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Drafting Irrevocable Trusts: Flexibility Mechanisms, Retaining Access and Control, Distributions, and Other Issues

TUESDAY, MARCH 15, 2022

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Today's faculty features:

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Drafting Irrevocable Trusts:

Flexibility Mechanisms, Retaining Access and Control, Distributions and Other Issues

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DRAFTING IRREVOCABLE TRUSTS

Strafford Webinar – March 15, 2022

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Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

IRREVOCABLE TRUST BASICS

Irrevocable Trust Basics

- Revocable Trust
  - Can be modified, amended, revoked, terminated by Grantor at any time.
  - Typically disregarded entity for Federal and state income tax purposes. No separate EIN required until death of Grantor at which time becomes irrevocable.
  - Typically Grantor is the initial trustee.

- Irrevocable Trust
  - Typically cannot be revoked or terminated by Grantor.
  - Typically cannot be modified or amended by Grantor.* (*But wait . . . .)
  - May or may not be disregarded entity for Federal or state income tax purposes (i.e., "grantor" or "non-grantor" trust treatment IRC § 671 *et seq*.). If not disregarded, trust will obtain a separate EIN and file its own tax returns.
  - Typically, Grantor is NOT a trustee.

Irrevocable Trust Basics

- Irrevocable Trusts (cont'd)
  - In most cases, an "irrevocable trust" can be modified or amended, just not by the Grantor alone.
  - Typically can only modify or amend administrative provisions, not substantive or dispositive provisions (but see, *e.g.*, modification by consent, 12 Del. C. § 3342 – permitting modification with consent of Grantor regardless of whether modification would violate material purpose of the trust).
  - Typically, "trust protector" (or similar office holder) is given the authority to modify the administrative provisions of an irrevocable trust to achieve favorable tax treatment or facilitate effective administration of the trust. Often given authority to change situs of the trust or governing law to achieve these purposes.

TRUSTEE RULES AND POWERS

What are the Trustee’s Duties?

- Duty to Follow the Terms of the Trust
  - Distributions
  - Accountings
- Duty of Loyalty
- Duty of Impartiality
- Duty to Invest Prudently

Trustee Powers – Flexibility is Key

A Trustee is required to follow the terms of the trust. Flexible provisions allow the Trustee to address changes in circumstances, markets, and/or the needs of the beneficiaries. Examples:

- Modifying the duty of impartiality to provide that the needs of the income beneficiary outweigh the needs of the remainder beneficiary.
- Giving the Trustee the power to postpone outright distributions to a beneficiary if the distribution wouldn't be in the beneficiary's best interests.
- Waiving the duty to diversify to allow for concentrated holdings in real estate, family businesses, or other assets.

KEY TRUST PROVISIONS AND DRAFTING CONSIDERATIONS

Key Trust Provisions and Drafting Considerations

- Key is Flexibility

  - Advisers (Investment, Distribution, Trust Protector – see, *e.g.*, 12 Del. C. § 3313).

  - Include framework for resignation, removal and replacement of trustees and advisers. Who has the power to remove/replaced trustees and advisers? What happens if there is no trustee?

    - Limitations on persons eligible to serve as trustee or adviser (IRC § 672(c) concerns).

  - Waiver of Duty to Diversify (see *e.g.*, 12 Del. C. §§ 3303, 3312).

  - Statement of "primary purpose" – is this a second marriage? Does Grantor prefer distributions be made first to surviving spouse then to children? Avoiding controversy.

  - Situs and governing law is relevant to flexibility.

  - Provide framework for modification.

Key Trust Provisions and Drafting Considerations

- <u>Advisers</u>
  - <u>Investment Direction Adviser</u>

    - Power to direct trustee (or consent to trustee's recommendations) with respect to investment decisions.

      - "Investment decisions" include the retention, purchase, sale of assets, entering into loan agreements or borrowing against/pledging as security trust assets, selection of investment professionals.

    - Typically can be the Grantor (but watch out for ability to vote/control subchapter "S" stock owned by trust).

Key Trust Provisions and Drafting Considerations

- Advisers (cont'd)
  - Distribution Adviser
    - Authorized to direct the trustee (or consent to trustee decisions) regarding discretionary distributions of income or principal.
    - Except in limited circumstances, neither Grantor, any beneficiary, nor persons related or subordinate to Grantor or any beneficiary (for purposes of IRC § 672(c) should serve as Distribution Adviser.
  - Trust Protector
    - Typically granted the power remove and replace trustees, Investment Direction Adviser, Distribution Adviser, Designated Representatives, etc.
    - May be granted the power to amend administrative provisions of the trust instrument, change situs of the trust, change governing law of the trust.
    - Depending on authorities granted to Trust Protector, may be Grantor in some circumstances.

