

TRUSTS

A. Trust Terminology

1. Definition of a Trust - an arrangement in which one person transfers legal title to property to another person or entity, who manages the property for one or more other people
 - a. Person creating the trust is called the Grantor, Settlor or Trustor
 - b. Person deriving benefits from the property held in trust is called the Beneficiary
 - c. Corporate entity or individual holding assets in trust is called the Trustee

2. Trust instrument is the controlling "Contract". It controls:
 - a. Appointment of Trustee
 - b. Time for establishing and terminating the trust
 - c. Objectives of the trust
 - d. Names beneficiaries
 - e. Specifies trustee's discretion over income and principal
 - f. Gives trustee powers to act

3. Why establish a Trust?
 - a. Save estate taxes
 - b. Achieve a family planning objective
 - 1) Provide management assistance for creator of trust
 - 2) Provide management assistance for survivors of the creator of trust

B. Types of Trusts

1. Testamentary Trusts
 - a. Are created by terms of a Will and take effect upon the death of testator
 - b. Property flows to trustee instead of outright to a beneficiary
 - c. Used to provide management for testator's survivors, i.e., a spouse, child, minors, spendthrifts, incompetents
 - d. Used to save estate tax usually through a marital / bypass trust arrangement

2. Living Trust (inter vivos trusts)
 - a. Can become operative during Grantor's lifetime
 - b. Can be used by Grantor to provide management of assets during Grantor's lifetime
 - c. Income and principal paid as per Grantor's direction
 - d. Commences or continues to manage Grantor's property and pay Grantor's bills if Grantor becomes incompetent, thereby avoiding a conservatorship and court proceedings
 - e. Usually continues after death of Grantor for survivors or can terminate at Grantor's death
 - f. Used to save estate tax usually through a marital / bypass trust agreement
 - g. Property in trust at death is not subject to probate
 - h. Usually revocable and amendable
 - i. Provisions are confidential. Not filed for public record
 - j. Can be funded by use of a Durable Power (survives disability) of Attorney if Grantor becomes incompetent. Avoids a conservatorship and court proceedings
 - k. Used by persons who want to be relieved of management burden, who are without management ability, who are becoming incapacitated, who want to travel
 - l. Used in conjunction with a pour-over will
 - m. See Appendix 6 for diagram of a typical living trust with a pour-over Will, Power of Attorney and marital / bypass trust arrangement

3. Revocable Life Insurance Trusts
 - a. Usually are unfunded and is the trust is the beneficiary of Grantors life insurance policies; operates like an unfunded living trust
 - b. Grantor retains ownership of life insurance policies but names trust the beneficiary of them
 - c. Used in conjunction with a pour-over will
 - d. At Grantor's death the trust is funded by insurance proceeds with residuary estate pouring over from will
 - e. Can be funded by use of a Durable Power of Attorney if Grantor becomes incompetent. Avoids a conservatorship and court proceedings
 - f. Can be funded during lifetime by Grantor
 - g. Used to save estate tax usually through a marital / bypass trust arrangement
 - h. Used where Grantor has substantial amounts of life insurance
 - i. See Appendix 6 for diagram of a typical living trust with a pour-over Will, Power of Attorney and marital / bypass trust arrangement

4. Irrevocable Life Insurance Trusts (Crummey Trusts)
 - a. Used to remove life insurance proceeds from Grantor's estate and estate of Grantor's spouse
 - b. Grantor transfers ownership of policies to trustee
 - 1) Assigns all incidents of ownership
 - 2) Possible problems with assignment of group life insurance if employer changes insurer
 - 3) Gift tax consequences of assignment - cash value and premiums - interpolated terminal reserve value
 - c. Grantor periodically transfers funds into trust to cover premiums, interest on policy loans and trustee fees
 - d. Written notice of each transfer of property (policy and cash) into trust must be sent to beneficiaries and beneficiary must have a right of withdrawal in order to qualify Grantor for annual gift tax exclusion per beneficiary. Potential problems in using the entire \$10,000 gift tax exclusion because 5x5 rule may cause taxable transfer to beneficiary upon lapse of right of withdrawal
 - e. Trust agreement gives trustee the right to transfer funds into Grantor's estate to cover estate settlement costs by:
 - 1) Loaning money to estate
 - 2) Purchase of estate assets
 - f. Trust agreement provides for distribution of trust assets and termination of the trust - usually complements marital / bypass trust arrangement
 - g. Since trust is irrevocable, client must be fully aware of all ramifications and trust instrument must be as flexible as possible - is not right for everyone
 - h. Law is in a state of flux in this area
5. Other Irrevocable Trusts
 - a. IRC Sec. 2503 (b) & (c) "Minors Trusts"
 - b. Charitable Remainder and Charitable Lead Trusts
6. Trusts for Children
 - a. Provide management of assets at death of surviving parent of if both parents are killed in a common accident, i.e., contingent trust
 - b. Assets are left in trust until child (children) is of sufficient maturity to manage on his or her own

- c. Income and principal are expended by trustee for child according to terms of trust agreement until trust assets are distributed
- d. Trust agreement sets forth time for distribution to the child
- e. If more than one child must be provided for, either a single “pot” trust or multiple trusts can be established