Demystifying Trusts

By Roger E. Stevens

General: Roger E. Stevens, Craig Weinberg, and Jessica Catlin draft trusts for clients of The Firm. A trust is created whenever a person chooses to place his property in a trust. A trust will have a Trustor (or Settlor) who is the person putting the property into the trust. It will also have a Trustee who is the person that manages the property in accord with a fiduciary relationship owed to the Beneficiaries. There are many reasons a client may wish to establish a trust. All trusts can be made spendthrift trusts, protecting the property from most creditors; however, a Trustor cannot place his property into trust for his own benefit in order to shield those assets from his own creditors.

Intervivos or Living Trusts: A "Living Trust" is simply a trust created during life (as opposed to one established in a person's will). A "Living Trust" may be used in place of a will and can avoid having the assets be subjected to the probate process. However, "probate" and estate taxes are entirely different concepts, which many people often confuse. Frequently, the Trustor, Trustee, and Beneficiary are the same person. Of itself, such an arrangement has no tax benefits, but is often used by people whose health is compromised. Distributing property to the primary beneficiary after death through a "Living Trust" is generally less expensive and easier than probating and distributing under a will. The beneficiaries usually can get their property sooner and do not have to wait for probate (which sometimes can last a year or more). If the Trustor owns property in more than one state, a Living Trust can avoid the expensive probating in more than one state--which would otherwise be necessary. These trusts may be set up for estate tax reduction, but unless so employed are estate tax neutral.

Bypass Trusts: A married person can leave everything to his spouse with no estate tax. But state and federal law allow an exemption of an amount left to other persons without tax. A person who simply left everything to his spouse, although avoiding estate taxes, would be losing his ability to use the tax free estate-gift tax exemption. Thus, when his spouse dies, assuming the spouse still holds that property, the amount which could have been spared from taxation are then subject to a potential estate tax. At present, 2003, the exemption is $1 million. Changes in the exemption amount are programmed into the law and have to be taken into account in any Bypass Trust that is drafted. Estate taxes are high, and in general the field of estate planning is primarily concerned with avoidance of confiscatory taxes. A Bypass Trust allows the surviving spouse to get the income from the trust and give the principal to the other beneficiaries when the surviving spouse is dead.

Generation Skipping Trusts: If one leaves property to his children in a taxable amount, and there is a 55% estate tax levied, and then the children leave the property to their children and there is another 55% estate tax levied, suddenly the estate property has been reduced to about 20% of its original value. A person can leave up to $1.1 million in a generation skipping trust for the benefit of grandchildren. This amount is also programmed to change under the law, and the changes in amount must be taken into account. Generation Skipping must be coordinated with the Estate and Gift Tax Exemption, since there is overlap.

Qualified Personal Residence Trusts: In a Qualified Personal Residence Trust, the Trustor-Grantor transfers his residence to a trust but retains the right to use the trust property for a specified term, after which the property goes to his beneficiaries. A gift tax may be paid or applied to reduce the gift-estate tax exemption, but the property should be discounted in value by the number of years in the term. If the Trustor lives through the term, his beneficiaries get the property free of further tax. It is especially useful with regard to a second or vacation home. If worse comes to worse, if the Trustor still wants to live in the house after the term, he can pay rent to the beneficiaries, and thereby get even more money out of his estate.

Charitable Remainder Trusts: In Charitable Remainder Trust, a charity is made a beneficiary, and the charity makes either annuity payments in a fixed-dollar payment or a fixed percentage of the fair market value of the donated assets to the Settlor or his designated beneficiaries. The two kinds of Charitable Remainder Trusts are called annuity and unitrust, respectively.

Disclaimer: The above subjects are often dealt with in voluminous books, and the outline here merely attempts to describe a few trust tools and their primary purpose and obviously should not be relied on for any purpose, but simply used to broaden one's knowledge.