Key Trust Provisions and Drafting Considerations

- <u>Situs and Governing Law Considerations</u>
  - Where is the situs of the trust?
    - Specified in Trust Instrument
    - Place of Administration
  - What law governs administration?
    - Specified in Trust Instrument
    - General principles of state law (<u>see</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3332(b): "*the laws of [the State of Delaware] shall govern the administration of the trust while the trust is administered in this State unless the governing instrument expressly provides [otherwise] ....*")
  - Migration of trust situs, change/designation of law governing administration.
    - Look to language of governing instrument:
      - Ability to modify situs/law governing administration (ex. Trustee or trust protector may designate situs/law governing administration).
      - Remove/replace trustees to add trustee located in favorable jurisdiction
    - "Pitch and Catch" concerns: Does current jurisdiction require action to relinquish jurisdiction/change situs?

Key Trust Provisions and Drafting Considerations

- Common Pitfalls
  - Resignation, Removal and Replacement Language
    - Make sure to allow you trustees, advisers, trust protector, designated representatives to resign. (More banks will require this language if you are using a corporate trustee)
    - Include provisions for removal and replacement of trustees, advisers, trust protector, designative representative. Be aware of IRC § 672(c) concerns.
  - Trustee/Adviser/Protector/DR compensation provisions
  - What happens if there is no trustee?

Key Trust Provisions and Drafting Considerations

- <u>Modification of Irrevocable Trusts</u>
    - Generally five options (depending on jurisdiction)
        - Decanting
        - Merger
        - Modification by Consent
        - Non-Judicial Settlement Agreement ("NJSA")
        - Judicial Settlement Agreement (a/k/a "Consent Petition")

Key Trust Provisions and Drafting Considerations

- Decanting
  - Decanting is the exercise of discretion by a trustee to distribute ("decant") the principal or income of a trust to the trustee of another trust with the same dispositive provisions as the first trust. See, *e.g.*, 12 Del. C. § 3528.
  - Requirements - varies by state – but generally:
    - Trustee must have power to distribute principal.
    - Beneficiaries of the second trust must also be beneficiaries of the first trust.
    - Second trust must comply with any standards of distributions under the first trust.
    - Written "decanting instrument" must be signed and acknowledged by the trustee and filed with the records of the trust.

• Note: Decanting is an exercise of trustee discretion – no consent of the beneficiaries may be required - but may be advisable. Consider implications of "trustee" action vs. "beneficiary" action, and implications of beneficiary "consent" vs. beneficiary "acknowledgement" or "statement of no objection".

Key Trust Provisions and Drafting Considerations

- <u>Merger</u>
  - Combining first trust with (or "into") second trust that has similar (but not necessarily identical) dispositive provisions or differing (and perhaps more advantageous) administrative provisions. <u>See</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3325(29).
  - Generally permitted without judicial involvement.
  - Generally permitted so long as the merger does not result in a material change of the dispositive provisions of the trust defining a beneficiary's interest in the principal or income of the trust.
  - Generally can be used to modify administrative provisions in the same way as decanting, NJSA, modification by consent or judicial modification.
  - As with decanting, merger is an exercise of trustee discretion. Consent of the beneficiaries generally is not required - but may be advisable. Consider implications of trustee "action" vs. "beneficiary" action.
  - <u>See</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3341 for consequences of merger.

Key Trust Provisions and Drafting Considerations

- <u>Modification by Consent/Nonjudicial Settlement Agreement</u>

  - Several states have adopted some version of UTC 411, authorizing modification of trusts with the consent of the grantor, all then-serving fiduciaries and all beneficiaries. <u>See</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3342.

  - Requirements (varies by state – these are DE)

    - Written consent (or non-objection) of: (i) trustor(s); (ii) all then-serving fiduciaries; and (iii) all beneficiaries.

    - New provisions or modified provisions must be provisions that would otherwise have been permitted in the original governing instrument on the date of creation.

    - Modification permitted even if modification violates a material purpose of the trust, with consent of trustor.

    - Trustee (fiduciaries) may not have a duty to consent to proposed modification. Distinction between providing consent and merely acknowledging and not objecting?

**<u>Warning</u>: Be aware of tax consequences of modification since: (i) trustor and beneficiaries may be deemed to have "consented" or affirmatively agreed to the modification and (ii) this may be a modification of a material purpose (such as limitations on distribution of income or principal, charitable purpose, etc.).

  - NJSA is substantially similar to Modification by Consent, except consent of grantor not necessary, and cannot violate material purpose of the trust. Purely administrative in nature.

Key Trust Provisions and Drafting Considerations

- <u>Who has to Agree to Modification?</u>

  - <u>Decanting and Merger</u>: Exercise of trustee discretion. Beneficiaries do not necessarily have to consent, but may acknowledge or indicate non-objection.

