



ADVANTAGES OF THE SIX GENERATION FAMILY FORTRESS DYNASTY TRUST (FFDT)

Building Your Family Fortress

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Summary: The FFDT was created by our firm to consolidate a family's assets into an Irrevocable Trust. This article explains the advantages of this Trust including reduction of estate taxes and asset protection against creditors. The FFDT is set up to benefit the family for up to six generations. We help our clients build their family fortresses by establishing the FFDT.

What is a Family Fortress Dynasty Trust (FFDT)?

The six generational Family Fortress Dynasty Trust is an irrevocable trust, similar to the previously used "irrevocable life insurance" trust and has additional provisions which enhance the benefits to the family. The FFDT is a receptacle for family assets and life insurance. It sets up a family in a structure that will provide income and emergency funds for the members of the family for five generations, possibly six if grandparents are alive. A revocable trust also may be structured to become a FFDT after both grantor spouses die.

An ideal receptacle for life insurance.

The FFDT is an ideal receptacle for all of the life insurance on the lives of the husband and wife, the children of the family, and, in some instances, on the lives of the grandchildren. The FFDT protects the life insurance so that it is available to take care of the family and to provide last-to-die insurance for paying estate taxes. The life insurance placed in the trust includes insurance on the breadwinner parents, stay-at-home grantor, children, grantor's parents, grandchildren, and key persons.

What other assets may be placed in an FFDT?

In addition to life insurance, other assets that may be placed in the FFDT include:

1. Stocks, bonds, and other securities portfolio
2. Limited partnership and limited liability company ownership percentages
3. Family corporation stocks
4. Household goods and personal effects of grantors
5. Real estate rentals that are not in the family limited partnership
6. Furniture, equipment, and other personal property rentals
7. Second homes
8. Secured loans receivable

A source of emergency funds.

The FFDT provides emergency funds not only for the husband and wife who set up the trust but also for the children, grandchildren, great-grandchildren, great-great-grandchildren, and, in some instances, the grandparents if they are still alive. Most of the time, these emergency funds are transferred out in the form of loans. These loans are secured by the property of the borrower, resulting in a “creditor screen” on the borrower's assets that protects them from having their property taken away by outside “predator” creditors. For example, loans may be made from the FFDT to family members to increase the liens on their residences so that the \$100,000 homestead exemption will fully protect their residence from being taken away by predator creditors.

A stash of retirement funds.

The FFDT may be used to provide retirement funds for the husband and wife who created the trust, the grandparents, the children, or grandchildren. Funds may be disbursed either as loans or distributions, depending on the relationship of each person to the trust. What is advantageous about the distributions of FFDT funds for retirement is that these distributions, if made in the form of loans, will not subject the recipient of the cash to income taxes.

Protection from wipe-out situations through six generations.

The FFDT provides protection for six generations – the generation of the husband and wife who set up the trust, their parents, their children, their grandchildren, their great-grandchildren, and their great-great-grandchildren. The assets in the trust are subject to distribution when the grandchildren die. The grandchildren then will have raised the next generation and will be the grandparents of the following generations. During the years that the trust is in existence, the trustees may release funds to the various recipients so that they may set up identical trusts to benefit later generations, assuming of course that the tax laws remain the same. The FFDT provides the following advantages:

Protection from predator creditors.

Currently, many people are exposed to unfair creditors which we call “predator creditors.” For example, suppose you buy a house. If the property had been used previously for a gasoline station with an underground fuel tank, you could be held liable for hundreds of thousands of dollars to clean up the toxic substances. Suppose you buy a building that secures a bank loan. If the building becomes worth less than the bank loan (an upside-down situation), you may end up with a foreclosure and a deficiency judgment to the bank. Suppose you are a doctor, lawyer, dentist, architect, or other professional. If you allegedly make a mistake, you may end up with a malpractice judgment against you. In conventional circumstances, a predator creditor could wipe out most of your hard earned assets and decades of labor in accumulating those assets by you and your family. In such instances, you may find yourself being a “do-it-yourself” insurance company to insure the rest of the world from unfortunate mistakes or bad luck.

Security from divorce claims.

No matter how hard you try, the potential exists that the property which you inherited from your parents or which you give your children may end up in a divorce court where the in-law makes a claim on the family property. If you keep your assets in the FFDT, the assets will remain the separate property of the family member and will not be subject to a divorce claim.

No exposure to devastating medical bills.

In today's world, escalating medical bills can wipe out a family's estate. The assets of the FFDT, however, are not subject to those medical bills. The ill family member will be allowed to qualify for federal and state aid like everyone else. The funds in the FFDT are available as extra funds to make the family member more comfortable during the disastrous medical calamity.

