GREENLEAF TRUST

Perspectives

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Chief Executive Officer

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Purposeful Culture

As you all know culture is something that is very important to Greenleaf Trust. It defines us and differentiates us. One of our founding goals in 1998 was to find really talented teammates and create a culture that would engage and inspire them. If we could do that, then just think about what that team could do for our clients.

Because our culture is so important to us, it's a critical component of our long-term strategic plan and something we work hard at every day. We also carefully and continuously take its temperature. One of the ways we do this is through our behavioral science partner, Humanex Ventures. Every year we provide our teammates with an anonymous survey to inquire about what is important to them and how they feel about their role, support from their manager, their team, and the Greenleaf organization as a whole. Response rates are high because teammates believe in the importance of the culture we have created together. This year's response rate was 88%.

I am extremely proud to share with you the five questions with the highest scores (from 1-5, with 5 being the highest) from our survey this year and the percentage of teammates that answered either "agree" or "strongly agree".

1) I take complete ownership for my attitude and effort in embracing a growth mindset. 4.77 (99.4%)
2) I am driven to contribute to the success of our organization. 4.77 (96.8%)
3) I am committed to achieving my potential through learning and growing. 4.77 (99.4%)
4) I support our organization's mission. 4.75 (97.5%)
5) I feel great pride in being a part of our organization. 4.75 (96.8%)

When analyzing the scores from all 180 questions, we can get a gauge for the percentage of our team that is highly engaged. According to Gallup, a global analytics and advisory company that has conducted employee engagement studies for years, 32% of full- and part-time employees working for organizations in the United States are engaged, while 18% are actively disengaged. The engagement trends downward from 2020. Engaged employees based on their definition are involved and enthusiastic about their work

Purposeful Culture, continued

"… this is the type of team and culture we wanted to build, nurture, and grow as we did from the beginning 25 years ago."

and workplace. We would agree with that definition. Our results are a little different, though. More than 89% of our team is highly engaged, and that trend is up from 2020.

As previously mentioned, this is the type of team and culture we wanted to build, nurture, and grow as we did from the beginning 25 years ago. There are many benefits of having a strong culture and highly engaged team from an organizational perspective like increased productivity, improved recruiting, a louder brand identity, better retention, and even enhanced profitability. Those are all important benefits from a long-term success perspective and our ability to serve clients from generation to generation. We are OK though with being a little myopic when considering the benefits. That is because we have experienced these long-term organizational benefits by focusing more on the impactful benefits that a strong culture and highly engaged team provide to our clients and teammates.

Nicholas A. Juhle, CFA®
Chief Investment Officer

April Update

The second quarter of 2023 is off to an interesting start. For the most part, investment markets performed well in April and first quarter earnings season is shaping up better than expected. Meanwhile, consensus expectations for the economy portend a high likelihood of a recession in the next 12 months, and our preferred indicators support this view as well. Looking forward, we believe geopolitics and monetary policy will carry the greatest influence over how the rest of the year transpires for the economy and the markets.

Investment markets built on year-to-date gains in April. In the month of April, global equities gained 1.3%. U.S. stocks added 1.3% while developed international stocks rose 2.8% and emerging market stocks fell 1.1%. Year-to-date, global equities are up 8.4% with domestics (+8.6%), developed international (+11.5%) and emerging markets (+2.8%) all showing gains. Bonds returned 0.6% for the month as the U.S. 10-year Treasury yield retreated 5 bps to 3.42%. Year-to-date, core bonds are up 3.0% with the U.S. 10-year Treasury yield down 45 bps.

"… first quarter earnings season is shaping up better than expected."

First quarter earnings season is off to a relatively strong start. With 53% of S&P 500 constituents reported, corporate earnings are tracking to a blended decline of 3.7%. This compares favorably to expectations for a decline of 6.7% when the quarter ended. Analysts are currently forecasting a 5.0% earnings decline in the second quarter, followed by growth of 1.7% and 8.8% in the third and fourth quarters and 1.2% earnings growth for the full year.

Shifting to the economy, an initial look at U.S. GDP showed annualized growth of 1.1% in the first quarter, marking deceleration from annualized growth of 2.6% in the fourth quarter of 2022. As it stands, 65% of economists

believe the U.S. will enter a recession at some point in the next 12 months, while a model produced by the New York Federal Reserve calculates the probability at around 58%. If it happens, it will be the most widely anticipated recession in history.

Our primary recession indicators, among the many we monitor, suggest an elevated likelihood of a recession as well. Unemployment remains historically low at 3.5%, but monthly payroll additions have moderated of late, job openings appear to be on the decline, and workforce reductions are increasingly prevalent in the headlines. Meanwhile, retail spending appears to be losing momentum with an inflation adjusted decline of more than 2% in March. The yield curve remains sharply inverted with short-term interest rates meaningfully higher than long-term interest rates.

While many variables, known and unknown, will influence the timing and depth of the next recession, we believe geopolitical risks and monetary policy decisions will heavily influence the near-term path of the economy and markets.

The geopolitical landscape is complicated, with issues ranging from an ongoing war between Russia and Ukraine to tensions between the US and China. In Washington, brinksmanship over the US debt ceiling continues to fuel anxiety. House Republicans recently introduced a bill that would cut federal spending in exchange for lifting the ceiling for one year. The legislation is unlikely to succeed in the majority Democrat Senate in its current form but could provide the basis for eventual negotiations. All of these concerns are notoriously difficult to evaluate.