  - <u>Modification by Consent</u>: Generally, trustor, trustee and all beneficiaries must provide written consent or written statement of nonobjection. <u>See</u>, *e.g.*, 12 <u>Del</u>. <u>C</u>. § 3342(a).

  - <u>Non-Judicial Settlement Agreement</u>: "Interested Persons" or "Qualified Beneficiaries" – Definition varies by state.

    - UTC 111(a) defines "interested persons" as "persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by the court".

    - 12 <u>Del</u>. <u>C</u>. § 3338(a) defines "interested persons" as those persons "whose interest in the trust would be affected by the proposed [NJSA] . . ." which may include the trustees, beneficiaries, trustor and any other persons having an interest in the trust (such as holders of powers of appointment, powers to remove/appoint fiduciaries, or any other powers held in a nonfiduciary capacity. This might include advisers, such as investment advisers or trust protectors.

Key Trust Provisions and Drafting Considerations

- <u>Who has to Agree to Modification? (cont'd)</u>
  - What if required persons (typically the beneficiaries) are unborn, unknown or unascertained?
  - Many states have "virtual representation" statutes. <u>See</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3547 ("a minor, person who is incapacitated, or unborn person, or a person whose identity or location is unknown and not reasonably ascertainable . . . may for all purposes be represented by and bound by another who has a substantially identical interest").
  - Some states have "designated representative" statutes. <u>See</u>, *e.g.,* 12 <u>Del</u>. <u>C</u>. § 3339 (permitting a person to be authorized or directed by the governing instrument to "represent or bind 1 or more beneficiaries in connection with a judicial proceeding or nonjudicial matter . . . .").

Key Trust Provisions and Drafting Considerations

An excellent summary (as of 03/11/2019) of what states permit modification of irrevocable trusts, and using what methods, can be found at:

https://www.actec.org/assets/1/6/Overview_of_State_Statutes_Permitting_Modification_of_Irrevocable_Trusts.pdf

BENEFICIARIES AND DISTRIBUTION RULES

Beneficiaries and Distribution Rules

- Who can be a Beneficiary of an Irrevocable Trust?

  - Grantor? Pursuant to an ascertainable standard if intent is to avoid estate tax inclusion. Consider in conjunction with incomplete gift/grantor trust status for tax planning goals.

  - Grantor's Spouse? Typically same considerations as with grantor.

  - Children? Common. Generally subject to ascertainable standard or Trustee's sole discretion (or upon direction or consent of Distribution Adviser). Consider possible "quiet trust" provisions – discussed below).

  - Charitable beneficiaries? Often not known or selected until death of all grantor's descendants (i.e., typically a remainder beneficiary if no other beneficiaries). Consider appointment of a Designated Representative to represent the interests of unknown charitable beneficiaries – perhaps avoid need for involving state attorney general (choice of law/situs considerations).

Beneficiaries and Distribution Rules

- Distribution Provisions
  - Ascertainable standard (HEMS)
  - If "trustee discretion" consider use of Distribution Adviser.
  - Beware of who is the Distribution Adviser – IRC § 672(c) concerns and who can appoint, remove or be appointed as Distribution Adviser: Typically not grantor, grantor's spouse, any beneficiary, or any individual or entity related or subordinate to grantor, grantor's spouse or any beneficiary).

Beneficiaries and Distribution Rules

- <u>Sssshhhhh! *Quiet trust . . . . . .*</u>

  - Some jurisdictions permit Grantor to restrict trustee's duty to inform beneficiaries of the existence of interests in a trust. <u>See</u>, *e.g.*, 12 Del. C. §§ 3303(a) and (c) *("the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any laws of general application to fiduciaries, trusts, and trust administration, including, but not limited to, any such laws pertaining to . . . . the rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for a period of time [related to, for example, the age of a beneficiary, the lifetime of the Grantor, a terms of years/specific date or the occurrence of a specific event]*.

  - Often used in conjunction with appointment of a "Designated Representative" appointed to serve in a fiduciary capacity to represent the interests of a beneficiary and receive notice of trust activities on behalf of and in lieu of the beneficiary. <u>See</u>, *e.g.,* 12 Del. C. § 3339.

ESTATE TAX AND OTHER CONSIDERATIONS

What Strategies Are Favored For Gift Tax Purposes?

