Trusts

Background

A trust is a legal entity created for the purpose of holding, managing, and distributing property for the benefit of one or more persons. A trust can hold cash, PERSONAL PROPERTY, or real property, or it can be the BENEFICIARY of life insurance proceeds. In the most basic sense, a trust is just another form of a contract. Centuries ago, English landowners, in order to insure the continued wealth of the family, put their estates in trust to be controlled and managed under the terms of the trust agreement for an indefinite period of time. Once the land was placed in trust, the landowners controlled but technically no longer owned the land. As wealth was primarily measured at that time in history by the amount of land owned, the trust arrangement allowed the landowners IMMUNITY from creditors and may have absolved them of certain feudal obligations. While feudal concerns no longer exist and wealth is held today in many forms other than land, the concept of placing property in third party hands for the benefit of another while avoiding creditors has survived. A trust remains in many circumstance an effective tool to insure that the trust creator's wishes regarding the trust assets are complied with for many years, even during periods of the creator's mental INCOMPETENCYor after death.

Types of Trusts

A trust can be created during a person's lifetime and survive the person's death. A trust can also be created by a Will and formed after death. Once assets are put into the trust they belong to the trust itself, not the TRUSTEE, and remain subject to the rules and instructions of the trust contract. Most basically, a trust is a right in property, which is held in a FIDUCIARY relationship by one party for the benefit of another. The trustee is the one who holds title to the trust property, and the beneficiary is the person who receives the benefits of the trust. While there are a number of different types of trusts, the basic types are revocable and irrevocable.

Revocable Trusts

Revocable Trusts are created during the lifetime of the trustmaker and can be altered, changed, modified or revoked entirely. Often called a **L**IVING **T**RUST, these are Trusts in which the trustmaker transfers the title of a property to a Trust, serves as the initial Trustee, and has the ability to remove the property from the Trust during his or her lifetime. Revocable Trust are extremely helpful in avoiding PROBATE. If ownership of assets is transferred to a revocable trust during the lifetime of the trustmaker so that it is owned by the trust at the time of the trustmaker's death, the assets will not be subject to probate.

Although useful to avoid probate, a revocable trust is not an asset protection technique as assets transferred to the trust during the trustmaker's lifetime will remain available to the trustmaker's creditors. It does make it more somewhat more difficult for creditors to access these assets since the CREDITOR must petition a court for an order to enable the creditor to get to the assets held in the trust. Typically, a revocable trust evolves into an irrevocable trust upon the death of the trustmaker.

Irrevocable Trust

An Irrevocable Trust is one which cannot be altered, changed, modified or revoked after its creation. Once a property is transferred to an Irrevocable Trust, no one, including the trustmaker, can take the property out of the Trust. It is possible to purchase Survivorship Life Insurance, the benefits of which can be held by an Irrevocable Trust. This type of survivorship life insurance can be used for estate tax planning purposes in large estates, however, survivorship life insurance held in an Irrevocable Trust can have serious negative consequences.

Asset Protection Trust

An Asset Protection Trust is a type of Trust that is designed to protect a person's assets from claims of future creditors. These types of Trusts are often set up in countries outside of the United States, although the assets do not always need to be transferred to the foreign JURISDICTION. The purpose of an Asset Protection Trust is to insulate assets from creditor attack. These trusts are normally structured so that they are irrevocable for a term of years and so that the trustmaker is not a current beneficiary. An asset protection trust is normally structured so that the undistributed assets of the trust are returned to the trustmaker upon termination of the trust provided there is no current risk of creditor attack, thus permitting the trustmaker to regain complete control over the formerly protected assets.

Charitable Trust

Charitable Trusts are trusts which benefit a particular charity or the public in general. Typically Charitable Trusts are established as part of an estate plan to lower or avoid imposition of estate and gift tax. A charitable remainder trust (CRT) funded during the grantor's lifetime can be a financial planning tool, providing the trustmaker with valuable lifetime benefits. In addition to the financial benefits, there is the intangible benefit of rewarding the trustmaker's altruism as charities usually immediately honor the donors who have named the charity as the beneficiary of a CRT.

Constructive Trust

A Constructive Trust is an implied trust. An Implied Trust is established by a court and is determined from certain facts and circumstances. The court may decide that, even though there was never a formal declaration of a Trust, there was an intention on the part of the property owner that the property be used for a particular purpose or go to a particular person. While a person may take legal title to property, equitable considerations sometimes require that the equitable title of such property really belongs to someone else.

Special Needs Trust

A Special Needs Trust is one which is set up for a person who receives government benefits so as not to disqualify the beneficiary from such government benefits. This is completely legal and permitted under the Social Security rules provided that the disabled beneficiary cannot control the amount or the frequency of trust distributions and cannot revoke the trust. Ordinarily when a person is receiving government benefits, an

INHERITANCE or receipt of a gift could reduce or eliminate the person's eligibility for such benefits. By establishing a Trust, which provides for luxuries or other benefits which otherwise could not be obtained by the beneficiary, the beneficiary can obtain the benefits from the Trust without defeating his or her eligibility for government benefits. Usually, a Special Needs Trust has a provision which terminates the Trust in the event that it could be used to make the beneficiary ineligible for government benefits.

