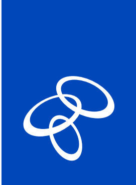


UNITED CAPITAL

MOST COMMONLY USED TRUSTS

TRUSTS ALLOW YOU TO MANAGE your property, control your wealth, and minimize the amount that goes to pay taxes. There are many varieties of trusts, each designed to accomplish specific goals. Each type of trust has its own set of rules and unique advantages and disadvantages. This piece provides an overview and key considerations for the most common types of trusts.

Revocable Living Trust

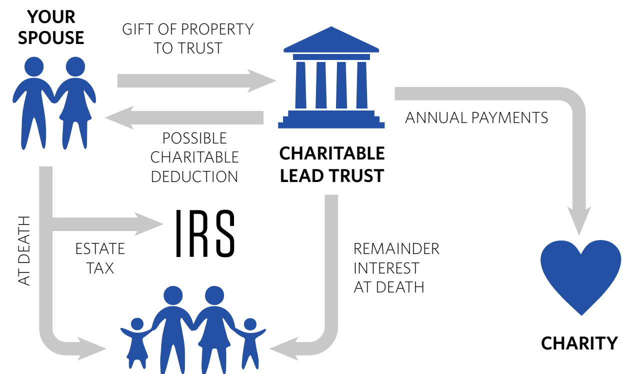
A revocable living trust (RLT) can help you manage your assets and offers a way to protect your assets and interests should you become ill, disabled, or otherwise incapacitated. Properly worded, a living trust can also be used as a substitute for powers of attorney. A living trust can be changed any time prior to death, at which time it might become irrevocable. A living trust operates in three stages: while you are alive and in good health, when you become incapacitated, and when you die. While you are in good health, you can manage, spend, and invest the assets of the trust. If your health fails and you become incapable of managing and investing the trust funds, your successor disability trustee will take over those responsibilities. Once you pass away, your successor trustee will pay your final bills, debts, and taxes, and distribute remaining funds according to trust provisions.

KEY CONSIDERATIONS

A living trust gives you control over who would handle your financial affairs in the event of incapacitation. Absent a trust, a guardian would have to be appointed. Revocable living trusts also help you avoid the probate process. This could save your beneficiaries time and money. It also protects your privacy and financial risk. Because they can be altered or amended at any time, living trusts pose relatively low financial risk. One drawback is that these types of trusts do not minimize estate taxes.

Charitable Lead Trust

A charitable lead trust (CLT) allows you to gift assets to heirs at a discounted value while also providing a consistent annual gift to charity for a predetermined length of time. It's also called an irrevocable split interest trust. The charity receives income for a period of time and your other beneficiaries (your children) get the remaining assets left once the income period expires. The income term could extend for a period of years or it could expire on your death. There are two basic types of CLTs. A grantor CLT is where you or your spouse would receive the remaining trust assets after the income period. A non-reversionary CLT may be appropriate if you want your children or someone other than you or your spouse to get what is left after the income period. For gift tax purposes, the present value of the income interest received by the charity reduces the value of the CLT gift.



KEY CONSIDERATIONS

A charitable lead trust allows you to accomplish charitable goals while also minimizing gift or estate taxes. It allows you to provide a reliable income stream to your favorite charity for as long as you would like. The financial benefit to you is that any leftover assets going to your noncharitable beneficiaries can be transferred free of federal gift and estate taxes. If you used a grantor CLT, you could claim an income tax deduction equal to the present value of the promised income stream to charity. If you are seeking income tax deductions rather than estate tax deductions, this might be a worthwhile strategy for consideration. If, however, you were looking for estate tax savings, you may want to consider a non-reversionary CLT. With non-reversionary CLTs, the value of your estate does not include the CLT (and any future growth). Like the grantor CLT, the present value of the charity's income stream reduces the value to your heirs for gift tax purposes. Even if the investment growth rate exceeds the income paid to the charity, the trust assets escape additional taxation. Gifts to CLTs do not qualify for the annual gift exclusion.