- Grantor Retained Annuity Trust (GRAT)
- Defective Grantor Trust
  - Gift
  - Gift + Installment Sale

Review: Grantor Trusts

- For income tax (but not necessarily gift or estate tax) purposes, assets of a grantor trust are treated as owned by the grantor
  - The grantor pays income taxes on income/gain from trust assets
  - Transactions between the grantor and the trust are <u>ignored</u> for income tax purposes
- Common types of grantor trusts
  - Fully revocable trust (for example, a revocable living trust) – grantor has total control
  - Irrevocable trust – grantor's retained power over or interest in a trust that would otherwise be taxed under normal trust income tax rules causes the trust to be a "grantor" trust for income tax purposes
    - Intentionally Defective Grantor Trust (IDGT) – grantor retains a power over the trust (e.g. the power to replace trust assets with other assets of equivalent value)
    - Grantor retained annuity trust (GRAT) – grantor retains the right to receive annuity payments
- Why is it helpful that IDGTs and GRATs are grantor trusts?
  - By paying the income taxes on assets that will ultimately benefit others, the grantor makes additional gift-tax-free gifts each year of the amount of tax the trust would otherwise pay
  - In addition, the grantor can engage in transactions with the trust without income tax consequences

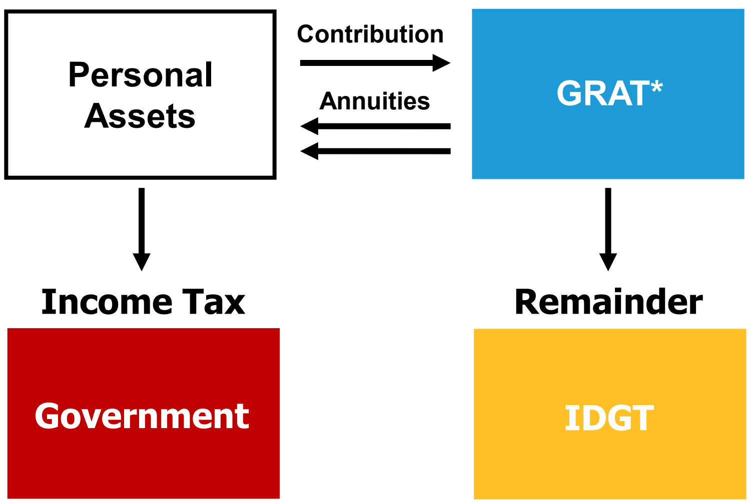
Common Grantor Trust Powers

- What are the most common “grantor trust taints”?
  - Power to add beneficiaries and cause distribution to be made to them under IRC Section 674
  - Power to make loans to the grantor without adequate security under IRC Section 675(2)
  - Power to use income to pay premiums on insurance on the life of the grantor or the grantor’s spouse under IRC Section 677(a)(3)
  - Power exercisable in a non-fiduciary capacity to reacquire assets by substituting assets of equivalent value.*
- Why are these the most common? These powers are generally considered “safe” because they should not cause estate tax inclusion. **
  - Is the ability to borrow assets a retained power under IRC Sections 2036 and 2038? Some practitioners think so.
  - Some grantors aren’t comfortable with a power to name beneficiaries.
  - Does the power to use income to pay premiums on life insurance on the life of the grantor or the grantor’s spouse really cause grantor trust status if the trust doesn’t own insurance on the life of the grantor or the grantor’s spouse?

* Pursuant to Rev. Rul. 2008-22, 2008-1 C.B. 796, trust property will not be includible in the grantor’s gross estate under IRC Sections 2036 or 2038 as long as the trustee has a fiduciary obligation to ensure that the grantor complies with the trust terms.

** Jeanne L. Newlon, Developments Involving Grantor Trusts, ALI-ABA Estate Planning Course Materials Journal, August 2010.

Grantor Retained Annuity Trust (GRAT)



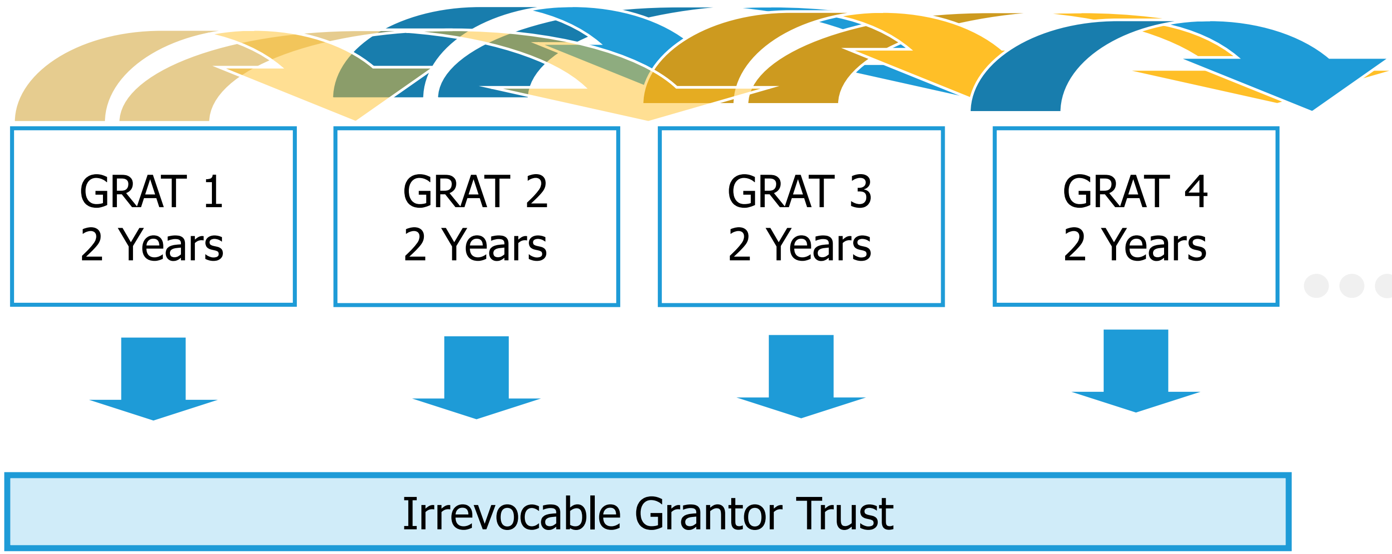
Key Points:

