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 Reminder 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