Turning to monetary policy, by the time this article goes to print, the FOMC will likely have delivered a third consecutive quarter point rate increase at its May meeting bringing the Fed funds rate to a range of 5.00%-5.25%. Market participants are pricing for rate cuts in late 2023 and early 2024, though policymakers have yet to concede that narrative. With expectations for relatively slow growth, a gradual rebalancing of supply and demand in the labor market and inflation moderating, committee members don't foresee rate cuts this year. Even so, a 5.00% terminal rate is lower than the peak expectation of 5.50%-5.75% just prior to regional bank failures in March. Deposit flows continue to be negative across the banking sector, moving primarily toward money market mutual funds, and we will be monitoring the extent to which this tightens credit conditions throughout the rest of the year.

The year-to-date experience is a prime example that while it may be easy to identify risks and issues facing the economy and financial markets, it is impossible to consistently predict their timing, magnitude and interdependence. Throw in a couple of unforeseen variables and any semblance of a crystal ball is quickly dashed. We expect the same to be true in the balance of 2023 and continue to rely on the key tenets of our investment philosophy to guide us through the conditions we find ourselves in.

"...65% of economists believe the US will enter a recession at some point in the next twelve months, while a model produced by the New York Federal Reserve calculates the probability at around 58%."

George F. Bearup, J.D.
Senior Legal Trust Advisor

Gifts – Deceptively Simple

Wealthy individuals are regularly encouraged by their advisors to make gifts of their assets while alive. Lifetime gifts remove the asset, and any future asset appreciation, from the donor's taxable estate. In addition, if the gifted asset is income-producing, then the donee will report and pay the tax on that income, presumably at a lower marginal income tax bracket than the donor's tax bracket. That said, while several benefits are associated with lifetime gifts, lifetime gifts are *deceptively simple*.

DONATIVE INTENT: For property law purposes, a valid gift in Michigan has three elements: (i) the donor must possess the *intent* to transfer title to property gratuitously; (ii) there must be actual, or constructive, *delivery* of the property to the donee, unless the donee is already in possession of the property; and (iii) the donee must *accept* the property.

Under federal law that imposes gift taxes, neither donative intent nor an identifiable donee is actually required for a taxable gift to occur. Instead, for a taxable gift to exist there must be a *completed transfer* and the transfer must be for *less than full and adequate consideration*. Consequently, what might not appear to be a gift under Michigan's property law will nonetheless be treated as a taxable gift for federal gift tax purposes.

"... while several benefits are associated with lifetime gifts, lifetime gifts are *deceptively simple*."

DIRECT AND INDIRECT GIFTS: A direct gift, as the term suggests, is the transfer of property directly to the donee. However, a donor can make a taxable gift without being aware of it. An example of an indirect gift is the sale of an asset to a child for an amount of money that is later determined by the IRS to be less than the asset's fair market value. Direct gifts are obvious. Other transactions though may be classified as a taxable gift without the donor even being aware that a taxable gift has occurred. For example, a below-market interest rate that is charged on a loan constitutes a gift by the lender to the borrower on the use of the loan proceeds, the taxable gift being the difference between the interest rate used and the federal applicable rate of interest for the month of the loan. Another example is when an individual holds a general power of appointment with respect to property held in trust and later exercises that power of appointment in favor of another person; the powerholder has made a taxable gift. Or, an individual who releases, or allows to lapse, a power to withdraw assets from a trust may also have made a taxable gift simply by doing nothing.

PRESENT INTEREST ANNUAL EXCLUSION GIFT: In 2023, an individual donor may gift up to $17,000 a year to each donee gift tax-free. This *annual exclusion* gift opportunity of $17,000 covers *all* gifts made by the donor during the calendar year, including birthdays, Christmas, graduations, etc. However, this tax-free gift opportunity only applies to a *present interest* gift. Gifts of a future interest, like a gift to an irrevocable trust for the donee's benefit, will

not qualify for the gift tax annual exclusion; a gift in which the donee's right of enjoyment in the transferred property is deferred until some future date will not qualify for the gift tax annual exclusion. For example, if the donor owns vacant land and transfers that land to an LLC, and then proceeds to gift some of the LLC units to the donee, those gifted LLC units may not satisfy the present interest requirement if the LLC's Operating Agreement limits the transfer or sale of LLC units, or the LLC does not generate any present income that is distributable to the donee-member.

GIFTS TO A MINOR'S TRUST: The *present interest* condition does not apply when a gift is made to a trust that is established for a minor beneficiary. To qualify as a *minor's trust* only the minor child can be the trust's beneficiary, the child must possess the right to withdraw all trust assets upon reaching the age 21 years, and all of the trust assets must be included in the minor's taxable estate should he or she die prior to age 21 years.

REVOCABLE GIFTS TO A 529 ACCOUNT: Gifts can be made to a qualified education IRC 529 account that is established for a donee-beneficiary. The donor may make up to five years of *annual exclusion* gifts in one year to the one 529 account, or $85,000 at one time. However, the donor cannot make any future *annual exclusion* gifts to the beneficiary for the following 5-year period. Unlike other tax-free gifts made by the donor which are irrevocable, the donor to the 529 account can either (i) change the beneficiary of the 529 account or (ii) revoke the gift and regain the contributed funds from the 529 account, albeit subject to a 10% penalty and income tax on the 529 account's earnings at the time of the termination of the account.

HEALTH AND TUITION TRANSFERS NOT GIFTS: A donor can make unlimited gifts to pay for certain tuition and medical expenses of the donee without incurring any gift tax liability. However, the gift must be in the form of a *direct* payment from the donor to the medical expense provider or the school for the donee's tuition. Giving the money to the donee to pay these expenses will not qualify for this exception for unlimited health or tuition gifts. These *direct* payments are not even treated as *annual exclusion* gifts; they are in addition to *annual exclusion* gifts to the donee. The definition of *medical expenses* is fairly broad while the definition for *tuition* is narrow and literal.