- Grantor transfers assets to GRAT
- Grantor receives annual annuity payments from trust
- Grantor pays taxes on trust income
- If GRAT assets grow faster than Section 7520 rate, wealth is transferred free of gift tax**
- "Wins" go to irrevocable grantor trust for children

*The assets of a GRAT are generally invested as directed by the trustee;
**Assuming the GRAT is "zeroed out" so that the present value of the annuity stream, discounted by the Section 7520 rate, the IRS specified interest rate, equals the original contribution, and assuming that the grantor survives the term of the GRAT.

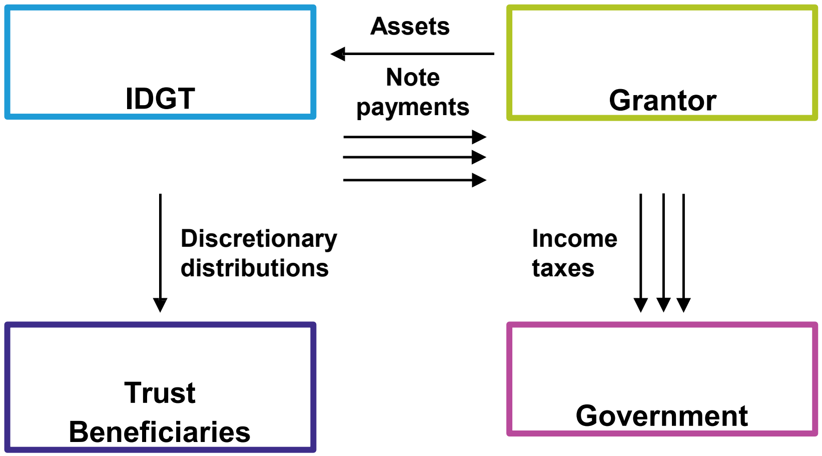
Short-Term Rolling GRATs

- Contribute initial assets to a two-year trust
- Annual annuity payment is contributed to a new two-year GRAT every year
- Any assets remaining in a GRAT at the end of its term pass tax-free to a grantor trust for the children*



*Assuming the GRAT is zeroed-out so that the present value of the annuity stream, discounted by the Section 7520 rate, equals the original contribution, and assuming the grantor survives the term of the GRAT.
In recent years, Congress has considered legislation that would (1) outlaw zeroed-out GRATs, requiring that the present value of the remainder interest, at inception, to result in a taxable gift equal to a minimum proportion of the initial contribution; and (2) mandate a minimum annuity term of 10 years for each GRAT established after the proposal becomes law.
Source: AB

Installment Sale to Intentionally Defective Grantor Trust (IDGT)



Key points:

- Grantor transfers assets to IDGT
- Collectively, transfer is treated as part-gift (10%), part-sale (90%)
- In exchange for assets sold, grantor receives promissory note; interest payable annually for eight years, with principal and final interest installment due upon maturity at the end of the ninth year
- Until then, grantor pays all income taxes on behalf of IDGT and its beneficiaries
- Annual growth in excess of mid-term AFR may avoid gift, estate, and GST taxes*

