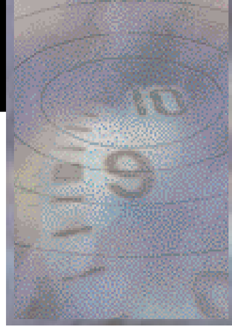

A Trust May be in Your Future

Any parent with children and a moderate amount of wealth should have a trust document. It's an ideal way to secure your family's resources in case of your death, and may be used to save on estate taxes.

BY JOHN ALLEVATO

I bet you have one now. If you don't, it's a much-better-than-even bet that you'll get one, or more, later. Trust me.

What is it? A trust.

At some point in time, a financial planner, accountant, bank officer, estate planning attorney, or some other close adviser will recommend a trust document for you—maybe more than one. And possibly one for your spouse as well.

Already got one? It wouldn't surprise me at all. As an estate planner, it is the rare client, irrespective of his amount of wealth, who leaves my office without some sort of trust document. Trusts are a staple of estate planning.

In this column I will attempt to take the mystery out of trust documents. I will focus on trusts normally associated with estate planning. Trusts are used in a variety of contexts in business and personal transactions other than estates. There is a lot more to know about trusts, but I will strive to educate you about how they are used in estate planning and why you will probably have one as part of your estate plan.

> **While you are alive, the trust sits there and waits in case the unlikely occurs—the death of you and your spouse. In that event, the trust can be funded with your assets, including your insurance proceeds.**

What is a trust?

It seems that much confusion stems from a lack of basic understanding about trust agreements. Trusts are entities recognized by law, established primarily for the protection, management, and administration of assets for the benefit of one or more beneficiaries. A beneficiary is one who will benefit from the trust (in an economic sense). In its most basic form, a trust is a contract (the trust agreement) between a person establishing the trust (called the grantor or settlor most often), and a trustee.

In addition to those parties, a trust needs beneficiaries and what lawyers call corpus, or assets for the trustee to hold. That is why most times when you set up a trust, your lawyer will ask you to open a bank account with a minimum amount, or may actually request $5 or $10 to put with the trust document. This modest amount will provide evidence that, indeed, assets were exchanged to create a valid trust. Interestingly, many states (Ohio, for one) no longer require by law the existence of corpus before a trust comes into being under cer-

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tain circumstances. These "corpus-less" trusts are known as 'dry,' or empty trusts.

The trust agreement dictates the relationship among the parties—the most significant being the relationship between the beneficiaries and the trustee. In the estate-planning context, it is common for beneficiaries to be members of different generations. For example, a parent may establish a trust for a child and for that child's children. This creates tension between those beneficiaries. The younger generation has to wait to enjoy the benefits from the trust until the older generation has passed away. As a result, they are interested in asset growth and preservation, while the older generation may want more income from the assets. The trustee gets caught in the middle in all this, and will consult the trust agreement to resolve this inherent conflict.

Many times the trust language does not adequately resolve this issue, and then state law and other rules come into play. Not surprisingly, the role of the trustee in this is crucial.

Trusts can be revocable (they can be modified or revoked, usually by the person establishing the trust) or irrevocable (they can't be changed). There are various reasons why each is used, but the revocable trust is the most common. Generally, at some point in time (usually when the person establishing the trust dies), even revocable trusts become irrevocable.

Who should be the trustee?

Naming a trustee is one of the most difficult decisions that you will have to make in your estate plan. Not just anyone can do the job—considering that it requires a person to not only make economic decisions which affect your heirs, but also someone who can comfortably manage and make productive the assets of the trust, which might be significant. In addition, tax filings and other legal requirements have to be met, so it is not unusual for an individual serving as trustee to hire an attorney, an accountant, and a financial manager for the assets. The trustee is in charge of someone else's resources—it is an awesome responsibility.

Any competent adult person may be named as a trustee, or the trustee may be a corporation having powers to act as a trustee under state law. This includes trust companies and trust departments of banks, variously known as corporate trustees. The trustee owns the assets of the trust—but in a capacity known as a fiduciary for the benefit of the beneficiary. The trustee is required to hold the trust assets in a manner that identifies that the trustee 'owns' the assets as a trustee for the benefit of someone else.

Trust companies do this day in and day out. While their fees may range annually from 3⁄4 percent to 1 1⁄2 percent of the assets they are managing, consider the cost of hiring an attorney, an accountant, and a financial expert, which will be necessary for the trustee. The individual serving as trustee is entitled to a fee, as well. Thus, not choosing a trust company or bank to serve as your trustee should not be an economic decision—this is not the place to try and save some money.

There is no blueprint for choosing a trustee. Keep in mind the responsibilities and duties of the trustee, and make your decision accordingly. Your estate planner can help in this decision.

Reasons for a trust

In the estate-planning context, trusts are widely used as vehicles to hold assets until beneficiaries attain certain ages, or to preserve wealth in larger estates. Many times trusts are established to protect beneficiaries from themselves or creditors. These are called spendthrift trusts, and most trusts have these provisions in them.

Let's look at a typical situation. Assume you are an internist and the parent of two small children, ages six and two. Your husband is an engineer. You both are in your early 30s. Your practice is just starting to grow and your husband's career is progressing nicely. While your personal wealth is still modest, you and your husband both have insurance to protect your family should one of you die. In the event both you and your husband die while the children are still young, you are advised by your estate planner to establish a trust.

The estate planner tells you that having a will is not enough. Leaving everything to your minor children outright, or even titling assets in the name of a guardian, means that as the children attain legal adulthood (age 18), they are entitled to their share of the assets. When you consider that, with life insurance, you and your husband would leave over $1.5 million, you realize that your child may not be ready to handle a windfall of over $750,000 at age 18. Your estate planner says that a trust will make the assets available to insure that your children's needs are met, including college costs, while at the same time leaving the management and investment of the funds with a trustee. You will make the decision now as to the time when your children would start receiving distributions of your estate from the trust.

That is an example of how beneficial a trust can be to a young family. While

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you are alive, the trust sits there and waits in case the unlikely occurs—the death of you and your spouse. In that event, the trust can be funded with your assets, including your insurance proceeds. Your estate planner has assisted you in ensuring this occurs. While a parent can never be replaced, it is good to know that prudent stewardship of one's assets can be planned ahead of time by the use of a trust.

Do trusts save taxes?

The example above assumed that federal estate taxes were not a major consideration in that young couple's estate plan. Many times, the elimination or reduction of federal estate taxes is a major consideration.

In those circumstances, trusts play an important role. Just placing assets in a trust does not necessarily insulate those assets from the federal estate tax. Rather, a properly drafted trust can aid in the reduction of such taxes for estates of $1 million and larger.

If your estate (counting the proceeds from life insurance) is at least that size, then you must consider the impact of estate taxes. Using trusts can insure that the maximum amount which is exempt from the estate tax for married couples (this year, $1 million each for a total of $2 million) is preserved, thus increasing the amount of wealth which passes to your heirs.

For example, leaving all your assets to your spouse insures that no estate taxes are due at the first death, as you can pass an unlimited amount of assets to a spouse and not incur estate taxes. However, the estate of the second spouse to die can only exempt $1 million from the reach of the federal estate tax. If, instead, the first spouse to die had left $1 million in trust for the benefit of the surviving spouse, then that $1 million plus the surviving spouse's $1 million (a total of $2 million) would be outside the reach of the IRS. Make sure you have a competent estate planner advise you on this type of plan.

Trusts may be in the cards for you, irrespective of the size of your estate. If you have minor children, a trust for the family is just the thing. ■

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