Special needs has a specific legal definition and is defined as the requisites for maintaining the comfort and happiness of a disabled person, when such requisites are not being provided by any public or private agency. Special needs can include medical and dental expenses, equipment, education, treatment, rehabilitation, eye glasses, transportation (including vehicle purchase), maintenance, insurance (including payment of premiums of insurance on the life of the beneficiary), essential dietary needs, spending money, electronic and computer equipment, vacations, athletic contests, movies, trips, money with which to purchase gifts, payments for a companion, and other items to enhance self-esteem. The list is quite extensive. Parents of a disabled child can establish a Special Needs Trust as part of their general estate plan and not worry that their child will be prevented from receiving benefits when they are not there to care for the child. **D**ISABLED PERSONS who expect an inheritance or other large sum of money may establish a Special Needs Trust themselves, provided that another person or entity is named as Trustee.

Spendthrift Trust

A Trust that is established for a beneficiary which does not allow the beneficiary to sell or pledge away interests in the Trust. A Spendthrift Trust is protected from the beneficiaries' creditors, until such time as the Trust property is distributed out of the Trust and given to the beneficiaries.

Tax By-Pass Trust

A Tax By-Pass Trust is a type of Trust that is created to allow one spouse to leave money to the other, while limiting the amount of Federal Estate tax that would be payable on the death of the second spouse. While assets can pass to a spouse tax-free, when the surviving spouse dies, the remaining assets over and above the exempt limit would be taxable to the children of the couple, potentially at a rate of 55%. A Tax By-Pass Trust avoids this situation and saves the children perhaps hundreds of thousands of dollars in Federal taxes, depending upon the value of the estate.

Totten Trust

A Totten Trust is one that is created during the lifetime of the grantor by depositing money into an account at a financial institution in his or her name as the Trustee for another. This is a type of revocable Trust in which the gift is not completed until the grantor's death or an unequivocal act reflecting the gift during the grantor's lifetime. An individual or an entity can be named as the beneficiary. Upon death, Totten Trust assets avoid probate. A Totten Trust is used primarily with accounts and SECURITIES in financial institutions such as savings accounts, bank accounts, and certificates of deposit. A Totten trust cannot be used with real property. A Totten Trust provides a safer method to pass assets on to family than using joint ownership. To create a Totten Trust, the title on the account should include identifying language, such as "In Trust For", "Payable on Death To", "As Trustee For", or the identifying initials for each, "IFF", "POD", "ATF". If this language is not included, the beneficiary may not be identifiable. A Totten Trust has been called a "poor man's" trust because a written trust document is typically not involved and it often costs the trustmaker nothing to establish.

Parties to a Trust

There are typically three main parties to a Trust. The Trust Maker, sometimes called the Grantor or Maker, is the person who creates the Trust. The Trustee is the person or entity named to hold the legal title to the Trust estate. There may be one or several Trustees. The Beneficiaries are the persons who the Trust Creator intended to benefit from the Trust estate. The rights of the beneficiaries depend on the terms of the Trust. Beneficiaries have the equitable title to the property held in the Trust. During the lifetime of the Trustmaker, the Trustmaker, Trustee and Beneficiary can all be the same individual. This is most often the case in Revocable Trusts.

Trustmaker

The Trust Creator, sometimes called the Grantor or Trustmaker, is the person who started out as owner of the property that is to be transferred to and held by the Trust. The trustmaker makes an agreement with the trustee agreeing to convey his or her property into the name of the trustee for the benefit of the beneficiaries.

Trustee

A Trustee is a person or institution selected to follow the instructions provided by the DECLARATION OF TRUST. A Trustee has a very high "fiduciary duty" to act with the utmost GOOD FAITH in dealing with the Trust estate. Many grantors and their respective spouses act as the initial Trustees of a revocable living Trust. In this way they remain in control until they are incapacitated or die. Then pre-selected successor Trustees are appointed in accordance with the terms of the declaration of Trust. Usually a spouse, family member or trusted friend are selected as successor Trustees. Trustees should be knowledgeable about financial matters, be Trustworthy, know how to manage and invest the Trust estate, care about the beneficiaries of the Trust, and have the financial capacity to reimburse the Trust in the event that they make serious mistakes. If a bank or TRUST COMPANY is selected to serve as a Trustee of a Trust, it will usually charge a fee for this service, which is paid from the Trust estate.

Because the beneficiary, trustmaker, and the trustee can be the same person, the trustmaker and trustee can agree that the trust creator keep complete control over the trust by retaining the right to remove and replace the trustee, sell or transfer the original trust property, DISSOLVE or revoke the trust, and change the trust beneficiaries.

