexibility to meet changing family needs and changing laws, particularly the tax law. That is why the PAM Trust has been structured to be as flexible as reasonably possible to take into account the changing world. There are many provisions within the trust document that provide extreme flexibility in financial and investment planning as well as in the distribution of assets.

7. **Liquidity at Death.** How does one provide for estate taxes? Generally speaking, either one has to accumulate a large amount of cash or liquid assets to be sold at his or her death or to purchase life insurance to provide the cash for estate taxes. Life insurance is traditionally purchased for estate creation and estate preservation. By utilizing the PAM Trust, there is less need for outside liquidity in succeeding generations' estates since their taxable estates do not include the assets of the GST-Exempt PAM Trust. Furthermore, the PAM Trust can accumulate assets and make the dollars available in the form of loans or purchases of assets from the taxable estate of each generation to form a bank of liquidity that is not tapped by estate taxes each generation.

### **The "Whys" of Utilizing the Personal Adult Management Trust**

The PAM Trust has the best opportunity of accomplishing most of the aforesaid seven goals families have when doing their estate planning. It is designed to provide the primary beneficiary with substantially all the rights, benefits, and control over the trust property that he or she would have if the property had been owned outright. In addition, there may be tax, creditor, and divorce protection benefits that are not obtainable with outright ownership. These benefits alone are reasons why the PAM Trust is an extremely valuable alternative to outright transfers.

The concept of the PAM Trust is fairly simple. It is a trust where the primary beneficiary is either the sole administrative trustee, or under certain circumstances, has a co-administrative trustee that can make all day-to-day management decisions and investment choices. The primary beneficiary generally has a power of appointment that gives the primary beneficiary the ability to eliminate all participation in the enjoyment of trust assets by future secondary or remote beneficiaries. Therefore, these individuals are not likely to bring a lawsuit or challenge the administrative trustee, since their rights can be eliminated. This ability of the primary beneficiary enables him or her to cut out any complaining secondary beneficiary, and thus, he or she should be free of interference from downline contingent beneficiaries. This is probably one of the most singular and important components of this plan that gives the beneficiary "control."

There are also many situations in which circumstances dictate that an individual should not be given complete control over the assets. Generally speaking, when an individual is legally incapacitated in some way, such as if he or she is a minor, inexperienced, disabled, or lacks certain skills, a co-administrative trustee or a third party acting as a sole administrative trustee may be assigned to manage the trust. Under those circumstances, the trust may provide that upon the curing of the legal incapacity, the beneficiary can obtain full control. For example, a trust for a 10-year old child would

provide that other persons acting as trustee govern the trust until the child reaches age 25 or 30, and then the child assumes full management control over the trust.

### **How the Personal Adult Management Trust is Designed for Maximum Benefits**

The PAM Trust is designed in most situations so that the beneficiary is the primary administrative trustee and has the right to all of the income of said trust. In addition, he or she has a broad special power of appointment during his or her lifetime and at death to give to a wide classification of individuals except for himself, his creditors, his estate, or the creditors of his estate. The special trustee can then (with an open ear to the needs of the beneficiary and his or her family) make reallocations of income for tax savings and direct distribution of principal for almost any reason (within the limits set by the grantor).

The PAM Trust generally provides that all of the trust income is paid to the primary beneficiary, unless reallocated by the special trustee. If the primary beneficiary is also the administrative trustee, he or she controls the investments and may determine whether he or she wishes to have the trust grow and produce a larger future income, or be invested primarily for a larger current income. If you were to use the services of a financial institution to invest your trust assets, you would learn that they would recommend investments that produce a smaller income for you and greater growth for the remainder beneficiaries, even though you may wish more income. If you desire investment advice, the trust can hire such advisors without limiting your choice of investment opportunities.

### **Investment Choices**

In addition to all of the investment choices allowed under the trustee power section and under state law, we have provided some or all of the following broad additional investment choices that permit you to make investments much as you would do if you had the property outright, including but not limited to the following:

- (a) Invest in family partnerships or business enterprises;
- (b) Acquire a residence or vacation home for yourself or any family member and make loans or aid a family member in acquiring same;
- (c) Acquire tangible personal property such as artwork, jewelry, coins, stamp collections, and other collectibles;
- (d) Invest in all types of investment opportunities;
- (e) Operate with a brokerage firm in having a margin account and buy and sell puts and calls; and
- (f) Make secured or unsecured loans to a wide spectrum of individuals or businesses.

In summary, as the administrative trustee of the PAM Trust, you have almost the same investment decision making capacity as you would if investing your own monies. Furthermore, you are absolved from liability for investment decision mistakes and have the right to tell a contingent beneficiary that if he or she complains how you invest the money, you will simply disinherit him or her.

### **Concern Over Future Trust Beneficiaries**

One of the main concerns that banks and other financial institutions have in administering trusts is the fact that they have to concern themselves with not only the investments that can be made but also the risk that if they do not act in what is called a "prudent manner" they can be sued by the

remainder beneficiaries. In the PAM Trust you are absolved from liability if you make investments that are not successful. Furthermore, you are given a "special power of appointment" that allows you, in effect, to disinherit a future potential beneficiary who might threaten you by saying you are mismanaging the trust funds, or for any other reason. You control the purse strings to decide who will receive the money upon your death. However, there are certain limits on your ability to name individuals who will get the money at your death. You are limited to the beneficiaries designated by the grantors of the original trust. Generally, these include descendants and descendants' spouses of the grantors, or other close or distant relatives, and any public charity. The original grantor of the trust can make the potential list very broad or very restrictive, so you must read that section of the trust to determine all of the potential remainder beneficiaries.