> "A donor can make unlimited gifts to pay for certain tuition and medical expenses... However, the gift must be in the form of a direct payment from the donor to the medical expense provider or the school..."

REFUSAL TO ACCEPT A GIFT: A *disclaimer* is an irrevocable and unqualified refusal to accept an interest in property. The individual who makes a *qualified disclaimer* is not treated as having made a taxable gift. However, if the individual's disclaimer fails to satisfy the conditions imposed under the Tax Code, and it is not made within 9 months after the interest has been conferred on the disclaiming individual, then the non-qualified disclaimer is treated as a taxable gift by the disclaiming individual for gift tax purposes, even when their disclaimer meets the requirements of a valid disclaimer under Michigan's disclaimer of property interest laws. For example, a father dies and leaves

Gifts – Deceptively Simple, continued

assets in trust for his children; one son disclaims his beneficial interest in the trust, but the disclaimer is made 10 months after his father's death. That is a non-qualified disclaimer; the result is a taxable gift of the interest in the trust is made by the son.

GIFTS TO A SPOUSE: The marital deduction for federal gift tax purposes is of an unlimited amount, unless the spouse is a non-citizen. As such, a gift tax-free transfer can be either: (i) outright; (ii) by creation of joint tenancy between the spouses; or (iii) by the creation of certain *qualifying interests* in irrevocable trusts, called QTIP trusts. However, transfers of assets made prior to the marriage or after a divorce do not qualify for the federal gift tax unlimited marital deduction. To qualify for the unlimited marital deduction the gift to a spouse must be a *nonterminal* interest; loosely translated, this means that a transferred property interest will terminate or fail upon the lapse of a period of time, or upon the occurrence or non-occurrence of an event, such as a life estate, a term of years, or an annuity interest. For example, a gift in trust for the benefit of a husband for 20 years will not qualify for the marital deduction, because after 20 years the husband's interest in the property ends, even if the husband is still alive. Similarly, a gift in trust to a wife who is to receive all income from the trust, unless she remarries, is also a *terminal* interest that does not qualify for the unlimited marital deduction. These *terminal* interests will cause the transferring spouse to pay a federal gift tax.

> "A tax-free gift can also be made to charity, but there are numerous limitations on the type of gift made and/or the amount that can be claimed as a charitable income tax deduction."

GIFTS TO CHARITY: A tax-free gift can also be made to charity, but there are numerous limitations on the type of gift made and/or the amount that can be claimed as a charitable income tax deduction. One important limitation is that the gift to a charity cannot be a *split-interest* unless the gift takes a specific form. For example, a gift in trust where the donor retains the right to all trust income for life will not qualify for a federal income tax charitable deduction; the donor's retained right in the trust must take the form of a fixed annuity amount or an annual percentage of the trust's assets for the donor to be able to deduct the value of the remainder interest in the trust that passes to the charity. Also, for such a gift in trust that ultimately passes to the charity, the charity's present interest in the trust must be at least 10% of the value of the assets that are gifted into the trust by the donor.

PROS AND CONS OF GIFTS: One negative to making a lifetime gift is that if the property that is given has a low income tax basis, that low basis will not be adjusted to its fair market value on the donor's death. Thus, the opportunity to avoid capital gains after the death of the donor will be lost when the asset is sold; there will be a tax basis adjustment only on the death of the donee.

One positive to a lifetime gift (candidly, seldom viewed as such by the donor!) is that the gift tax that is actually paid by the donor is tax *exclusive*. This means that the 40% gift tax is only paid on the value of the asset that is actually transferred by the donor – no gift tax is imposed on the money that is

used to pay the gift tax. In contrast, the federal estate tax, also assessed at a flat 40%, is tax *inclusive*, which means that the federal estate tax is also assessed on the money that is actually used to pay the federal estate tax. Thus, it is more tax-effective, if a tax must be paid, to pay a gift tax on lifetime gifts than it is to pay the federal estate tax when assets are transferred on the donor's death.

Advising an individual to make lifetime gifts is a good strategy. As always seems to be the case, the "devil is in the details." Any time the Tax Code uses the word *qualified*, that should be "code" that there will be conditions that have to be met.

Retirement Saving Coverage Gap

Chris A. Middleton, CTFA
Executive Vice President
Director of Retirement Plan Division

Recent Perspectives articles have called attention to the newly passed SECURE 2.0 Act of 2022, which initiated several retirement plan changes and enhancements. A key focus of this legislation is to expand coverage and retirement savings for those who are not taking advantage of their 401(k) or who do not have access to a corporate retirement plan whatsoever. Some of the numerous steps to expand and enhance American retirement savings over the coming years include expanding auto enrollment, enhancing tax credits for start up plans, and enhancing the savers credits. Still, some believe a whole new system would be helpful to solve the ever present savings gap.

Enter The Economic Innovation Group (EIG), a public policy organization dedicated to advancing solutions that empower entrepreneurs and investors to forge a more dynamic and entrepreneurial economy throughout America. EIG was founded by Sean Parker, the former president of Facebook (now Meta); John Lettieri, former public policy head for the Organization for International Investment; and Steve Glickman, who served as a senior economic adviser during the Obama administration. Michigan's own Dan Gilbert, founder and Chairman of Quicken Loans, has even recently joined EIG's Founders Circle.

EIG has recently been making noise on the national scene by proposing a new retirement saving program modeled after the federal Thrift Savings Plan, which is a 401(k)-like program enjoyed by federal employees. EIG's stated mission is to provide a government supported retirement option for the tens of millions of workers not currently being served by private retirement plans, rather than supplanting those existing workplace plans. Their proposal, in its simplest form, mandates that any eligible worker would automatically be enrolled into this government subsidized program

"A key focus of [the SECURE 2.0 Act of 2022] is to expand coverage and retirement savings for those who are not taking advantage of their 401(k) or who do not have access to a corporate retirement plan..."

