PLANNING FOR PRIVACY IN A PUBLIC WORLD

By Jeffrey D. Chadwick and Jordan M. Ware

We live in a public world, where anyone with a computer, smartphone or tablet can easily access an unsettling amount of our clients' personal information in a very short amount of time. Clients have become increasingly concerned with protecting their privacy and personal security, and often look to professional advisors for practical solutions. This article discusses several privacy planning strategies that professional advisors can recommend to their clients.

Utilizing a "Pour-Over" Will and Revocable Trust

A common technique to secure a client's privacy is to suggest that the client's core estate plan include a "pour-over" will and revocable trust, instead of a "standalone" will. A standalone will contains all the substantive provisions regarding the disposition of a client's assets. Because most wills become a matter of public record upon death, including the dispositive provisions of a client's estate plan in a will reveals potentially sensitive information to the public.

By contrast, a pour-over will simply provides that a client's assets will be distributed to the client's revocable trust upon death. The revocable trust agreement contains the substantive provisions of the client's estate plan. Although the client's will may be filed with the probate court upon death, the revocable trust should not be filed, which prevents the client's estate plan from becoming a public record.

In addition to protecting the privacy of a client's overall estate plan, a revocable trust can be an effective tool to privatize only certain portions of the plan. For instance, a client may desire to create a charitable trust upon death. In creating and administering the charitable trust, third parties may ask to view the entire trust agreement, which could contain dispositive provisions that the client does not wish to disclose.

A simple solution is to reference the creation and funding of the charitable trust in the body of the trust agreement, but include the governing provisions as a

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separate exhibit or even a separate trust agreement. This approach makes the charitable trust easy to amend during the client's lifetime without disturbing the other trust provisions. It should also enable the trustee to provide third parties with only the information that is relevant to the administration of the charitable trust.

If it is necessary to appoint an executor to administer a client's probate estate, most states, including Texas, will require the executor to file an inventory with the probate court. The inventory must generally identify the probate assets owned by the client at death, as well as the value of such assets. Many clients would prefer to keep the nature and extent of their assets from becoming a public record, either because of a general desire to limit disclosure of their wealth, or in an effort to prevent their survivors from becoming the target of financial overtures, scams or even theft.

To address this, Texas now permits the filing of an "affidavit in lieu of inventory," which allows the executor to prepare and send an inventory to the beneficiaries of the estate, while not actually filing the substance of the inventory with the probate court.

The more complete solution to secure a client's privacy, however, is for the client to fully fund a revocable trust during lifetime. Because the assets of a revocable trust are not part of a client's probate estate, the executor of the client's estate should not be required to disclose the trust assets on the estate's inventory. As further discussed below, a client can also fund a revocable trust during lifetime to facilitate the anonymous ownership of certain assets, such as real estate, vehicles, firearms and potentially controversial investments.

Finally, revocable trusts can better maintain a client's privacy and dignity if the client becomes incapacitated during lifetime. Typically, when a person becomes incapacitated, it is necessary for a court to appoint a guardian to care for the person's physical well-being (i.e., a guardian of the person) and to manage the person's financial affairs (i.e., a guardian of the estate). Not only is a guardianship expensive, it often requires personal information to be disclosed in court filings, which are a public record. A funded revocable trust can prevent the expense and publicity of a guardianship proceeding in the event of a client's incapacity.

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Upon the client's incapacity, the named successor trustee can accept the trusteeship and immediately begin to manage and expend the trust assets for the benefit of the client. Even if a client's revocable trust has not been funded prior to incapacity, a financial power of attorney can give the agent authority to transfer assets to the revocable trust.

Limiting Disclosure to Beneficiaries

As advisors, we work with many clients who express a desire to limit the information made available to certain trust and estate beneficiaries. The reasoning behind the client's desire for nondisclosure may be legitimate and prudent. For example, a beneficiary may be financially immature, struggling with substance abuse, or prone to undue influence from a spouse or business partner.