### **Managing the PAM Trust**

Management of this trust is not significantly different from managing your own assets. You as the administrative trustee are responsible for managing all of the trust assets. It will be necessary to obtain a separate federal tax identification number (EIN) for the trust and to file income tax returns each year. Under present tax laws, the trust itself would be subject to income taxes on income or capital gains that it retains. Since the trust normally will distribute all of the income annually, all of the ordinary income will normally be distributed to you as the beneficiary and taxed in your own personal tax return. The trust itself generally will retain any capital gains and pay income taxes on the capital gains retained. It is of benefit to you because those gains should not be part of your estate and since they are retained by the trust, such property is not subject to claims by your creditors. The retained property will be in the trust and can be utilized to generate additional income for you if you so desire and pass free of estate tax to your heirs.

**NOTE:** *You should be aware that if you are the sole trustee of the trust and have discretion to pay income to yourself or another person, you will still be taxed on any income that you pay out to someone else. The IRS will take the position that if you have the authority to give income to yourself, it will be treated as if it were distributed to you first and then as your gift to someone else. That is why you as the administrative trustee are not given that authority. Such authority is given to the special trustee and since the special trustee is "independent," said trustee can make such reallocations of income to a third party and not have the income taxed to you as the primary income beneficiary.*

A review of the general trustee powers of the trust will show that there are certain limitations on investments. In addition, state laws generally provide what is called "prudent man" rules for investments. However, we have provided in the PAM Trust a broad exception to the aforesaid investment limitations. Please review the paragraphs entitled "Special Investment Authority" in the trust documents. These paragraphs allow you to make substantially all types of investments that you as an individual are able to make with your own personal funds but now can be in the form of trust investments. You must be careful to document all investments in the trust name and keep records to show that the trust owns the actual assets. In that respect, the assets should be titled in the name of the trust. For example, if your name was MARY SMITH and the name of your parents' trust was the JOHN & JANE SMITH TRUST, you would then state that the assets are titled: MARY SMITH PAM TRUST U/A THE JOHN & JANE SMITH TRUST U/AD \_\_\_\_\_, 20\_\_\_\_.

It will also be important for you to keep accurate accounting records detailing the income earned each year, the distribution to yourself of the income as the beneficiary, and the retention of principal. Whenever there is a principal distribution made as a discretionary distribution, records will be kept by you and the special trustee stating why the distribution was needed and support the provision that the decision was made by the special trustee and not by you as the income beneficiary. These records should be maintained essentially forever, as this trust will be in existence for your entire lifetime and beyond, perhaps even beyond the lifetimes of your children and grandchildren. These

records will be important to show tax authorities and any potential creditors you may have that the trust in fact was managed as described under the trust agreement and should not be included in your estate or the estates of your children or grandchildren, and not subject to attachment by creditors. Some people even maintain a record book similar to that maintained by corporations in their minute books. The better the records are kept, the better the case will be for you and your family if creditors attempt to get at the trust assets, or the estate tax collector tries to prematurely include the trust in your estate. It is important that the trust be treated as a separate legal entity. If there is a co-trustee named or later appointed, said co-trustee must be aware of his or her responsibilities and duties.

### Summary

The above is a brief summary of the administration and management of the trust as of the time this memo was written. If you have questions, please contact a competent tax and legal advisor who can advise you how the current tax laws apply to these types of entities, since tax laws and other rules will change from the time the trust was drafted until the date the trust becomes effective. For that reason, JAMES G. KNOLLMILLER, an attorney with the law firm of KNOLLMILLER & ARENOFSKY, LLP or his successor in that firm, has been named as the special trustee. He provides legal advice primarily in the trust, estate and taxation fields of law. No one can assure you that any trust is 100% spendthrift proof; however, it has been designed to provide this protection if properly administered and is likely to succeed if challenged in court. Nevertheless, no assurance can be given that in a review of the trust, a court might not uphold the spendthrift provisions. In summary, the trust offers you flexibility in operations, estate tax savings, and creditor protection that no other vehicle can offer. **JAMES G. KNOLLMILLER works with attorneys in many other states and, if necessary, will consult with local legal counsel in the state of residence of the income beneficiary to determine the then current governing statutes of that state and the status of the law regarding this particular trust in that jurisdiction, to preserve as much of the tax and creditor protection possible for you.**

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### **CAUTION: PLEASE BE ADVISED**

**This memorandum has been prepared to provide general educational information on the stated subject matter. It should not be interpreted as providing specific legal advice or response to any individual questions or issues you may have. Application of the ideas and concepts presented should only be undertaken after you consult with your legal counsel and obtain their advice as it pertains to your individual situation.**

**PLEASE NOTE:** Based on IRS Circular 230, the Internal Revenue Service may consider this memorandum as a "covered opinion." Therefore, we make the following disclaimer regarding its usage. Any tax advice we provide in this communication is not intended or written to be used, and cannot be used by you or any other person or entity for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or any applicable state or local law. It is provided for information and guidance only. You need to consult with your tax advisor regarding any tax issues that arise in the funding and operation of your trust.

## IRS Circular 230 Disclosure

**Pursuant to recently enacted U.S. Treasury Department Regulations and to ensure compliance with the requirements imposed upon us by the United States Internal Revenue Service, we are now required to advise you that, unless otherwise expressly indicated, any federal tax advice contained in this communication, including attachments and enclosures, is not intended or written to be used, and may not be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matters addressed herein.**

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