Retirement Saving Coverage Gap, continued

and receive direct credits and federal matching contributions. Beyond being extremely well funded, EIG has hired prominent D.C. lobbyists and PR firms that have catapulted their initial retirement savings ideas into the enviable position of bipartisan support.

Of course, enacting a whole new government backed program is far from a panacea. Critics of the EIG initiative quickly cite the numerous dangers of bringing the federal government into the retirement savings industry. For starters, federal government programs have a way of quickly burgeoning out of control, causing runaway spending and unplanned taxpayer obligations. Look no further than the financial state of our current Social Security and Medicare systems to see how the noble cause of caring for retiring Americans can lead to unacceptable trade-offs between public policy and taxpayer interests. And then there is the debate of federal government entering competition against the private sector within the American retirement system – a debate that parallels with the well-worn argument of public versus private health care coverage. Perhaps the most direct rebuttal is urging policymakers to not push for a new system until SECURE 2.0 has had a chance to continue bridging the retirement savings gap. After all, this sweeping legislation just passed in December of 2022 and aspires to bridge the savings gap through a combination of incentives and mandates.

> "Despite the numerous saving gap enhancements recently passed… there are concerns that too many Americans have still yet to engage the current retirement plan system."

Despite the numerous saving gap enhancements recently passed through SECURE 2.0, there are concerns that too many Americans have still yet to engage the current retirement plan system. The debate will continue as to whether the retirement plan system that we know should continue to be controlled by the private sector, as it is now, or if the federal government will intervene and start taking over. To be sure, no new retirement plan system is likely to be created within the next few years, but the EIG initiative does have bipartisan support. The private sector system needs to continue decreasing the coverage gap by getting more Americans to save and at higher saving rates. In the meantime, everyone can agree that retirement savings is paramount for all Americans. The 401(k) is the poster child for doing a good thing (saving) on repeat in order to achieve a great result (retiring with dignity). Greenleaf Trust is committed to that charge and continues to help as many American workers achieve that goal.

Higher Interest Rates Lead to a Paradigm Shift in Financial Planning

Kristin Bennett, CFP®, CPWA®
Vice President
Assistant Director, Wealth Management

A little over a year ago, the Federal Reserve issued the first of nine federal fund rate increases to combat inflation. Between March 2022 and March 2023, the federal funds rate increased from 0.25% to a range of 4.75-5.00%. This rate serves as a benchmark interest rate that influences how much consumers are paid to save and how much it costs for them to borrow. You may have noticed that it has become increasingly expensive over the past year to finance big ticket items like your home or vehicle or to maintain a balance on your home equity line of credit. At the same time, the rate has affected the yields on savings instruments like savings accounts and certificates of deposit for the better. While the strategy of aggressively raising rates can affect various aspects of consumers' lives, it also creates an opportunity to reevaluate and refresh the traditional financial planning guidance that has been in place for the past decade.

Cash Reserve Balances

In the financial planning world, a good rule of thumb is to keep at least three to six months' worth of expenses in cash savings. For most of us, that means putting aside those funds in our savings account at the bank. However, even though borrowing costs have increased rapidly, banks have been slow to raise savings account interest rates. According to the FDIC, the national average interest rate on savings accounts stands at 0.39% (as of April 17, 2023). If your bank is still offering low annual percentage yields on your savings account, you could be missing out on significant interest earnings. High-yield savings accounts through online banks and money market funds through investment accounts are offering yields much closer to the federal funds rate in the 4% to 5% range.

> "$100K [in a savings account] would yield $390 interest per year. That same amount in a money market fund ...would yield $4,500 in interest."

For example, at Greenleaf Trust, we utilize a government money market fund as the primary option for the cash allocation in our clients' portfolios. A government money market fund invests in a restricted pool of government-backed securities. Keep in mind that money market funds are not FDIC insured like savings account balances. However, in government money market funds, the manager invests exclusively in US government securities, and the US government is the ultimate backstop for FDIC insurance as well. The current annual yield on our money market fund is just over 4.5% as of the end of last month. To put that in perspective, a $100,000 cash reserve using the annual average savings account interest

Higher Interest Rates Lead to a Paradigm Shift in Financial Planning, continued

rate(0.39%) would yield $390 in interest per year. That same amount invested in a money market fund at 4.5% would yield $4,500 in interest over the same time period. An easy adjustment of where you hold your cash reserve could result in a significant increase in interest with very little increase in risk.

Paying off Fixed Rate Mortgages

The decision to pay off your mortgage early is influenced by many factors – both quantitative and qualitative. As advisors, we are often asked to evaluate the quantitative side and weigh the alternatives of using extra cash to put towards savings, position towards investments in a portfolio, or pay down debt. A loan's interest rate is a major part of the analysis as it provides the hurdle rate for that decision point. For example, if your mortgage rate was 5%, and you were using cash/investments to pay off the debt, you would want to compare the loan rate to current cash yields or the potential return on your investment. When you pay off the mortgage, you essentially lock in a return equal to the loan rate (in this instance, a 5% return). You don't have to think very far back to when cash yields were basically non-existent, CD and bonds yields weren't much better, and the outlook for the equity markets was quite grim. At that time, a 5% return on any investment was welcome.

In our current rate environment, the advice on whether to pay off existing fixed rate debt has turned a bit on its head. If you were lucky enough to secure a mortgage or re-finance when rates were in the 2.5-3.5% range for a 15 or 30 year fixed rate mortgage, you might consider maintaining the debt and earning more interest on your cash investments (such as the money market fund described earlier). In this instance, your cost of borrowing may only be 3%, while your money market fund is paying you 4.5%. Here, you can take advantage of the 1.5% rate arbitrage opportunity as your borrowing costs are lower than what you are getting paid for your cash-like investments.