Alternatively, the client may simply wish to create an irrevocable trust during lifetime to minimize transfer taxes and wants to limit the risk that the trust serves as a disincentive to a beneficiary's development as a productive, self-supporting member of society. In these instances, the client may seek to structure the trust so that it does not provide immediate financial benefits to the beneficiaries and, in some cases, so that the beneficiaries are not even aware of the trust's existence.

Some states, but not Texas, permit clients to create "silent trusts." A silent trust is an irrevocable trust, the very existence of which is kept secret from the beneficiaries. The trustee is obligated to manage the trust's assets during a specific period of non-disclosure, during which time the beneficiaries are unaware the trust exists. At some designated time in the future, the trustee may disclose the existence of the trust to the beneficiaries, who may then be eligible to receive distributions from the trust. While

Securing Third Party Confidentiality

While a client's efforts to maintain privacy can be effective, it may be more difficult to prevent the disclosure of confidential information by friends, family members, employees, caretakers and romantic partners. These individuals often possess sensitive information regarding a client's finances, health, activities and relationships.

An effective strategy to limit disclosure of confidential information is the proactive use of non-disclosure agreements or confidentiality clauses in third-party contracts. Non-disclosure agreements can be designed to secure privacy with respect to a client's personal and professional relationships, as well as mandate litigation alternatives, such as mediation and arbitration, that may avoid the public court system.

silent trusts may satisfy a client's legitimate privacy objectives, clients should proceed with extreme caution, as non-disclosure may conflict with a trustee's duty under traditional trust law to keep beneficiaries reasonably informed.

Just as a client may wish to limit disclosure to certain beneficiaries during lifetime, the client may also wish to limit disclosure upon death. The basis consistency rules enacted in 2015, however, require executors to disclose asset information to beneficiaries who historically were not entitled to receive such information. Specifically, Internal Revenue Code (Code) § 1014(f) provides that, subject to certain exceptions, the income tax basis of property acquired from a decedent shall not exceed the value of that property as finally determined for federal estate tax purposes.

Code § 6035(a), in turn, provides that an executor who is required to file a federal estate tax return (Form 706) under Code § 6018 must also furnish an "information return" to the IRS and a "statement" to the recipients of estate property that identifies the value of such property for federal estate tax purposes.

The information return required to be filed with the IRS is Form 8971. The statement required to be furnished to each beneficiary of the estate refers to a separate Schedule A to Form 8971 for each beneficiary. In most cases, the executor must file the Form 8971 with the IRS and send each beneficiary a copy of the statement within 30 days of filing the estate tax return.

From a privacy perspective, the reporting requirements associated with the basis consistency rules may raise a significant issue when administering a client's estate. Under Prop. Regs. § 1.6035-1(c)(3), "if … the executor has not determined what property will be used to satisfy the interest of each beneficiary, the executor must report on the statement for each such beneficiary all of the property that the executor could use to satisfy that beneficiary's interest." Thus, if an executor is unsure how a bequest will be satisfied under the decedent's will or revocable trust, the executor must disclose any and all property, along with its value, that could be used to satisfy such bequest.

Executors are rarely in a position to distribute the entire estate to beneficiaries within 30 days of filing the estate tax return. In situations involving feuding siblings or when an estate plan includes small gifts to various friends, family members, employees or charities, it may be inappropriate and, in some cases, dangerous to disclose the value of all estate property to all beneficiaries. Moreover, preparing and sending a statement to each beneficiary of an estate that essentially mirrors the asset information provided on the estate tax return may involve significant time and expense.

If a client wishes to make small bequests to friends, extended family members, caretakers, employees or charities, the client can engage in one or more of the following techniques to minimize the disclosure of asset information at death.

Fund Bequests with Non-Probate Assets. Perhaps the simplest technique involves designating the gift recipients as beneficiaries of non-probate assets, such as retirement plans, life insurance policies, or bank or brokerage accounts that are payable-on-death or subject to a survivorship agreement. Upon the client's death, the asset should pass directly to the gift recipient and should not be subject to the reporting requirement under the basis consistency rules.