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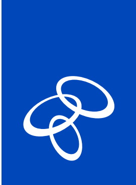

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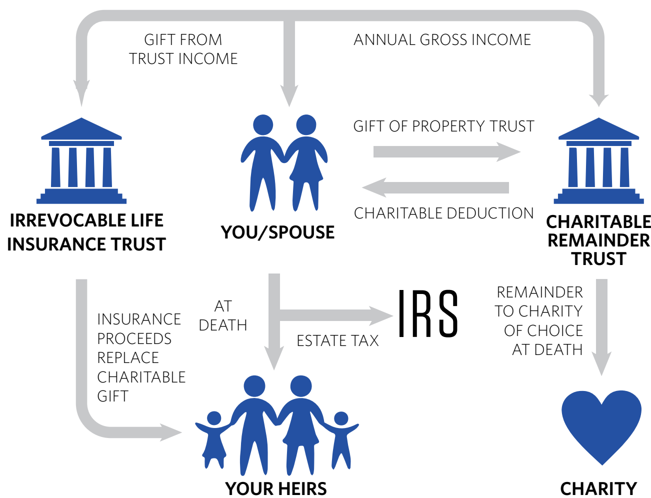
MOST COMMONLY USED TRUSTS (cont.)

Charitable Remainder Trust

A charitable remainder trust (CRT) is the flip side of the coin to the charitable lead trust. A CRT lets you donate property and assets to a trust with the charity as the ultimate beneficiary, and the income stream comes to you for a specified time or for your lifetime. Your income preferences dictate whether you use a charitable remainder annuity trusts (CRAT) or a charitable remainder unitrust (CRUT). A CRAT pays you a fixed dollar amount, at least annually, based on assets initially transferred to the trust. A CRUT pays a fixed percentage rate, varying the payout based on annual fluctuations in trust property value.



If you have highly appreciated or non-income producing property, a CRT might be worthy of consideration. The trust can sell the donated property without paying capital gains tax and invest the proceeds in an income-producing, diversified portfolio. You will receive income at least annually, and, at the end of the specified term, the charity receives what is left. You obtain a current income tax deduction based on the present value of the charity's future interest. The term of the trust can be for any number of years up to 20, for your life, or for the lives of you and your spouse. At the end of the term, the remaining assets go to your designated charity. If the CRT generates a growth rate greater than the amount due, the trust assets will grow over time and represent a potential windfall for your charity.

KEY CONSIDERATIONS

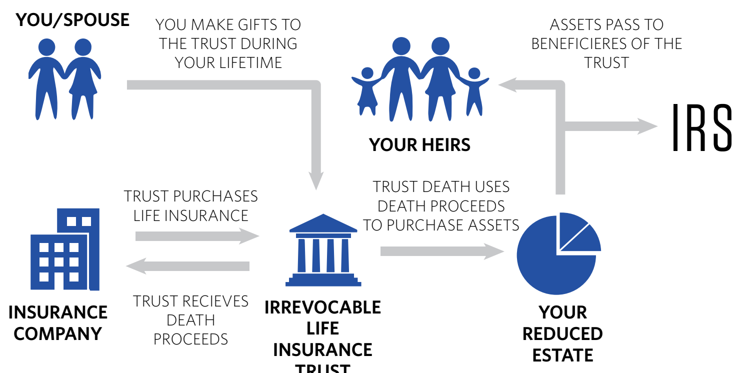
Your gift to a CRT removes the assets from your estate, thus creating estate tax savings. As long as you or your spouse receive income, no gift taxes are due. You also receive a charitable income tax deduction based on the money you expect to designate to the charity at the end of the term. Any assets remaining in the CRT at termination of the term pass to the specified charities. The potential risk in this strategy is that it is irrevocable. You permanently transfer control over the assets to the trust. Also, the income distributed is taxable. At the end of the term, the trust assets go to charity, and nothing (from the trust) passes on to your children.

Irrevocable Life Insurance Trust

Many people mistakenly believe that if they buy a $1 million life insurance policy, then $1 million would go to their beneficiaries. What they don't realize is that death benefits may be included in your gross estate for federal estate tax purposes. An irrevocable life insurance trust (ILIT) provides tax-free liquidity to your estate and can help preserve real estate, family business, or other illiquid assets. With an ILIT, the trust becomes the owner of the life insurance policy either previously owned by you or of a new policy purchased. Non-taxable annual exclusion gifts can be made to the trustee to pay the premiums on the policy. When you pass, the full death benefits will go to your beneficiaries. This planning technique serves as the foundation to many people's overall estate plan and is popular with business owners and people with sizable assets.

