

Protect Your Assets With a Trust

Topical Education for Today's Investor

ESTATE PLANNING

Contrary to what many people think, trusts are not reserved only for the wealthy. The truth is, people from all walks of life may benefit from a trust.



What is a Trust?

Generally speaking, a **trust** is a legal entity that is central to a three-part agreement in which the owner of an asset — the trust's "**grantor**" — transfers the legal title of that asset to a trust for the purpose of benefiting one or more beneficiaries. The trust is then managed by one or more trustees. Trusts may be revocable or irrevocable and may be included in a will to take effect at death.

Revocable trusts can be changed or revoked at any time. For this reason, the IRS considers any trust assets to still be included in the grantor's taxable estate. This means that the grantor must pay income taxes on revenue generated by the trust and possibly estate taxes on those assets remaining after his or her death.

Irrevocable trusts have a legal arrangement that gives a trustee control over select assets and cannot be modified once it is established. The assets placed into a properly drafted irrevocable trust are permanently removed from a grantor's estate and transferred to the trust. Income and capital gains taxes on assets in

the trust are paid by the trust to the extent they are not passed on to beneficiaries. Upon a grantor's death, the assets in the trust are not considered part of the estate and are therefore not subject to estate taxes.

Most revocable trusts become irrevocable at the death or disability of the grantor.

The Role of a Trustee

The trust's grantor names a trustee to handle investments, manage trust assets, and make decisions regarding distributions. The grantor can work with the trustee on major decisions in a revocable trust, or the trustee can be assigned full authority to act on the grantor's behalf.

A trustee may be an individual such as an attorney or accountant, or it may be an entity that offers experience in such areas as taxation, estate tax law, and money management. Trustees have a responsibility — known as "fiduciary responsibility" — to act in the beneficiaries' best interests.

Benefits of a Trust

Although trusts can be used in many ways, they are most commonly used to:

- Control assets and provide security for the beneficiaries (of whom can be the grantor in a revocable trust)
- Provide for beneficiaries who are minors or require expert assistance managing money
- Avoid estate or income taxes
- Provide expert management of estates
- Avoid probate expenses
- Maintain privacy
- Protect real estate holdings or a business

Generally speaking, most people use trusts to help maintain control of assets while they're alive and medically competent, as well as indirectly maintain control of the disposition of assets if they're medically unable to do so or in the event of death.

Trusts Offer Flexibility to Meet Your Needs

Different kinds of trusts are designed to meet different needs and objectives. For example, if your primary goal is to ensure privacy in the settlement of your estate, to centralize control of assets, or to fully take advantage of estate tax credits provided by the IRS, you might choose a **living trust**.

The living trust allows you to remain both the trustee and the beneficiary of the trust while you're alive. You maintain control of the assets and receive all income and benefits. Upon your death, a designated successor trustee manages and/or distributes the remaining assets according to the terms set in the trust, avoiding

the probate process. In addition, should you become incapacitated during the term of the trust, your successor or co-trustee can take over its management.

An **irrevocable life insurance trust (ILIT)** is often used as an estate tax funding mechanism. Under this trust, you make gifts to an irrevocable trust, which in turn uses those gifts to purchase a life insurance policy on you. Upon your death, the policy's death benefit proceeds are payable to the trust, which in turn provides tax-free cash to help beneficiaries meet estate tax obligations.

A **qualified personal residence trust (QPRT)** allows you to remove your residence from your estate at a discount. Under this trust, you get to use the home for a predetermined number of years, after which time ownership is transferred to the trust or beneficiaries. Any gift tax you might incur from giving away the property is discounted because you still have rights to the house during the term of years spelled out in the trust. The potential drawback is that if you die before the term of the trust ends, the home is considered part of your estate.

If you want to leave money to your grandchildren, you might consider a **generation-skipping trust**. This trust can help you use your \$2,000,000 generation-skipping transfer tax exemption (for 2007) on bequests to your grandchildren and thus avoid or reduce your generation skipping transfer tax exposure, which can be up to 45%.

To help benefit your favorite charity while serving your own trust purposes, you might consider a **charitable lead trust (CLT)**. This trust lets you pay a charity income from the trust for a designated amount of time, after which the principal goes to the beneficiaries, who receive the property free of estate taxes. However, keep in mind that you'll need to pay gift taxes on a portion of the value of the assets you transfer to the trust.

Another charitable option, the **charitable remainder trust** (CRT), allows you to receive income and a tax deduction at the same time, and ultimately leave assets to a charity. Through this trust, the trustee will use donated cash or sell donated property or assets, tax-free, and establish an annuity payable to you, your spouse, or your heirs for a designated period of time. Upon completion of that time period, the remaining assets go directly to the charity. Highly appreciated assets are typically the funding vehicles of choice for a CRT.

Trust Terms

Grantor — the owner of the assets that are transferred to the trust

Trustee — the person or entity that oversees management of the trust according to the grantor's specifications

Beneficiary(ies) — the person(s) or entity(ies) that receive benefits from the trust

Consider the Costs

Different types of trusts and trustees can require a variety of fees for administration and wealth management. As you develop your trust strategies, remember to consider the costs that may be involved and weigh them carefully in relation to the benefits.

Although not quite as popular as wills, trusts are becoming more widely used among Americans, wealthy or not. Increasing numbers of people are discovering the potential benefits of a trust — how it can help protect their assets, reduce their tax obligations, and define the management of assets according to their wishes in a private, effective way. Your financial advisor can help you evaluate a certain type of trust to determine if it may be appropriate for your circumstances.

Points to Remember

1. A trust is a three-part agreement among the grantor, the trustee, and the beneficiary(ies).
2. Trusts are either revocable or irrevocable.
3. Because you can change or discontinue a revocable trust at any time, the government considers the trust's assets as part of your estate for tax purposes.
4. Irrevocable trusts cannot be altered once they are established; for this reason, they generally are not considered part of your estate for tax purposes.
5. There are some basic types of trusts: living trust, qualified personal residence trust, generationskipping trust, charitable lead trust, and charitable remainder trust.
6. Different types of trusts involve different costs for administration and management.
7. Your financial advisor can help you determine if a trust will meet your needs.

For more information, please contact your financial advisor.

Important Additional Notes

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Please note that this article provides an introductory overview of trust strategies. There are nuances to the selection of an appropriate trust strategy for different investors that should be considered and discussed with a tax and/or financial advisor prior to implementing any financial or investment plan.

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