Require Bequests Be Satisfied With Cash. If the bequests are to be made through the client's will or revocable trust, require that such bequests be satisfied with cash. An executor is not required to provide a statement to a beneficiary who will receive a cash bequest (regardless of when the bequest is satisfied), because cash is not subject to the reporting requirement under the basis consistency rules.

Utilize Multiple Funded Revocable Trusts. Another alternative is for the client to create and fund multiple revocable trusts to segregate smaller bequests from the balance of the client's estate. Specifically, the client can create

one revocable trust, the sole purpose of which is to make smaller bequests to friends, extended family members, caretakers, employees, and other individuals or charities. In tandem, the client can create another revocable trust to dispose of the balance of the client's estate among children or other named beneficiaries. This structure should ensure that the beneficiaries of the "specific bequests" trust only receive asset information pertaining to that trust and not the client's other assets.

Liquidate Estate Assets to Satisfy Bequests. If a client's estate plan is not structured to avoid the reporting requirements under the basis consistency rules (i.e., if specific bequests may be satisfied in kind), the executor may preserve the client's privacy by liquidating estate assets and utilizing the cash proceeds to satisfy the bequests. Even if the executor does not satisfy the bequests by the statement's due date, the beneficiaries will not be entitled to receive a statement because their bequests will be paid in cash. Note, however, that this approach could cause gain to be recognized, which may have been avoided if the executor satisfied the bequests in kind, rather than in cash.

Borrow Cash to Satisfy Bequests. If the executor cannot liquidate estate assets to satisfy the bequests, the executor may borrow cash from a third-party lender and utilize the borrowed funds to satisfy the bequests.

Set Aside Estate Assets to Satisfy Bequests. If an executor cannot obtain cash to satisfy a bequest, consider setting aside a particular asset to fund the bequest. The executor is only required to disclose all of the estate's property if the executor "has not determined what property will be used to satisfy the interest of each beneficiary." If the executor has "determined" the estate asset that will be used to satisfy a bequest, the statement furnished to the beneficiary should only include that asset and may exclude all other estate assets.

Titling Real Estate and Other Assets

Many clients seek privacy with respect to ownership of particular assets, including real estate, firearms, artwork or other collectibles. As public access to real estate records and other information increases, titling these assets in a client's individual name may pose particular risks to a client's privacy and, in some cases, personal security.

To secure privacy with respect to a client's ownership of these assets, the client can title the property in the name of a business entity, such

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as a limited liability company (LLC) or a revocable trust. Both forms of ownership should provide privacy during lifetime and upon death, while also avoiding probate.

To maximize privacy, the LLC or revocable trust should have a name that is not easily linked to the client and should be managed by a third-party manager or trustee. In deciding whether to utilize an LLC or revocable trust, the professional advisor should also consider state and local disclosure requirements, eligibility for the homestead exemption and the client's asset protection goals for the property. The most appropriate ownership structure will depend on the client's objectives, as well as the jurisdiction in which the property is located.

Making Anonymous Charitable Gifts

Many clients desire to make charitable gifts anonymously to minimize future solicitations, uphold religious or philosophical ideals, place the focus on the charity or protect a client's personal security. Following are several ways to shield the client's identity from the general public and, in some cases, the charity itself.

Client Gives Directly to Charity. Generally, a public charity is not required to publicly disclose a donor's gift. While charities are required to file an annual tax return (Form 990), the IRS is required to redact substantial contributors' information, including name and address, before the Form 990 becomes public. A client seeking additional assurance that a charitable gift will not be disclosed to the public and that only a limited number of the charity's personnel will have access to the donor's information, should consider entering into a written agreement with the charity prohibiting disclosure.

Client Gives Through an Agent. Clients who wish to make a charitable gift that will be anonymous both as to the public and the charity should consider appointing an agent to make the gift. The agent would work with the charity to transfer the property and obtain the charity's written acknowledgement of the gift, which the client may use in claiming a charitable income tax deduction. To further protect the client's privacy and define the scope of the client's charitable gift, the agent may enter into an anonymous donation agreement with the charity.