KEY CONSIDERATIONS

An ILIT maximizes the value of your life insurance policy. There are, however, two potential drawbacks. One is somewhat obvious: As the name suggests, the policy is permanent. You can't change beneficiaries at a later date. Another potential disadvantage is that, unless you have an existing life insurance policy, you will have to apply and qualify for the ILIT to purchase. Depending on your health and other circumstances, the premiums may be prohibitively expensive, or your application for insurance could be denied.



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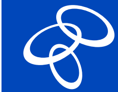

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MOST COMMONLY USED TRUSTS (cont.)

Special Needs Trust

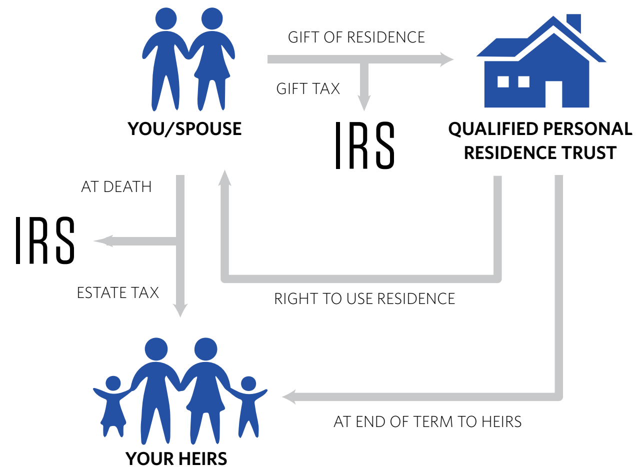
A loved one with special needs raises complex financial and emotional concerns, particularly when planning for a time you can no longer provide care. A special needs trust (SNT) allows you to provide funding for specific purposes to benefit a disabled person, even after your death. While a SNT fund cannot pay for food, clothing, and other expenses deemed maintenance, they can be used to improve the person's quality of life. For example, the funds could pay for enrichment programs, vacations, travel, sports equipment, or other therapeutic needs.

KEY CONSIDERATIONS

The funds used to create the trusts are tax-deductible. The trust can help maintain the person's eligibility for Medicaid while covering service and care above and beyond what the government provides. Another significant advantage is that creditors cannot go after trust assets. A potential disadvantage is that the disabled person can't control his or her own money. Even at the age of majority, he or she must make a request to the trustee and rely upon the trustee's interpretation of the trust. Another potential drawback happens when the disabled person dies. Any money left in the trust must first reimburse Medicaid for payments made on the person's behalf before passing to the family. For many, this is not an issue because caring for the person before his or her death depletes trust assets. Careful planning and structuring of the settlement may minimize or eliminate this issue.

Qualified Personal Residence Trusts

A qualified personal residence trust (QPRT) has significant estate and gift tax savings and requires only minimal lifestyle changes. It involves making a gift of personal residence to a qualified personal trust. A common example is when someone transfers his or her interest in a vacation home to a QPRT for the benefit of his or her children, but retains the right to live there for a number of years. At the end of the specified time, the trust terminates and distributes the residence outright to the children. In some instances, the grantor can rent the residence from the trust at the end of the term. The beneficiaries' right to own and use sometime in the future is not as valuable as if they had the right to own and use immediately. Therefore, the value of the gift to the trust is reduced for tax assessment purposes. For example, if you created a QPRT with a $1 million beach house, the transfer would still be a taxable gift. Because you retain the right to live there for 10 years, the gift would have less than a $1 million value. Instead, it would equal the actuarial value when the property goes to the beneficiaries at the end of the 10-year term. The term of the retained interest, your age, and the monthly interest rate set by the IRS for the month of the actual transfer all impact the trust.



KEY CONSIDERATIONS

This is an appealing strategy because it allays the fear of giving away too much during your lifetime. The value of your estate is reduced because the trust owns the residence, not you. This strategy has an associated mortality risk. If you die before the end of the term, your estate includes the value of your interest. Also, the IRS could challenge the value of either the discount taken or the remaining interest. Furthermore, the stepped-up basis is lost at death if your child sells the residence after your death for estate liquidity or other reasons.