Avoidance of Probate expenses.

All of the assets in the FFDT, regardless of the generation, are not subject to probate either on the death or the incompetence of the family member. Avoiding probate eliminates the necessity of appointing a personal representative, executor, administrator, conservator, or guardian – all of which creates tremendous expense for the family.

Protection for the dead branch of the family tree.

Possibly, one or more children of the family will not have children of their own. Rather than have the inheritance go to that child and end up in the hands of an in-law, it is recirculated within the FFDT to the other branches of the family tree down to the great-grandchildren and great-great-grandchildren of those family members who have issue to carry on the family name, traditions, and bloodlines.

Protection against “Bedroom Blackmail.”

“Bedroom Blackmail” is a name used to describe the situation where one of the in-laws refuses to go to bed with the family member unless the family member takes money out of the family trust and uses it for some special project of the in-law. The FFDT, however, is set up so that the family member subject to bedroom blackmail is protected because that family member must go to other family member co-trustees for permission. The blame for the refusal is tagged on someone other than the family member being subjected to bedroom blackmail. Consequently, the family member will not receive the blame and can live an ordinary, happy married life.

Reduction of estate taxes.

When loans are made from the FFDT to family members, the loans become debts of the respective family members' estates and thereby reduce the potential estate taxes of that family member. The liens created by these loans are called “creditor screens.” The collateral for the loans could be interests in family corporations, partnerships, real estate, and/or residences. The loans and the liens securing those loans put the FFDT in first position so that the asset is protected against predator creditors. To the extent that

various family members pay interest on those loans, the interest payments further reduce the future estate taxes of the various family members.

Reduction of need to use commercial financial institutions.

The FFDT essentially becomes a family "bank" either with the investments that were placed in the trust or with the proceeds from the life insurance that was placed in the trust. The family bank is available to lend money to the family businesses, secured with collateral, and to give the family the benefit of (1) providing the funds the family needs, like a bank; and (2) enjoying the high interest rates of a comparable bank loan.

Avoidance of unscrupulous landlords.

To the extent that property has been placed in the FFDT, the trust acts as a landlord, leasing property to the various family members and to their businesses. As a landlord, the FFDT protects the leased property from the creditors of the various family members and is always available to provide living quarters and business opportunities for family members.

Reduction of family unemployment.

The FFDT may own the controlling interests in the businesses of the family. In such situations, the family businesses are protected from the creditors of all the family members. At the same time, the FFDT provides employment and business continuity as a controlling owner of the family businesses.

Reduction of high income taxes.

The FFDT is set up with a mechanism of breaking down into small sub-trusts, each with its own tax number. The sub-trusts result in the breaking up of income within the trust into small units with lower tax rates and further allow distributing income from the trust to multiple beneficiaries who themselves may be in lower tax brackets. Income taxation also may be diverted back to the grantor allowing the grantor to pay income taxes for the trust and thereby further reduce estate taxes.

Tax inflexibility.

The trust may be set up with family members as co-trustees. If further restrictions or careful discretion is needed, professional bank employees or financially astute, competent persons can be added as additional co-trustees to increase the "gene pool" of careful thinkers managing the FFDT. Depending on the situation of each family member who is a beneficiary of the trust, these trustees have infinite flexibility to open the drawbridges of the castle and let income or property out or to keep it in.

Methods of keeping the trust from going astray.

If the actions of a trustee warrants the removal of the trustee, the trust permits a "Protector" to remove the trustee without court proceedings. If the tax laws change or if assets are imperiled, the "Protector" may shift the jurisdiction or change provisions of the trust subject to careful checks and balances. Normally, the attorney drawing up the trust is the "Protector" because that person knows the most about the overall estate plan and the purposes of the trust. The family CPA, however, may be set up as a Co-

Protector when the CPA is very close to the family. Religious persons whom the family trusts also may be set up as Co-Protectors with the attorney to provide adequate checks and balances. In any event, before the single Protector or the Co-Protectors act, they must obtain the approval of one or several family members who are designated in the trust so that there is little chance for abuse by the Protector. Essentially, the trust is set up like the United States government with various checks and balances so that none of the trustees, beneficiaries, or Protectors may go astray without being restricted by other officials involved with the trust. The mere fact that checks and balances exist will in all probability prevent aberrant conduct by anyone concerned with the trust.

Privacy from persons outside the family.