Client Gives Through a Revocable Trust or an LLC. A client may use a revocable trust or LLC to make charitable gifts while protecting the client's identity from both the public and the charity. The name of the revocable trust or LLC should not be easily associated with the client, a third party should serve as trustee or manager, and the revocable trust or LLC should obtain a separate taxpayer identification number.

Client Gives to a Designated Fund at a Community Foundation. A client may make an anonymous gift to a charity by transferring property to a designated fund at a community foundation. The fund agreement will specify the name of the charity and the obligation to transfer funds to such charity. This strategy can be useful when a client wants to make a single, anonymous donation to a charity.

Client Gives to a Donor Advised Fund. If a client would like to give anonymously to multiple charities, the client should consider creating and funding a donor advised fund (DAF). Many public charities sponsor DAFs, which allow donors to make charitable contributions, receive an immediate income tax deduction and retain the right to recommend grants from the DAF over time.

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When the DAF makes a distribution to a charity, the client may control the information that is provided to the charity, including withholding the name of the client and the DAF.

Client's Private Foundation Gives to a Designated Fund or DAF. A private foundation's annual tax return (Form 990-PF) must report financial information, including charitable grants and the names, addresses and contribution amounts of donors who give $5,000 or more during the taxable year. Form 990-PF must be available for public inspection. Clients who seek privacy with respect to grants made from a private foundation should consider utilizing a designated fund at a community foundation or DAF to distribute the funds to the ultimate charity. This strategy should make the charitable gift anonymous as to both the public and the ultimate charity.

Making Anonymous Political Contributions

Clients may desire to keep their political contributions confidential to minimize scrutiny from employers, business contacts or the general public, or to prevent a political candidate from being associated with an unpopular or controversial client. A client's contributions to a candidate, campaign or political action committee, however, can be easily identified by visiting the Federal Election Commission's website.

Clients seeking to privatize their political contributions should consider contributing to a social welfare organization created under Code § 501(c)(4). Although a 501(c)(4) organization is required to identify its contributors on its annual Form 990, the names and addresses of its contributors can be redacted.

A client seeking additional assurance of privacy should consider contributing funds to an LLC or revocable trust, which in turn contributes the funds to the 501(c)(4) organization.

Privacy Planning and Advice

As technology continues to develop, exposing more of our client's information to public scrutiny, the importance and demand for privacy planning will only increase. While absolute privacy may be impossible to achieve, professional advisors have an opportunity to assist clients in proactively structuring their estate plans, charitable gifts and financial transactions to secure increased privacy by limiting public disclosure of sensitive information.

The strategies discussed in this article provide the professional advisor with additional opportunities to demonstrate the value-added benefit of their advice to clients.

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[1]See Tex. Est. Code § 309.056.

[2]Many states have enacted silent trust statutes, with the more detailed and prominent statutes being enacted by Alaska, Delaware, New Hampshire, Ohio, South Dakota, Tennessee and Wyoming.

[3]Certain property is not subject to this reporting requirement, including cash, income in respect of a decedent, tangible personal property for which an appraisal is not required, and property sold, exchanged or otherwise disposed of by the estate in a transaction in which capital gain or loss is recognized.

[4]See Prop. Regs. § 1.6035-1(b)(1)(i).

[5]Prop. Regs. § 1.6035-1(c)(3).

[6]Texas, for example, requires LLCs to file an annual Public Information Report (Form 05-102) with the Texas Comptroller's Office, with only the names and addresses of the LLC managers required to be disclosed, and not the names and addresses of non-managing members. Revocable trusts, by contrast, generally have no associated disclosure requirements.

[7]Section 11.13 of the Texas Tax Code extends homestead protection to "qualifying trusts." Most revocable trusts can be easily structured as qualifying trusts for homestead purposes.