ESTATE PLANNING - TRUSTS

General

A trust is a legal arrangement that enables you to transfer money or property to a trustee who holds legal title for the benefit of the beneficiaries you name. This is accomplished through a written trust agreement tailored to your needs. It is a separate legal entity.

You can set up a trust for anyone and for just about any purpose. The outline will discuss several types of trusts. You can put into a trust just about any kind of asset that a trustee is willing to accept. It might be funded with cash or existing investments such as real estate, stocks or bonds. It might own or be funded by an insurance policy insuring the life of the trust's creator. A trust can be revocable or irrevocable.

Depending on the terms of the trust, the trustee may be required to make or hold certain types of investments or might be given a great deal of flexibility to invest based upon the wishes of the grantor as expressed in the trust agreement. A trustee can be an individual (even the creator of the trust in certain circumstances) or it can be a corporate trustee such as a bank or a trust company. Trustees are entitled to reasonable fees for their services.

There is no minimum size for a trust except what is practical. The administrative costs of a trust (such as trustee fees, accounting, etc.) will often make it undesirable to set up very small trusts.

Trusts can be established for specific purposes such as an education trust for children or grandchildren or can provide protection of the assets from beneficiaries who might have financial troubles or who cannot handle their money (spendthrift). A trust can distribute funds on an "as needed" basis or can have established times to distribute such as when a beneficiary reaches a certain age (½ at age 25 the balance at age 30) or when a certain event occurs (10% when the beneficiary graduates from college).

Testamentary Trusts

Instead of leaving your estate in a will outright to your beneficiaries, you may establish one or more trusts to administer your estate or some portion of it. A trust established under a will is called a testamentary trust. The trust is effective only on death and therefore does not interfere with the enjoyment of the property during your lifetime. Other advantages of a testamentary trust are: The family is protected against possible inability to deal with outright or lump sum distributions. By appointing a bank as trustee, the family is relieved from what may be unfamiliar financial and administrative responsibilities.

For minor children, costly and time-consuming guardianship proceedings might be avoided, and income can be accumulated for future needs and distributions.

The flexibility of a trust allows instructions to trustees to cover numerous contingencies.

Living Trusts

A living trust is a trust created for your own benefit, making it operative while you are living. It allows you to maintain control of your assets while enjoying many of the benefits of a trust. You can reserve the right to amend, change or revoke the trust at any time. You direct the trustee (either yourself or a third party) to look after your investments, handle your affairs and pay you the income. You can change the trustee at any time.

If you become disabled or do not wish to handle your financial affairs, your trustee or alternate trustee can assume management of the trust and carry out your financial wishes. A trust can protect you and your family if you suffer a disabling injury or incapacitating illness. The trustee is available to manage the assets of the trust and provide for the disabled person and the family immediately, without the intervention or approval of a court.

Upon your death, the trust becomes irrevocable and can dispose of your estate the same way a will would, with one important exception - if all your assets are in the trust, probate (and all its costs, delays and administration) can be avoided since there are no assets left in your name. All the estate tax planning tools that are available in a will such as credit shelter or family trusts, marital trusts and QTIP trusts can be a part of a living trust.

A living trust entails a two-step process - creating the physical documents and transferring the property out of your name and into the trust. Both are important to successfully implementing a living trust.

Disadvantages of a living trust over a will are:

- The establishment costs can be significantly more than a will.
- The transfer process can be a nuisance to you in marshaling the assets and making certain that everything is in the trust. There is some ongoing burden to maintenance of the trust as well.
- There is also the possibility of mismanagement of the trust by a successor trustee. By removing the court from the administrative process, the risk of mismanagement of an estate is increased unless you are careful in selecting a successor trustee.

Irrevocable Trusts

An irrevocable trust agreement cannot be changed once it is established and is usually set up with specific objectives in mind such as reducing taxable income, capital gains or estate taxes, supporting a family member or funding a charity. In irrevocable trusts:

- The management of the trust assets and distribution of income and principal are supervised by the trustee. In certain trusts, you cannot serve as trustee.
- Generally the assets placed in trust are considered as gifts to the beneficiaries of the trust and must remain in the trust. Federal annual gift tax exclusions of $14,000 per donee per year (the current gift amount in 2014) to fund the trust can be used without incurring a gift tax. Further, the annual gift tax exclusion does not

count against your lifetime gift tax exemption amount ($5,250,000 in 2014).

Minor's Trusts

A minor's trust or educational trusts are used to pass gifts to children or grandchildren. Using the annual exclusion, annual gifts can be made to a trust for the benefit of a child or grandchild with significantly more control over the assets, flexibility and tax benefits than do Uniform Gift to Minors Accounts.

Insurance Trusts

Insurance trusts are established to hold life insurance policies. At death, the trust is funded by the insurance proceeds. Properly structured, the trust and the insurance are not a part of your estate and therefore, not subject to estate taxes. These trusts can also be used to own special insurance policies that are designed to pay estate taxes due when the surviving spouse dies.

Charitable Remainder Trust

A charitable remainder trust is an irrevocable trust that is established during your life to pay a life income to you and/or family members with the remainder to go to a charity. The charity receives nothing during the term of the trust (usually during your life and the life of your spouse or other person named by you) with the charity getting the remainder when the trust terminates.

Contributions can be in property or cash and are made at the time the trust is established. Income to you or the designated primary beneficiary begins immediately. There are two types of charitable remainder trusts.

- An "annuity" trust which pays out a fixed amount annually – typically between 6% to 9% as determined under the trust agreement.
- A "unitrust" which pays an amount annually based upon a percentage of the market value of the trust annually. This can address concerns with inflation.

Sometimes called a life income gift, this trust offers many benefits to all the parties involved:

- Sizable tax savings for the charitable donation. You remove the assets from your estate (and therefore reduce possible estate taxes) and you get an income tax charitable deduction the year the transfer is made to the trust. The size of the deduction depends on your age and the age of any other beneficiary, the rate of payout to you and the value of the assets donated.
- Possibly more income from an investment to the beneficiaries that can be fixed by the trust terms.
- A way to avoid capital gains tax on properties contributed to the trust.
- An income stream to the beneficiaries and money to the charity upon the termination of the trust.
- If the trustee invests in tax-free securities, you can receive tax-exempt income from the unitrust, a benefit that is not available in other retirement plans.
- The value of the charity's remainder interest is completely free from estate tax.

Charitable Lead Trust

A charitable lead trust is a trust that pays income to a charity for a specified period of time and then distributes the trust principal back to you or the beneficiaries.

QTIP Trusts

A qualified terminable interest property trust (QTIP) is frequently used in connection with a by-pass or marital trust established in a will or a living trust. Using the QTIP provisions, you can give your spouse a life income from assets placed in the QTIP trust (allowing principal to be tapped by the trustee if needed for the spouse) with the remainder being passed to the children or others that you specify. While the trust pays its share of the estate taxes due in your spouse's estate, you are assured of controlling what is left to pass on to your designated beneficiaries. This is often used where there are concerns with a second marriage or with a spouse's financial responsibility.

Bypass Trusts

A bypass trust is used to pass assets after death without subjecting those assets to estate tax. This is a type of irrevocable trust most used to pass property from parents to children at the death of the second parent.

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