Paying off Variable Loans

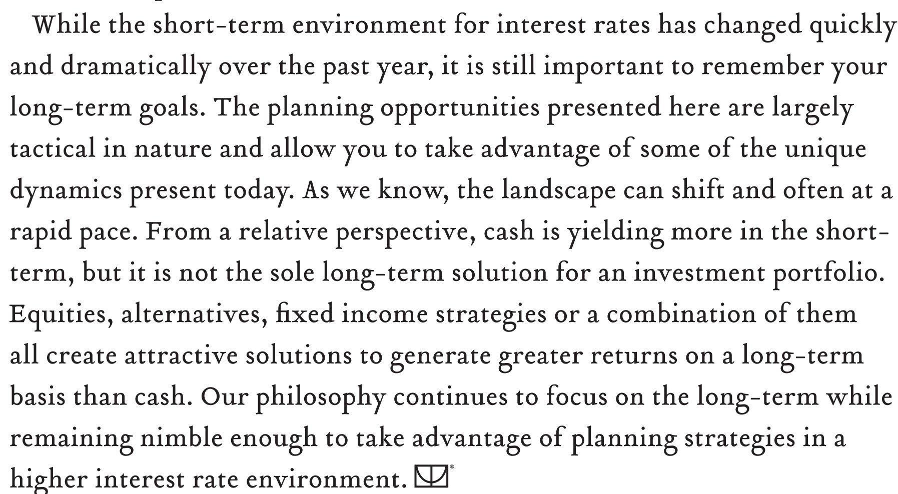
Unlike borrowers with a fixed rate loan, holders of variable rate loans, such as a home equity line of credit, have seen rates increase meaningfully over the last year. Home equity lines that started with 2.5-3% rates have jumped to more like 6.5-8%+ today. Adjustable rate mortgages (ARMs) nearing the end of their fixed rate period may also start to see an increase in rates. Keep in mind that many ARMs have caps on the annual increase in rates so evaluating the rate increase schedule in comparison to current rates is advisable before taking action. Still, it may be wise to convert a variable loan into a fixed loan or pay off the variable loan as soon as possible.

"Unlike borrowers with a fixed rate loan, holders of variable rate loans, such as a home equity line of credit, have seen rates increase meaningfully over the last year."

Vehicle Loans vs. Outright Purchases

The landscape has certainly changed for those that are finding themselves back in the market after having purchased their last vehicle five to ten years ago. With extremely low inventory and a tighter lending environment, 0% financing offers have all but vanished for those searching to finance a vehicle purchase. Depending on the duration of the loan, your credit score, and new vs. used condition, interest rates can range from about 6%-8% to finance a vehicle purchase according to national average rates published for April 2023.

Just as we assess the value of paying off existing debt, it's also important to evaluate whether taking on new debt is a sensible decision. Auto loans have a shorter duration than mortgages (typically three to five years), which makes it more difficult to forecast the ability of your investments to out-perform a particular interest rate. When debt was cheap, it would be more likely for your portfolio investments to be able to out-perform the interest you were accruing on the short-term loan. Now, with rates much higher, the opposite is true. For example, you would pay around $8,000 in interest over the life of a five-year auto loan for $50,000 at 6%. If invested, a 16% return on $50,000 would need to be achieved to get the equivalent value in the portfolio.



While the short-term environment for interest rates has changed quickly and dramatically over the past year, it is still important to remember your long-term goals. The planning opportunities presented here are largely tactical in nature and allow you to take advantage of some of the unique dynamics present today. As we know, the landscape can shift and often at a rapid pace. From a relative perspective, cash is yielding more in the short-term, but it is not the sole long-term solution for an investment portfolio. Equities, alternatives, fixed income strategies or a combination of them all create attractive solutions to generate greater returns on a long-term basis than cash. Our philosophy continues to focus on the long-term while remaining nimble enough to take advantage of planning strategies in a higher interest rate environment.

"While the short-term environment for interest rates has changed quickly and dramatically over the past year, it is still important to remember your long-term goals."

Michael Holmes, J.D.
Trust Relationship Officer

Grandchildren Trusts and Education Trusts

During our meetings with grandparents, a common topic is leaving assets to their grandchildren. While direct gifting, paying for tuition or medical bills, or funding 529 educational savings accounts are all effective techniques, this article focuses on another popular technique: establishing trusts for grandchildren. We will explore the different types of trusts, incentivizing them, and several other important considerations.

I. Types of Grandchildren Trusts

A. A Family Pot Trust For All Your Grandchildren

A Family Pot Trust lets grandparents list multiple grandchildren, who all have access to the same pool or pot of money. Hence the name, a Family Pot Trust. The trustee of a Family Pot Trust has a fiduciary obligation to manage the assets of the trust for the benefit of all the grandchildren named as beneficiaries of the trust. The trustee shall distribute the assets of the Family Pot Trust pursuant to the provisions of the trust. Family Pot Trusts may include various different types of distributive paragraphs that will be discussed later in this article. The establishment of a Family Pot Trust has several advantages and disadvantages.

> "A Family Pot Trust lets grandparents list multiple grandchildren, who all have access to the same pool or pot of money."

ADVANTAGES. The advantages of a Family Pot Trust include the fact that it gives grandparents the flexibility to treat all their grandchildren equally, or to make unequal distributions to their grandchildren based on their own individual needs. A Family Pot Trust may be advantageous when grandparents have grandchildren with different circumstances. Those differing circumstances include differences in age, financial needs, or financial means.

