THE ESTATE PLANNING & LEGACY LAW CENTER

INFORMATION PACKET

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WHAT IS A TRUST?

The concept of a trust is straightforward. A **trust agreement** is nothing more than your written instructions directing someone (the "trustee") on how to manage your property (the "corpus") for the benefit of your beneficiaries.

There are four components to a trust: (1) the settlor (the person who creates the trust), (2) the trustee (the manager of the trust), (3) the beneficiary (the entities or individuals receiving benefits from the trust), (4) the corpus (the trust property/assets).

> **TIP:** Each component is necessary to create a valid trust. For example, a trust without a corpus may not be valid. It is for this reason that most trusts are funded with something at the time it is created, even if it is only $1.00.

A trust is often an integral component of an estate plan. Settling upon the type of trust best suited for your particular estate plan should be based on considerations relating to your particular goals and objectives.

TYPES OF TRUSTS

Trusts can be categorized in several different ways:

- Living vs. Testamentary
- Revocable vs. Irrevocable
- Funded vs. Unfunded
- Self-Trusteed vs. Third-Party Trusteed

There are several types of trusts within each of these categories.

> **TIP:** In many estate plans the use of a revocable, self-trusteed trust as your basic estate planning document is a good option.

Living vs. Testamentary Trusts

Trusts can be created by a person either during life or after death. A trust created by a person during his or her lifetime is commonly called a **"living trust."** A trust can also be created after death through provisions in a decedent's last will and testament. This is called a **"testamentary trust."** Both living trusts and testamentary trusts can be used to implement estate tax planning techniques that shelter assets from the federal estate tax with a "credit shelter trust."

Revocable vs. Irrevocable Trusts

A **revocable trust** can be modified or even completely revoked by the person creating the document. This makes it a flexible tool for use in estate planning, since the settlor can change the terms of the revocable trust to meet the needs of the evolving family. One of the common advantages of a revocable trust is that the assets in the trust avoid probate, while the settlor retains control over the property.

An **irrevocable trust** cannot be changed after it is created. For that reason, it is critical that the language of the trust does what you want it to do before it is signed and funded. Normally, the creation and funding of an irrevocable trust is a taxable event. Irrevocable trust are used to remove assets from a settlor's estate through transfers of insurance or other property for the ultimate beneficiaries, who are usually younger generation family members. In some circumstances, an irrevocable trust may also be used to insulate assets from creditor liability.

- **NOTE:** Every revocable trust becomes irrevocable upon the death of the settlor.

Funded vs. Unfunded Trusts

Trust can also be characterized as either funded or unfunded.

A **funded trust** has assets (other than the nominal $1.00) titled in the name of the trust. Revocable trusts can be funded with assets any time and there are varying reasons to fund a trust during life, rather than waiting to fund the trust through provisions of your Will. For example, some individuals fund a trust if they want the trustee to begin managing the assets placed into the trust. Self-trusteed trusts are funded if the settlor (who is also the trustee) wants to avoid the probate process to transfer those assets at the death of the settlor).

An **unfunded trust** is a trust with just some nominal property (typically $1.00) as its assets (since some sort of corpus is typically required to have a valid trust). With proper planning, an unfunded trust can be just as effective as a funded trust to reduce estate tax liability. Unfunded trusts become funded when a decedent dies and the property passes to the trust through the Will. However, the property that is ultimately transferred into the trust must first pass through the probate process to get into the trust.

Self-Trusteed vs. Third-Party Trusteed Trusts

A **self-trusteed trust** is a trust with the settlor also serving as the initial trustee. This permits a person to create a trust and fund it with assets, while not having to give up control over the assets. A self-trusteed trust document typically provides that upon the death, resignation, or incapacity of the settlor/initial trustee, a successor trustee takes over.

A **third-party trusteed trust** is a trust created with someone other than the settlor (another individual or a corporate entity, such as a bank trust department), as the trustee. This independent, third-party trustee is charged with the fiduciary responsibility of managing the trust for the benefit of the beneficiaries.

HOW TRUSTS WORK

Trust work in different ways and with different goals, but in all cases, they are governed by the directions set out in the trust agreement. As the settlor (creator) of the trust, you provide the "rules" which the trustee will follow.

Typically, the settlor creates the trust by signing a valid trust agreement and adding at least some sort of assets into the trust corpus.

If the trust remains unfunded (other than the nominal assets to make it valid), then the trust is inactive, since there are no assets to manage. If the settlor (or someone else) adds assets to the trust (by retitling the assets into the name of the trust or making distributions to the trust from retirement accounts, a probate estate, or other source), then the trustee named in the document must manage and care for those assets. The trustee might be the settlor, a family member, some other trusted individual, or a professional bank or trust company (or a combination of these).

The trust document will provide instructions on how the trustee should manage those assets, including when the trustee should pay out income and /or principal to the trust beneficiaries.

The trust document may also set out the powers of the trustee to handle specific tasks, such as providing accountings of trust activities to the trust beneficiaries, paying taxes and, dealing with special assets or restrictions placed on certain beneficiaries. The document will also direct what happens if the serving trustee resigns or can no longer serve in that role by naming a successor trustee or a method for naming someone else to take over that role.

The trust will continue until the trustee distributes all of the trust assets and terminates the trust, again based on instructions provided in the trust document.

- ❖ **NOTE:** Remember, assets managed by the trust are not owned by the settlor—they are owned by the trust. As a result, when the settlor passes away, the trust assets do not need to be transferred through a probate process; the trust will direct what happens, if anything, at that point.

WRAP UP

- A trust agreement is a document containing instructions directing the trustee on how to manage property for the benefit of the beneficiaries.
- Trusts can be categorized in several different ways, including: living vs. testamentary, revocables vs. irrevocable, funded vs. unfunded, and self-trusteed vs. third-party trusteed trusts.
- Trusts can be an excellent way to control the distribution of your assets in a private and efficient manner.

For more information on this topic, contact us any time!

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