## CHAPTER TEN

# The Many Types of Trusts

"Trust" is only five letters long, but it is a big word. The first distinction, as alluded to earlier, is that between a trust contained in a will, a testamentary trust, and a stand-alone document, which may be either a revocable trust or an irrevocable trust. We are talking about the nontestamentary, nonprobatable trusts.

There are dozens of kinds of trusts, complex and simple, for all sorts of purposes. In this book, we are talking about fairly simple trusts, which the IRS refers to as "revocable grantor trusts" (what we normally call revocable living trusts). Revocable just means changeable. The grantor is the person who owns the trust itself. Sometimes they call the grantor the settlor, but it's the same thing. During the grantor's lifetime, he may change or revoke the trust. At his death or disability, the trust is unchangeable or irrevocable. I am not going to go into detail describing the many trusts available for many different purposes, since this would go beyond my intentions for this book.

Other trusts may be created for avoidance or minimization of estate taxes. There are a lot of kinds of trusts for those purposes, which can be complex and require the services of a skilled tax or estate planning attorney. Listing and defining all the variations of these trusts goes beyond the scope and intent of this book. The trusts needed by 95 percent of us are for the following purposes.

Probate avoidance is a common benefit shared by all the trusts we use. While probate does not have to be expensive or time-consuming, in many instances it is just that. As I have stated previously, there is no advantage whatsoever to anyone to have your estate go through probate. The only exception, of course, is the probate attorney, who receives a big fee for handling the estate. With a properly funded trust, there should be no need for court or even attorney involvement in your estate after your death.

Management of assets for beneficiaries is an extremely good reason to have a trust, and this type of trust is essential for anyone with minor children, disabled beneficiaries who are dependent upon federal or state aid, or spendthrifts who cannot manage their own money effectively. Without this type of asset-management trust, the money being inherited would go in a lump sum to the beneficiary, which might cause disastrous consequences.

As discussed in chapter 2, a lump-sum distribution to a child when he reaches adulthood is usually a bad idea. Most parents want their children to have the benefit of their inheritance but would prefer to have someone else assist in managing that money to be sure that it is put to the most beneficial use and is not wasted.

Having the money held in trust for the child solves that potential problem. The trust itself is not “funded” until the death of the grantor. At that time the trustee begins managing the money for the beneficiary and follows the trust instructions as to when to make trust distributions, for what purposes, and in what amounts. The rules set up for distributions are varied. Common examples of how people do it are:

**Attaining a certain age.** All the money is held in trust until the beneficiary reaches age twenty-five, for example. Up until then the trustee may be given the authority to use the money for the beneficiary’s health, education, welfare, and general living expenses. I have even seen people set up requirements that a portion of the money is to be held as a retirement account for the beneficiary to be turned over to him at age sixty-two and invested until then, essentially creating a retirement account for someone who might otherwise not have one. There may even be provisions allowing money to be paid out in certain limited instances such as medical emergencies. There also must be a provision saying where the money goes if the beneficiary dies before age sixty-two.

A variation on this is giving installments upon the beneficiary attaining different age levels, such as one-third at twenty-five, one-half the balance at thirty, and the remaining balance at thirty-five to split the inheritance into shares so that if a mistake is made with one installment, the beneficiary gets two more shots at it. People often want to split up the inheritance no matter the age of the beneficiary—perhaps one-third at the time of death of grantor, one-half the balance five years later, and the remaining balance ten years after the death of the grantor.

**Attaining certain benchmarks.** The trust may provide no money to be distributed until the beneficiary does certain things, such as graduating from college, acting as a missionary for a time, or getting married. There should be a default provision that would say where the money goes if the benchmark is not achieved. One example would be that the person would then have to wait until reaching age fifty.

## JOINT OR INDIVIDUAL TRUSTS FOR COUPLES

Couples can do their estate planning together by having a joint trust, or they may each have their own trust. Which is best depends upon the intentions of the couple, the nature of their assets, and the size of the total asset mix.