If the family wants privacy, they may designate family members solely as trustees. The family need not involve outsiders in the trust or designate outsiders as trustees. Since the trust is not involved in probate, it remains very confidential with few people ever knowing the terms of the trust.

We must act now – Congress may take away the lifetime estate tax exemption.

Normally, the FFDT contains investments and life insurance. Throughout the next year, as the politicians in Washington, D.C., contemplate taking away the \$600,000 estate tax exemption, sophisticated individuals will be making lifetime gifts of at least \$400,000 per person and possibly the full \$600,000 so that they may fund the trust with their lifetime estate tax exemptions while they are still available.

This lifetime exemption enables the so-called “balanced aquarium arrangement” – where there is enough income or extra principal from the investments –to completely make the premium payments on whatever life insurance is in the trust. In other words, no further “fish food” need be placed in the trust tank to feed the life insurance fish. The family may, in essence, forget about the trust and forget about making any further transfers to the trust and watch the cash value of the life insurance grow and grow.

Losses due to inflexible investments.

Some of the assets of the FFDT are invested in life insurance, and some of the assets are invested in other assets. By comparing the tax-free return on investment within the life insurance to the after-tax increases in the other investments outside the life insurance trust, the trustees may determine which class of investment achieves the greater after-inflation, after-tax return on investment. If the trustees determine that it is better to have the investments within life insurance policies, funds may be transferred into the life insurance policy as additional premiums. Their growth will be sheltered tax-free. On the other hand, if the trustees find that the other investments outside the life insurance policies are making more than the sheltered increases and the cash value within the life insurance, then the trustees may borrow out funds from the life insurance policies and invest them in other investments. The FFDT trustees possess a great deal of flexibility to ride the waves of changing economics.

How to deal with the income tax transference to parents.

To the extent that the income within the trust is used to pay the life insurance premiums on the parents of the beneficiaries, the income taxes on those funds are charged to the

parents. Normally, one would consider this income tax transference as being bad. Actually, it is good because it is, in effect, a phantom estate tax reduction. When the parents pay the income taxes of the FFDT, the income tax payments reduce the size of the parents' estate. For example, if their estate is within a 55% estate tax bracket, the government essentially pays 55% of the income tax payment in the form of reduced estate taxes!

Advantages from reducing the expense of property and casualty insurance, liability, medical, and disability insurance.

To the extent that the trustees confirm that cash monies are readily available, either within the cash values of the life insurance or the other investments of the FFDT, the family may reduce the costs of their medical, disability, property and casualty, and liability insurance.

Since the cash values within the FFDT are readily available for emergencies, the waiting periods and the deductibles on the other insurance policies may be increased when the family "self-insures" more. The self-insurance portion is backed up by the cash available in the FFDT. To that extent, the out-of-pocket costs of the insurance coverage outside the FFDT are reduced.

For example, when the deductibles on the property and casualty insurance policy on the house and personal property are increased to \$10,000 a year, the cost of the insurance goes down considerably. To the extent that the lower premiums on these policies results in savings, the funds that otherwise would have been "dumped in the river" and never seen again may be used to further fund the FFDT.

When the family knows that they have high insurance deductibles and that they will have to pay out of their own pockets, they tend to be much more careful in preventing accidents. In fact, family members are more inclined to use some of the money saved to hire safety inspectors and engineers to double-check and prevent losses.

Another benefit that this arrangement provides is that the family makes fewer claims on the insurance companies because of the large portion self-insured. This arrangement not only encourages family members to compile an excellent record of no claims with all of the insurance companies but also enables the family to get optimum rates on the various insurance policies. Imagine, the money that would have been paid out to these insurance companies is invested and reinvested within the FFDT with the earnings compounding again and again for the benefit of the family over the years.

Whenever there is a favorable tax savings structure or move, it is our policy to "move an armored division through the tax loophole" as soon as possible so that the structure or move is grandfathered before the laws are changed. With the FFDT, we follow and use the normal exemptions, deductions, and other tax laws that were set up as social legislation by Congress to bring about various benefits to our society. In this instance, the FFDT is insuring that the family unit will be financially strong for many generations.

If we recognize the principle that our nation is a collection of families, then the more families that are strong and secure, the stronger the entire nation will be. Those families

who do not use the vehicle of the six generational Family Fortress Dynasty Trust will be subject to substantial losses and be weakened in later generations.

Imagine how strong, solid, and long-lasting our culture would be if every family had a Family Fortress Dynasty Trust and built it up either with gifts of investments or with life insurance. Our whole nation would be an economically strong fortress with the assurance of multi-generational prosperity.

For additional information call: (602) 252-5110

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