A Matter of Trust

Once you create a trust, it takes on a life of its own.

Like a will, a trust is a written document that transfers property. But while a will is a statement of what you want to happen to your possessions after you die, a trust is a multipurpose tool that you can establish at any time to:

- Manage your property
- Distribute assets to your beneficiaries
- Avoid probate
- Save on taxes

Since no single trust can accomplish everything you may want to achieve, you can establish different trusts to serve different functions or benefit different people or organizations. It’s also true that restrictions on the trusts vary. To reduce your taxes, for example, you have to put your property into a permanent and unchangeable trust. But trusts you established solely to manage your assets can be changed as your circumstances change.

MONEY MATTERS

Creating a trust isn’t cheap. There’s a legal fee—sometimes substantial—for establishing it, and a fee when you transfer ownership of the property to the trustee. The trustee is also entitled to a fee for following your wishes, filing tax returns, and overseeing the investments. Most experts agree that trusts have limited value if you’re talking about property worth less than $50,000 to $75,000. Some bank trust departments, for example, set a minimum figure—usually in that range—before they’ll talk to you about a trust.

HOW TRUSTS WORK

The Donor
- Sets up the trust
- Names the beneficiaries
- Names the trustees
- Transfers property to the trust

The Beneficiaries
- Receive the benefits of the trust, according to its terms

The Trust
- Earns income
- Pay taxes
- Distribute benefits

The Trustees
- Control the property in the trust
- Manage the trust’s investments
- Oversee payments

A FIDUCIARY RELATIONSHIP

If you have fiduciary responsibility, your part of the bargain is to act in the best interests of the beneficiary or beneficiaries. In a trust, it’s the trustee who is the fiduciary, acting on behalf of the beneficiary.

TRUST ALTERNATIVES

If you want some of the advantages but not the expense of a trust, you can put your bank and brokerage accounts, as well as US savings bonds, in trust for a beneficiary. At your death, the money goes directly to your designee, outside the probate process. It’s similar to naming beneficiaries of insurance policies and employee benefit plans.

One limitation, of course, is that you can’t control what your beneficiary does with the money once it becomes his or hers, the way you often can with a trust agreement. And, though you avoid probate, the amount in these trusts is part of your estate and may be subject to estate tax.

THREE TYPES OF TRUSTS

Though there are many different types of trusts, each designed to achieve a certain goal, all trusts are created in one of three ways.

Testamentary
A testamentary trust is created by your will, funded by your estate, and administered by a trustee named in your will. Its primary goals are saving estate taxes and appointing someone to manage the assets included in the trust.

Living, or inter vivos
A living, or inter vivos, trust is set up while you’re alive. You can serve as the trustee yourself — though you usually name someone to succeed you when you die or if you’re unable to serve. Its primary goals are asset management and transferring property outside the probate process. There may or may not be tax advantages.

Pour-over
A pour-over trust is created while you are alive, but funded after you die. Its primary purpose is to receive one-time payouts like life insurance or pension benefits or the residue of your estate — that is, any property you haven’t transferred specifically to someone by gift, trust, or will. There may or may not be tax advantages.

BENEFITS OF CREATING TRUSTS

- Taking advantage of the federal gift tax exemption to transfer assets tax free
- Providing income to one person during his or her lifetime and, eventually, what is left to others
- Protecting assets rather than leaving them outright to heirs
- Using professional investment management
- Transferring assets outside the probate process

CREATING A TRUST

As the person creating a trust—known as a settlor, donor or grantor—you decide the terms of the trust, name the beneficiaries, decide which property will be included, and choose the trustee, or trustees, who will control it. You can also specify how the trust’s assets will be paid to your beneficiaries and how long the trust will last.

You specify what happens to the property you transfer to a trust by establishing the ground rules for how the assets will end up in your beneficiaries’ hands. For example, you can set up a trust so that all the property goes directly to one person when you die. Or the terms of the trust might say that assets should be used for major investments like houses or business opportunities, or to pay for college tuitions.

All that information is contained in the trust document, which should be drawn up by a lawyer. You don’t want to run the risk of writing your own.

Since the main purpose in creating a trust in the first place is to accomplish a specific goal, it should be structured to satisfy federal and state requirements, especially between now and 2011, as estate tax rates and rules go through a decade of change.