For the traditional family unit with a husband, wife, and children (who are the children of both parents) who do not have enough assets to worry about estate taxes (under $5.45 million) and who agree on a plan of asset distribution at both their deaths, a simple joint marital trust is the best answer. Only one-fifth of 1 percent of Americans have enough assets at death to pay estate taxes. That is not many, and those folks are not the focus of this book. They need more complex tax-planning advice, though they still need some sort of trust. (Keep in mind that even if the federal estate tax is eliminated entirely, as is proposed, state inheritance taxes may be reinstated. The law in this are is frequently changed.)

Joint trusts can be made for married couples, gay and other unmarried couples, and even a parent and child. Any two or more people can make a joint trust. Funding a joint trust is easy, since all the grantors put their assets into one trust name—for example, “The John Smith and Mary Doe Revocable Trust.” Typical provisions allow both of them to be trustees, and when one dies, the survivor continues on in control of all the trust assets without restriction on the ability to use the trust assets and may still have the full right to change the trust terms in any way the survivor desires.

But restrictions can be put into the trust language. For example, there may be a requirement that a survivor cannot change the trust terms in such a way as to disinherit the family of the first trust grantor to die—sort of an anti-disinheritance clause. The terms of the trust may also have different results as to distribution of trust assets, depending upon who is the last to die. So if John were the survivor, the assets would be split one way, and if Mary were the survivor, they would be split differently. Often the two grantors will agree on appointing co-successor trustees—one from his side of the family and one from hers.

Individual trusts are most often used for single people who are not in a joint relationship, but not always, as I will explain. The one-person trust has one grantor, and all assets are funded into the name of that trust. The grantor retains all authority over the trust and its assets and controls who gets what and when after he dies.

Married couples often have individual trusts primarily for tax purposes, but also for spousal and family protection.

The traditional estate planning method attorneys have used for married couples with an estate that is potentially subject to estate tax is the so-called "A/B trust." This is really two trusts—a husband trust and a wife trust. The couple's assets are split, with a portion going to one and the rest to the other. At the death of one of the spouses the trust of the deceased is then divided into two portions, an A trust and a B trust. To avoid confusion, we will call the A trust the family trust and the B trust the marital trust.

The survivor usually has some significant restrictions on the use of the assets in the deceased partner's family trust. The income from the family trust is payable to the survivor along with up to 5 percent or $5,000 per year of the principal, whichever is greater. Other than that, the principal itself may not be invaded unless the assets in the survivor's trust are insufficient to maintain the survivor's normal and accustomed standard of living.

At the death of the survivor, both trusts would be distributed to the ultimate beneficiaries named in the trusts. The advantage of this rather cumbersome arrangement is a doubling of the estate tax exemption to avoid estate tax. This is a very necessary objective when the estate tax exemption is low. Estate taxes are charged on the value of an estate that exceeds a minimum threshold. Right now, that amount is quite high at $5.45 million and is supposed to be permanent, but seems to change with each president. So for most of us, estate taxes are not a concern. We still sometimes use this method for large estates, although I refer these to tax experts for planning.

There is a simpler way that utilizes a joint trust to accomplish the same thing. What I call the joint option trust allows all the advantages of the simple joint trust but retains the tax advantages if necessary. This is a good option for couples who agree on an ultimate plan of distribution and who will be the successor trustee. The language of this trust states that at the death of one grantor, the survivor determines whether the current asset size of the joint estate is more than the current estate tax exemption amount. If it is not, the survivor needs to do nothing and has no restrictions on the use of all the trust assets from then on. If it is more, the survivor then allocates the excess taxable portion to a family trust and the balance goes to the marital trust. As we know, there are no restrictions on the marital trust, so this is a great advantage to a surviving grantor.

Single trusts are used by married couples for other reasons. Let’s say the wife has a lot of assets that were brought into the marriage and wants to be sure that her husband is cared for during his lifetime. However, she also wants to be sure that at the death of her husband the remaining assets go to her children. She can create a single trust funded with her assets that contains these provisions. She and her husband may also create a separate joint trust for their other assets, and he may have a single trust of his own with similar provisions to hers.

Other kinds of trusts include such things as educational trusts for children, land trusts, and various kinds of charitable trusts, which provide income to the grantor for life with the trust going to the charity at death. There are many others, which I did not cover because the focus of this book is on trusts for the majority of people who are not likely to need tax planning or complex estate plans. Other tax issues such as stepped-up tax basis for capital gains assets are in the venue of your tax advisor or attorney.