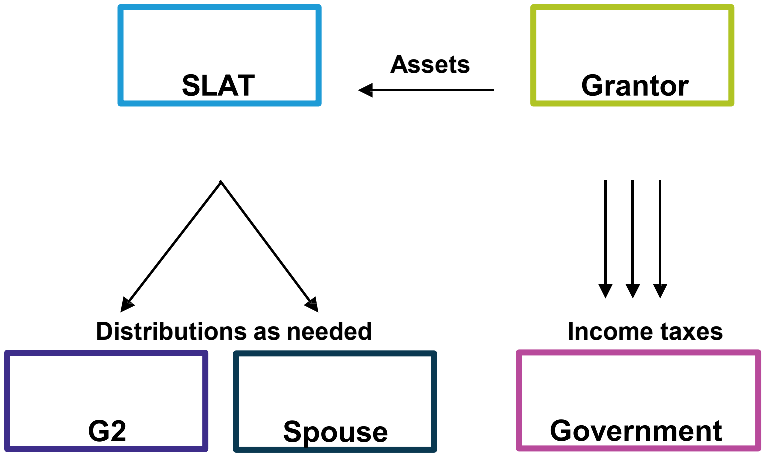
If transaction is structured properly and grantor fails to survive note term, value of note (*not assets sold*) will be subject to estate tax at grantor's death

*Potential benefit to trust and its beneficiaries equals post-transfer growth of assets given, plus growth of assets sold in excess of interest payable.
For illustrative purposes only; not an advertisement and does not constitute an endorsement of any particular wealth transfer strategy. Bernstein does not provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.
Source: AB

What Strategies Allow Continuing Access to Trust Assets?

- Spousal Lifetime Access Trust (SLAT)
- Incomplete Non-Grantor Trusts

Spousal Lifetime Access Trust (SLAT)

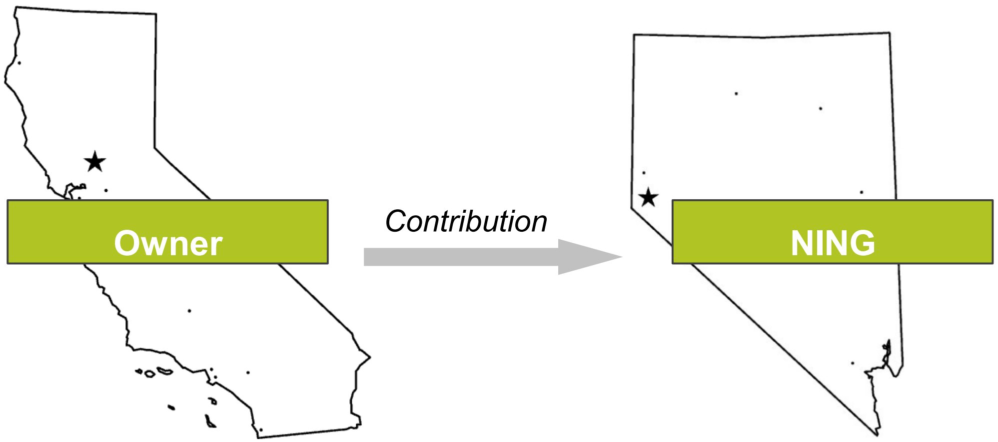


Key points:

- Can benefit children, grandchildren, and grantor's spouse, or benefit can be restricted to the grantor's spouse during life.
- The trust assets should be protected from the grantor's and beneficiary's creditors.
- A married couple could fund two SLATs, one for each spouse's benefit. However, each trust must be carefully drafted to avoid being considered reciprocal.
- Grantor pays taxes on trust income.
- When structured properly, trust assets should not be included in the grantor or spouse's estate.
- The significant risks to consider are death and divorce. At the beneficiary spouse's death, the grantor spouse no longer has a means of accessing the trust assets.

Bernstein does not provide tax, valuation, or legal advice; please consult professionals in these fields prior to making any decisions regarding strategies modeled in this analysis.
Source: AB