DISADVANTAGES. Establishing a Family Pot Trust naming a large amount of grandchildren may place the trustee of the trust in a precarious position if unequal distributions are necessary to certain grandchildren. Due to the fact that the Family Pot Trust operates as a common fund for all the grandchildren, trust assets could be distributed to older grandchildren first instead of remaining in one large pot with the rest of the trust assets. This type of distribution would create an unequal distribution between older grandchildren and younger grandchildren. These types of unequal distributions become more prevalent as the number of grandchildren named as beneficiaries increases and as the gap between the ages of the grandchildren widens.

B. Individual Trusts For Each Grandchild

In situations where grandparents want to leave assets to one or a small number of grandchildren, individual grandchildren trusts are most likely the best type of trust to utilize. When grandparents have a smaller number of grandchildren, individual grandchildren trusts with an equal amount of assets funded into each trust probably makes the most sense. The trustee then has the ability to decide when and how much of the trust assets to distribute to each individual grandchild without affecting the amount of assets held in trust for the other grandchildren. The trustee is required to distribute the assets pursuant to the standards outlined in the trust. Just like Family Pot Trusts, the individual grandchildren trusts for each grandchild have their own advantages and disadvantages.

ADVANTAGES. Individual trusts for each grandchild ensures that all of the grandchildren are treated equally. Most grandparents choose to fund an equal amount of assets into each grandchild's individual trust. Even though the grandchildren may use the assets in their individual trusts differently, each grandchild is treated equally because each individual grandchild trust is funded with the same amount of assets.

DISADVANTAGES. If grandparents have a considerable amount of grandchildren, and they decide to establish individual trusts for all of their grandchildren, the cost to administer those trusts can become costly as accountant fees and attorney fees often increase depending on the number of individual grandchildren trusts created.

II. Incentivizing Grandchildren Trusts

Whether grandparents choose to establish a Family Pot Trust or individual grandchildren trusts, most grandchildren trusts allow for discretionary distributions of income and principal to the grandchildren from the trust for health, education, maintenance, and support. In other words, the trustee can make discretionary distributions to the grandchildren based on an ascertainable standard.

However, when most grandparents establish grandchildren trusts they also incentivize those trusts with certain milestones their grandchildren must achieve before their grandchildren may demand a distribution of some, or all, of the trust assets. Incentivizing a trust allows grandparents to instill a good work ethic in their grandchildren or to ensure that their grandchildren are set up for success. Grandparents often use incentives in a trust to:

- Encourage the grandchildren to attain a certain level of education.
- Ensure that the grandchildren have access to the trust assets when they reach certain ages.

"… when most grandparents establish grandchildren trusts they also incentivize those trusts with certain milestones their grandchildren must achieve before their grandchildren may demand a distribution…"

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- Encourage the grandchildren to work hard and have a productive career.
- Impose moral restrictions or incentives on the grandchildren.

A. Graduation From An Accredited University, College Or Trade School

There are any number of provisions that can be added to a grandchildren trust to incentive grandchildren to further their education after high school. Some grandparents include a provision stating that their grandchildren may receive the remaining assets in the trust once they obtain a four-year degree from an accredited college or university. Many grandparents recognize that secondary education is not for everyone, and they state that the grandchildren may receive the remaining assets from the trust after they obtain a four-year degree from an accredited college or university, or when they complete skilled training at a vocational school. A number of grandparents want to make sure that the grandchildren trusts do not linger on for many years. Those grandparents will include a provision in the grandchildren trust stating that if the grandchildren have not obtained a four-year degree or completed skilled training at a vocational school by a certain age, the grandchildren may request an outright distribution of the remaining assets in the trust at that age.

ADVANTAGES. These types of provisions in a grandchildren trust are beneficial because they provide an incentive for grandchildren to seek higher education and receive a degree from either a college, university or vocational school. Most grandparents like the idea of their grandchildren obtaining a degree or specialized training in a trade, and providing them with the means to be able to achieve those goals.

"Grandparents need to be cautious when including education-based incentive provisions in the grandchildren trusts."

DISADVANTAGES. Grandparents need to be cautious when including education-based incentive provisions in the grandchildren trusts. If these provisions are too restrictive or narrow, the trustee may have a difficult time administering the trust when unanticipated circumstances arise related to the grandchildren's education. For example, if the grandchild is in an automobile accident and is unable to attend an institute of higher education, the trustee may be restricted to using the trust assets to pay for education, or the grandchild may only get a distribution from the trust once secondary education is completed. If the grandchild is unable to attend an institute of higher education, the trustee will be unable to use the assets in the grandchildren trust to benefit the grandchild.

Some grandparents establish pure Education Trusts for their grandchildren. Education Trusts are specifically designed to pay for education only. An Education Trust eliminates the ascertainable standard outlined above (health, education, maintenance, and support)

and states that the assets in the grandchildren trust must be used for education only. The benefits of an Education Trust are:

- Grandparents know their grandchildren's inheritance is being used for a useful purpose.
- Grandparents are giving their grandchildren the gift of education.
- Grandparents are allowing their grandchildren to leave college or a vocational school without student debt.

The primary disadvantage of an Education Trust is that it is limited to only education expenses. The grandchildren are not allowed to use the assets in the trust for medical expenses, living expenses, or any other expenses related to health, support or maintenance.

B. Release Funds At Certain Age Milestones

Linking age milestones to distributions from a grandchildren trust is a common way for grandparents to incentivize their grandchildren trusts. Most grandparents agree that giving all of the assets in the trust to grandchildren when they reach the age of majority (18) is not a great idea. Most adults at the age of 18 are not financially responsible, and they lack the discipline to appropriately manage wealth at that young age. Therefore, grandparents will base the distributions from the grandchildren trusts on certain age milestones. For example, the terms of grandchildren trusts may state that the assets in the trust may be used, at the discretion of the trustee, for health, education, maintenance and support. However, the terms of the grandchildren trusts may also state that the grandchildren may, upon request to the trustee, receive one-third of the trust assets at the age of 25, one-half of the trust assets at the age of 35, and the remainder of the trust assets at 45. The grandparents incentivized their grandchildren trusts to make sure they could control when their grandchildren received their inheritance.