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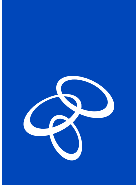

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MOST COMMONLY USED TRUSTS (cont.)

Spendthrift Trust

When you've worked hard to accumulate wealth, it is distressing to think that your legacy may be mismanaged or squandered. A spendthrift trust (ST) places the control of your money into the hands of a responsible trustee who determines, either through your specific instructions or through their own common sense, the appropriate reasons to release the funds. The trustee manages, oversees, and controls the asset distribution. Beneficiaries can't touch the assets until they receive the distribution. Another significant benefit is that the beneficiaries' creditors cannot access the funds either.

KEY CONSIDERATIONS

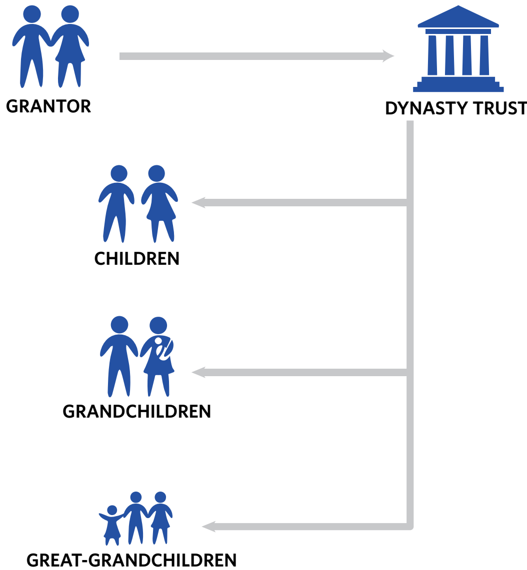
Assets in a spendthrift trust have three main benefits. They allow you to provide for a beneficiary while also protecting and controlling your assets. The spendthrift's creditors cannot access funds held by the trust. These trusts have the potential of causing family strife, particularly if a spendthrift trust applies to only certain children, while others have traditional trusts. Another disadvantage is that the trust cannot protect the money once it is in the hands of the beneficiaries. Courts consistently garnish trust payments for things such as child support, alimony, and back taxes.

Dynasty Trust

A dynasty trust (DT) is a trust that could go on indefinitely because it is used to transfer wealth efficiently to multiple generations. It is a strategy that takes advantage of the federal generation skipping transfer tax exemption. It allows money to accumulate inside the trust without the direct transfer of assets to any beneficiaries and excludes the assets from your taxable estate. If structured properly, it could potentially exclude the assets from your beneficiaries' taxable estates as well. To establish a dynasty trust, you create an irrevocable trust for the benefit of one or more beneficiaries such as children or grandchildren. Your trustee can distribute income and/or principal for the beneficiaries' reasonable support, medical care, and/or best interests. It can be structured to allow beneficiaries to give some or all of the trust's assets to any one or more descendants. Assets remaining after the beneficiary dies pass to similar dynasty trusts for the next generation. Keep in mind, though, that you can only transfer to an amount equivalent to your generation-skipping transfer tax exemption ($11.12 million worth of assets in 2018). You should note that $11.12 million is the lifetime maximum amount that can be transferred free of gift tax.

KEY CONSIDERATIONS

A dynasty trust is the simplest way to transfer wealth to future generations. It is a strategy that can result in significant estate tax savings. The assets you put in the trust (plus, any increase in their value over time) are subject to the federal gift/estate tax only when transferred. They do not get taxed again, regardless of the multiple generations benefiting. By contrast, if you simply left a large amount of money to your children (without a trust), it would be subject to the estate tax. Whatever they left to their children would be taxed again. If you tried to avoid one of those "tax events" by leaving assets directly to your grandchildren, the federal, generation-skipping transfer tax could apply. Another significant benefit is the credit protection it affords for future generations. Dynasty trusts give you a great deal of control. Without knowing what the future might hold, you determine your beneficiaries and decide what rights they will have. Usually children are the first beneficiaries and, when they die, grandchildren become the beneficiaries. Your descendants will have little control over the money held in the trust. This is the most expensive strategy from a gift tax perspective because the full value of the assets needed to fund the trust counts in the gift. You do not preserve your unified credit for other strategies or for use by your estate at death.



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