Incomplete Non-Grantor (ING) Trust - Funding



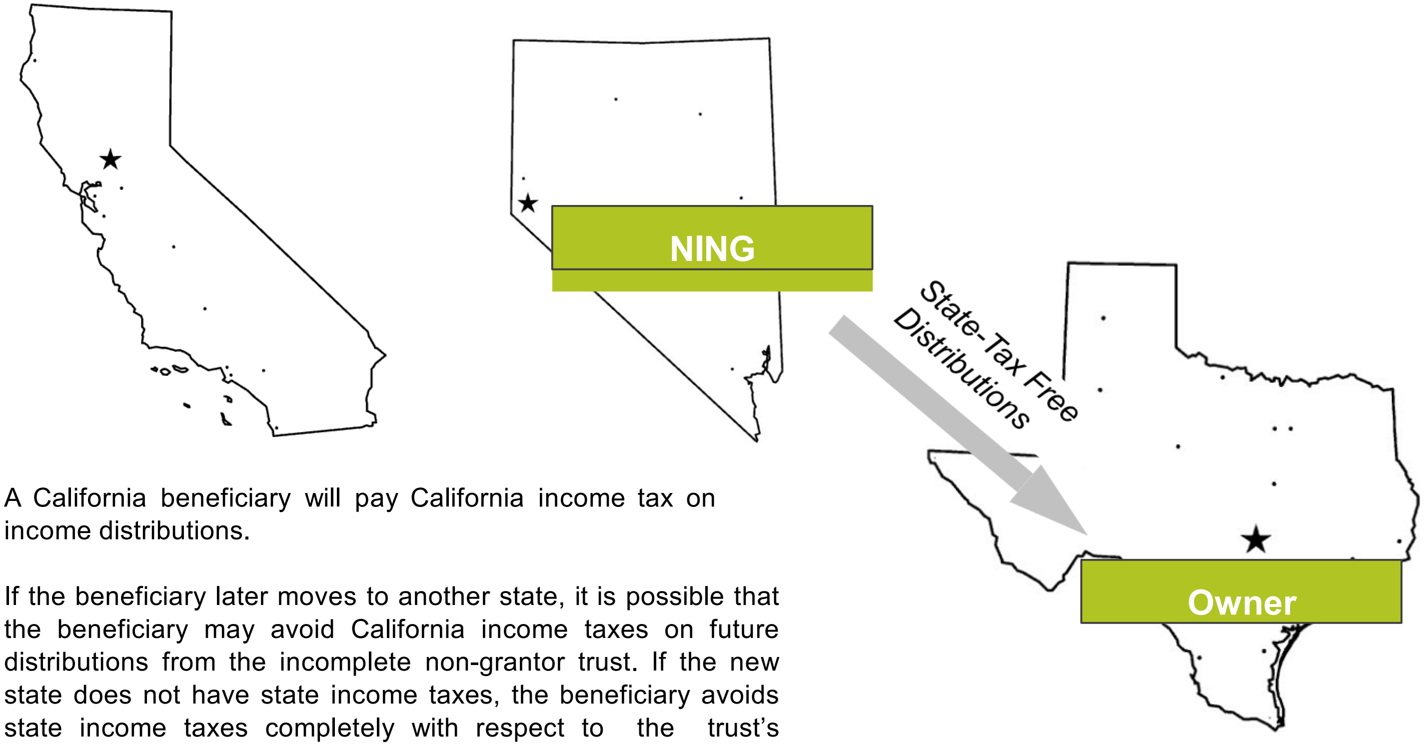
- An Incomplete Non-Grantor Trust ("ING") is a powerful vehicle, particularly for low cost basis assets with a contemplated future sale, that potentially eliminates state income/capital gain tax while taking advantage of asset protection.

- An ING is funded with an incomplete gift that never leaves the grantor's estate, which means there is no gift tax.

- An ING is a non-grantor trust, meaning the income is taxed at the trust level, not the individual level. As a result, state income tax may be avoided on assets within a trust if located and properly administered in a no-tax jurisdiction.

Bernstein does not provide tax or legal advice. This trust structure requires experts familiar with all applicable state and federal tax laws. Please seek qualified professional advice.

Incomplete Non-Grantor (ING) Trust - Distributions



- A California beneficiary will pay California income tax on income distributions.
- If the beneficiary later moves to another state, it is possible that the beneficiary may avoid California income taxes on future distributions from the incomplete non-grantor trust. If the new state does not have state income taxes, the beneficiary avoids state income taxes completely with respect to the trust's income.
- **BUT…BEWARE OF CALIFORNIA'S THROWBACK TAX!**

Bernstein does not provide tax or legal advice. This trust structure requires experts familiar with all applicable state and federal tax laws. Please seek qualified professional advice.

What Strategies Trigger Estate Tax Inclusion?

- Incomplete Non-Grantor Trusts
- Incomplete Gifts (e.g., retaining a limited power of appointment)
- Marital Trusts

Why is triggering estate tax inclusion desirable? Basis step-up (IRC Section 1014).

Grantor Trust vs. Non-Grantor Trust Status

- Grantor Trust Status
  - Benefits
    - Tax-free growth
    - Tax-free treatment of sales
  - Drawbacks
    - Tax burden to grantor (but can be turned off)
    - Potential inclusion under proposed tax legislation
- Non-Grantor Trust Status
  - Pros
    - QSBS Stacking
    - Grantor doesn’t carry tax burden
    - No inclusion if grantor trust provisions of proposed tax legislation pass
  - Cons
    - Compressed income tax rates
    - Loss of tax-free growth
    - Surcharges on trust income under proposed tax legislation

Leaving Assets in the Grantor Trust Creates Additional Wealth for Beneficiaries

*"Taxable Gift" assumes assets are never held by a grantor trust and are given to a non-grantor trust on day 1. The non-grantor trust is governed by the state of Wyoming for income tax purposes.
**"Typical Markets" means 50th percentile results of 10,000 trials in our Wealth Forecasting System. Based on AB's estimates of the range of returns for the applicable capital market (as of March 31, 2020) over the next 40 years.
Scenarios that include a grantor trust assume assets are held in a grantor trust for the period of time noted, after which they are transferred to a non-grantor WY trust where they continue to grow based on the underlying allocation until the end of year 40.
Based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed**. Data do not represent past performance and are not a promise of actual or range of future results.** Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Assumptions and Notes on the Wealth Forecasting System in the Appendix for further details.