ADVANTAGES. Age milestone provisions allow grandparents to control when their grandchildren may receive distributions from the grandchildren trusts. These provisions give the grandparents great flexibility to determine when they believe their grandchildren will be financially responsible enough to receive distributions from the grandchildren trusts. The grandparents can choose whatever ages and amounts of distributions are appropriate for their specific grandchildren.

DISADVANTAGES. Although age milestone provisions allow grandparents to control when their grandchildren receive distributions from the grandchildren trusts, it is impossible for any grandparents to know when their grandchildren will be ready to receive the assets in the trust at the ages selected by the grandparents. If grandparents had a crystal ball and could foresee what their grandchildren will be

"Age milestone provisions allow grandparents to control when their grandchildren may receive distributions from the grandchildren trusts."

Grandchildren Trusts and Education Trusts, continued

like as they hit their milestone ages it would make the estate planning process for grandchildren much easier. However, grandparents cannot tell the future, and therefore, age milestone provisions include a certain amount of risk regarding the conduct of grandchildren as they hit those milestone ages.

C. Encourage Hard Work And A Productive Career

Often grandparents want to encourage their grandchildren to be productive members of society. They want to promote hard work and a career that will allow their grandchildren to be financially stable without the help of their parents or grandparents. Grandparents with these goals in mind for their grandchildren may incentivize the grandchildren trusts by including provisions linked to their grandchildren's employment. These types of provisions usually include one of the following:

- Distributions from the grandchildren trusts that match the grandchildren's annual earned income.
- Deny distributions from the grandchildren trusts if the grandchildren are unemployed.
- Distributions from the grandchildren trusts if the grandchildren want to start their own business (these provisions normally require the grandchildren to present a viable business plan to the trustee).

"Provisions in the grandchildren trust linking distributions to employment can be beneficial because they encourage grandchildren to seek the highest paying employment they can find..."

ADVANTAGES. Provisions in the grandchildren trust linking distributions to employment can be beneficial because they encourage grandchildren to seek the highest paying employment they can find, or to be entrepreneurs and start their own businesses.

DISADVANTAGES. These types of incentive provisions can also discourage grandchildren from pursuing socially beneficial employment that normally has lower compensation. Jobs like teachers, social workers, ministers, stay at home parents, etc., are all meaningful professions, but they pay very little and sometimes nothing. Sometimes hard work and a productive career do not always equate to high compensation.

D. Impose Moral Restrictions Or Incentives

Grandparents are sometimes interested in encouraging behavior from their grandchildren which is in line with their values. Also, some grandparents are interested in providing disincentives for grandchildren that behave irresponsibly. Grandparents with these goals in mind for their grandchildren may incentivize the grandchildren trusts in numerous ways. The most common ways for grandparents to incentivize the grandchildren trusts based on moral restrictions or incentives are as follows:

- Limit distributions from the grandchildren trusts if the

grandchildren are abusing alcohol or drugs, or are gambling excessively.

- Allow distributions to grandchildren once they get married.
- Limit distributions to grandchildren if they get divorced.

Some grandchildren trusts include a provision that allows the trustees to override a mandatory distribution due to some of the immoral behaviors listed above. For example, a grandchildren trust might state that a grandchild may be allowed to receive one-third of the trust assets at the age of 30, but the grandchildren trust may also include a provision which states that the trustee can refuse to make that distribution if the grandchild is abusing alcohol or drugs, or gambling excessively. As you will see in the disadvantages section below, this is a great safety net for grandchildren trusts that have mandatory distributions, but it may also put an undue burden on the trustees of the grandchildren trusts to act as the "babysitter" for the grandchildren.

ADVANTAGES. The obvious advantage of these incentive provisions is that they encourage behavior that is in line with the family's values. Many grandparents are interested in making sure their grandchildren adhere to the same moral principles that they have for many years. These types of provisions allow grandparents to encourage the moral behaviors they want to instill in their grandchildren whether the grandparents are living or deceased.

DISADVANTAGES. The incentive provisions may cause certain issues related to the administration of the grandchildren trusts. They force the trustees of the grandchildren trusts to be "babysitters" for the grandchildren. For example, the trustee may have to make the determination whether a grandchild has a substance abuse problem.

"The benefit of making grandchildren trusts revocable during the grandparents' lifetimes is that the grandparents have more control over the provisions of the trusts…"

III. Other Issues to Consider When Establishing Grandchildren Trusts

A. Revocable vs. Irrevocable

When grandparents establish grandchildren trusts, those trusts may be revocable or irrevocable. Revocable and irrevocable grandchildren trusts have their own advantages and disadvantages.

REVOCABLE GRANDCHILDREN TRUSTS. The benefit of making grandchildren trusts revocable during the grandparents' lifetimes is that the grandparents have more control over the provisions of the trusts while the grandparents are still living. For example, what if grandparents decide to put an incentive provision in their grandchildren trust which states that their grandchildren may get an outright distribution of all the trust assets when they obtain a degree from a four-year college or university, and one of the grandchildren is in a terrible accident. That accident limits the grandchild's ability to attend

Grandchildren Trusts and Education Trusts, continued

a four-year college or university. If the grandchildren trust is revocable, and the grandparents are still living, they can amend the grandchildren trust to include provisions more suitable for their grandchild that has been in an accident. The disadvantage of making grandchildren trusts revocable is that grandparents cannot take advantage of the tax savings an irrevocable trust can provide.