Beneficiaries

The Beneficiaries are the persons whom the Trust Creator intended to benefit from the Trust estate. Beneficiaries are said to have the "equitable title" to the property held in the Trust. The rights of the beneficiaries depend on the terms of the Trust. The trust agreement can provide that the beneficiaries have almost complete control over the manner in which trust assets are held and managed, as well as control over the timing and dollar amounts of distributions. Or the beneficiaries could be given absolutely no control. The decision as to how trust powers are apportioned depends on the trustmaker's objectives, trust, and confidence in the trustee, and tax consequences.

Once the trustmaker of a revocable trust dies and the trust becomes irrevocable, an anti-alienation clause usually protects the assets held in the trust form being used as COLLATERAL by the beneficiaries. Thus, creditors cannot force a trustee to make a distribution to the trust beneficiaries and the assets held in a trust can remain outside the reach of the beneficiaries' creditors.

Reasons for Trust Creation

Asset Control

A trust can be use to maintain control over the trust assets for a designated period of time which may survive death.

Tax Savings

Tax and asset protection aspects of trusts depend on the financial situation of the creator and the type of trust used. In certain circumstances, a trust can achieve substantial tax savings yet not achieve asset protection from creditors of the trustmaker. Everyone gets a lifetime credit against Federal Estate Taxes that permits a transfer of up to $675,000 Estate Tax free. Individuals and married couples with a total estate value less than $675,000 in 2000 (the amount will gradually increase to the year 2006) do not need a trust to save on Federal Estate or Gift Tax. For those who are married, there is an unlimited marital DEDUCTION. All estate taxes can be avoided upon the death of the first spouse to die. However, the surviving spouse would have to remarry and give the entire estate to the new spouse in order to get another unlimited marital deduction. Many people would rather their own children benefit from their estate, rather than having a surviving spouse pass it on to a new spouse. A trust can accomplish this. The trustmaker can establish a tax by-pass Trust to hold property for children, while still allowing the trust funds to provide for the surviving spouse. This arrangement enables the trustmaker to place up to $675,000 in a Trust for the benefit of the surviving spouse and children which will not be subject to estate tax upon the death of the surviving spouse. Coupled with the surviving spouse's estate and gift tax credit, the children could then INHERIT up to $1,350,000 free from Federal Estate and Gift Tax. At current Federal Estate Tax rates, this could amount to a significant savings of hundreds of thousands of dollars.

Asset Protection

Assets may be put in trust because the trust creator has confidence in the prospective trustee's knowledge, experience, or ability to properly manage the type of assets to be transferred into the trusts. The utilization of a trustee in such circumstances may have the additional advantage of relieving the beneficiaries of what may otherwise be a burden.

Avoiding a Conservatorship

If property is held in a Trust, a successor Trustee can step in and take over management, without the delay and expense of going to court to appoint a conservator to manage the property, if the Trust Creator becomes disabled. This may be particularly important if the trustmaker is self-employed or owns a portion of a business or partnership.

Avoiding Probate

In many estate plans, the Trust is the central tool that is used to control and manage property. A Trust continues despite the incapacity or death of the grantor. It determines how a Trustee is to act with respect to the Trust estate. It determines how property is to be distributed after the death of the grantor. A properly drawn Trust is a separate entity that does not die when the creator dies. The successor Trustee can take over management of the Trust estate and pay bills and taxes, and promptly distribute the Trust assets to the beneficiaries, without court supervision, if the Trust agreement gives the Trustee that power. Trusts, unlike Wills, are generally private documents. The public would be able to see how much the descendent owned and who the beneficiaries were under a Will, but typically not with a Trust. Like a Will, however, a Trust can be used to provide for minor children, children from a prior marriage and a second spouse in the same trust, transfer a family-operated or closely-held business, provide for pets, provide for charities and can remove life insurance benefits from a taxable estate, while still controlling the designation of insurance beneficiaries.

State Law

Trusts are often created as an alternative to or in conjunction with a Will. Trusts are today usually considered an estate planning tool. The Uniform Probate Code includes provisions dealing with affairs and estates of the deceased and laws dealing with nontestamentary transfers such as trusts. The theory behind the Code is that wills and trusts are in close relationship and thus in need of unification. Since its creation, over thirty percent of states have adopted most provision of the Code.

Additional Resources

Beyond the Grave: The Right Way and the Wrong Way of Leaving Money to Your Children (and Others). Condon, Gerald, HarperCollins, 2001.

Make Your Kid a Millionaire: Eleven Easy Ways Anyone Can Secure a Child's Financial Future. McKinley, Kevin, Simon & Schuster, 2002.

Organizations

The Elder Law Project Legal Services For Cape Cod And Islands, Inc.
460 West Main Street
Hyannis, MA 02601
Phone: (508) 775-7020

National Academy of Elder Law Attorneys, Inc.
1604 North Country Club Road
Tucson, AZ 85716
Phone: (520) 881-4005
Fax: (520) 325-7925
URL: http://www.naela.com