Notes on Wealth Forecasting System

1. **Purpose and Description of Wealth Forecasting Analysis**
   Bernstein's Wealth Forecasting Analysis is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client-Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long-term, and how different asset allocations might impact his/her long-term security; (3) The Capital-Markets Engine: our proprietary model that uses our research and historical data to create a vast range of market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of returns and asset values the client could expect to experience are represented within the range established by the 5th and 95th perce ntiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not establish the boundaries for all outcomes. Expected market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results or the actual probability that these results will be realized. The information provided here is not intended for public use or distribution beyond our private meeting.

Notes on Wealth Forecasting System

2. **Modeled Asset Classes**
The following assets or indexes were used in this analysis to represent the various model classes:

Asset Class	Modeled As	Annual Turnover
Cash Equivalents	3-month US Treasury bills	100%
Short-Term Treasuries	US Treasuries of 2-year maturity	50%
Short-Term Taxables	Taxable bonds of 2-year maturity	50%
Short-Term Diversified Municipals	AA-rated diversified municipal bonds of 2-year maturity	50%
Int.-Term Treasuries	US Treasuries of 7-year maturity	30%
Int.-Term Taxables	Taxable bonds of 7-year maturity	30%
Int.-Term Corporates	US investment grade corporate debt of 7-year maturity	30%
Int.-Term Diversified Municipals	AA-rated diversified municipal bonds of 7-year maturity	30%
Global Int.-Term Taxables (Hedged)	50% sovereign and 50% investment grade corporate debt of developed countries of 7-year maturity	30%
Int.-Term TIPS	US TIPS of 7-year maturity	30%
High Yield	Taxable bonds of 7-year maturity with credit characteristics of CSFB High Yield Index II	30%
Global Large-Cap (Unhedged)	MSCI World Index (NDR) Index	15%
US Diversified	S&P 500 Index	15%
US Value	S&P/Barra Value Index	15%
US Growth	S&P/Barra Growth Index	15%
US Mid-Cap	Russell Mid-Cap Index	15%
US Small/Mid-Cap	Russell 2500 Index	15%
US Small-Cap	Russell 2000 Index	15%
Developed International	MSCI EAFE Index (Unhedged)	15%
Emerging Markets	MSCI Emerging Markets Index	20%
Global REITs	NAREIT Index	30%
Real Assets	1/3 NAREIT, 1/3 MSCI ACWI Commodity Producer Index, 1/3 DJ-UBS Commodity Futures Index	30%

Notes on Wealth Forecasting System

3. **Volatility**
   Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital-Market Projections page at the end of these Notes. In general, two-thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two-thirds of the projected returns will be between (8.9)% and 28.8%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatilit y is assumed to be 6.0%, two-thirds of the outcomes will typically be between (1.1)% and 11.5%. Bernstein's forecast of volatility is based on historical data and incorporates Bernstein's judgment that the volatility of fixed income assets is different for different time periods.
4. **Technical Assumptions**
   Bernstein's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. Bernstein's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of December 31, 2017. Therefore, the first 12-month period of simulated returns represents the period from December 31, 2017, through December 31, 2018, and not necessarily the calendar year of 2018. A description of these technical assumptions is available on request.
5. **Expenses and Spending Plans (Withdrawals)**
   All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized gains or losses, which will have capital gains tax implications.
6. **Tax Implications**
   Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein, including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions

Notes on Wealth Forecasting System

7. **Tax Rates**
   Bernstein's Wealth Forecasting Analysis has used the following tax rates for this analysis

Taxpayer	Scenario	Start Year	End Year	Federal Income Tax Rate	Federal Capital Gains Tax Rate	State Income Tax Rate	State Capital Gains Tax Rate	Tax Method Type
Client	All	2018	2037	43.4%	23.8%	0.0%	0.0%	Top Marginal

The federal income tax rate represents Bernstein's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is represented by the lesser of the top marginal income tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among o ther things, federal deductions for state income and capital gains taxes. The state income tax rate represents Bernstein's estimate of the 'average' rate calculated based upon the applicable state's marginal tax schedule. Where an applicable state tax code permits the exclusion of a portion of capital gain income from gross income for purposes of calculating state income tax such exclusions have been included in the calculation.

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