IRREVOCABLE GRANDCHILDREN TRUSTS. The benefit of making grandchildren trusts irrevocable is that the grandparents can fund assets into those irrevocable trusts, and those assets may no longer be includable in the grandparents' estates for estate tax purposes. These assets may be real estate, cash, or securities. Due to the fact that those assets have been removed from the grandparents' estate and funded into the irrevocable grandchildren trusts, this reduces the grandparents' estate tax liability. In 2023, grandparents may gift up to $17,000 a year into grandchildren trusts without reporting it to the IRS. In 2023, each grandparent may gift up to $12.92 million without paying gift taxes. However, it must be noted that if grandparents use all or a portion of their gift tax exemption by funding assets into grandchildren trusts, that will reduce the amount the grandparents may leave at death estate-tax-free. In other words, the gift tax exemption and estate tax exemption are linked. The disadvantage of making grandchildren trusts irrevocable is that grandparents lose the flexibility and control of the trust assets provided by revocable grandchildren trusts. Once irrevocable grandchildren trusts are established, the grandparents cannot change the terms of those trusts.

B. Spendthrift Provision

"Spendthrifts" are defined as people who, by excessive drinking, gaming, idleness, or debauchery of any kind, shall spend, waste, or lessen their estates as to expose themselves or their families to want or suffering. For purposes of this article, grandchildren are considered spendthrifts if it is anticipated that they will spend, waste, or lessen the assets in their grandchildren trusts as a result of poor financial decisions. Therefore, every grandchildren trust should include a spendthrift provision. A spendthrift provision prevents grandchildren from pledging or spending the assets in their trusts before they actually receive the benefits of their grandchildren trusts. The assets in the grandchildren trusts are protected by the spendthrift provision until the trust assets are distributed directly to the grandchildren.

"...every grandchildren trust should include a spendthrift provision. A spendthrift provision prevents grandchildren from pledging or spending the assets in their trusts before they actually receive the benefits..."

C. Corporate Trustee v. Individual Trustee

When selecting a trustee to administer grandchildren trusts it is important to weigh the advantages and disadvantages of corporate trustees and individual trustees.

CORPORATE TRUSTEES. Corporate trustees are beneficial because they have the time, expertise, and resources to fully administer grandchildren trusts properly. Also, corporate trustees are impartial. They are required to administer grandchildren trusts with an unbiased point of view. Corporate trustees remain neutral when family dynamics are strained. Often corporate trustees can prevent disagreements and angst among family members. The corporate trustee is in place to make difficult decisions regarding distributions from the grandchildren trusts. Decisions that may cause strife within a family if an individual family member is acting as trustee. However, some grandparents are not in favor of corporate trustees acting as the trustee of grandchildren trusts. Corporate trustees charge a fee, which some grandparents do not want to pay to administer the trusts. Also, some grandparents want to keep family decisions, like distributions from grandchildren trusts, in the hands of family members or close friends.

INDIVIDUAL TRUSTEES. Individual trustees are typically family members or trusted friends who usually receive little to no compensation for their administration of the grandchildren trusts. The benefit of naming an individual trustee of the grandchildren trusts includes the relatively inexpensive administration of the trusts, but it also includes that individual trustee's intimate knowledge of the family dynamic. Intimate knowledge about the family that a corporate trustee may not hold. Some grandparents want the trustees of grandchildren trusts to have a deep, intimate background regarding their grandchildren's behavior so those trustees can make appropriate decisions regarding distributions from the grandchildren trusts to the grandchildren pursuant to the guidelines outlined in the trusts. However, with individual trustees you lose the time, expertise, and resources corporate trustees provide. Also, some individual trustees are not capable of making tough decisions regarding distributions from the grandchildren trusts. Individual trustees can sometimes be easily convinced or manipulated by the grandchildren to make unwarranted distributions from the grandchildren trusts. Corporate trustees do not have a difficult time making tough decisions regarding distributions from grandchildren trusts to the grandchildren because they are not connected to potential toxic family dynamics.

"… corporate trustees are impartial. They are required to administer grandchildren trusts with an unbiased point of view."

The establishment of grandchildren trusts is a great estate planning technique that grandparents can utilize to transfer wealth to their grandchildren. However, there are numerous decisions that grandparents need to make regarding the provisions of the grandchildren trusts to ensure that the assets are being transferred to their grandchildren pursuant to the grandparents' goals.

Stock Market Pulse

Index	4/30/2023	Total Return Since 12/31/2022
S&P 1500	949.05	8.56%
Dow Jones Industrials	34,098.16	3.53%
NASDAQ	12,226.58	17.13%
S&P 500	4,169.48	9.16%
S&P 400	2,490.40	2.98%
S&P 600	1,148.17	-0.31%
NYSE Composite	15,545.88	3.24%
Dow Jones Utilities	959.61	0.13%
Barclays Aggregate Bond	2,122.20	3.59%

P/E Multiples	4/30/2023
S&P 1500	19.4x
Dow Jones Industrials	19.7x
NASDAQ	34.0x
S&P 500	19.9x
S&P 400	14.2x
S&P 600	15.0x

Key Rates

Fed Funds Rate	4.75% to 5.00%
T Bill 90 Days	4.95%
T Bond 30 Yr	3.67%
Prime Rate	8.00%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	949.05	19.4x	1.68%
S&P 500	4,169.48	19.9x	1.66%
Dow Jones Industrials	34,098.16	19.7x	2.06%
Dow Jones Utilities	959.61	20.5x	3.49%

Spread Between 30 Year Government Yields and Market Dividend Yields: 1.99%

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