



A Guide to Understanding Trusts

Living Trusts

A Living Trust is a legal document established by a person (Trustmaker) to hold assets for the benefit of the Beneficiaries named in the Trust with a Trustee managing the trust assets. Most people who create a Living Trust act in all three positions (Trustmaker, Beneficiary, and Trustee) and name successor beneficiaries in the event of their death and Successor Trustees in the event of their death or incapacity.

A Living Trust becomes a separate legal entity, like a corporation, but it takes on the social security number of the

Trustmaker. Therefore, since there is no separate tax form filed for the Living Trust, the Trustmaker continues to file his or her taxes just as before.

Families, couples, and individuals who have assets and/or dependents need an Estate Plan. Living Trusts can be used to effectively plan for the future with great flexibility. Living Trusts may be fundamental to your planning regardless of your financial objectives, concerns, or net worth.



The Advantages of Living Trusts Include:

- Assets in the Living Trust are not subject to probate. This saves executor and attorney fees. It also grants more privacy as to who gets the estate, when they get it, and how much they get.
- The Successor Trustee can step in and manage the estate without delay or "red tape" when the Trustmaker dies. The Trustee can also control assets in any state without going through probate.
- A Successor Trustee can be designated to take over management if the Trustmaker becomes mentally incompetent or wants to be free of the worries of management. A Living Trust prevents court control of assets at the Trustmaker's incapacity.
- A Living Trust can be amended or cancelled at any time.
- Annual court accountings, with accompanying legal fees, are not required.
- A Living Trust can be used to reduce or eliminate estate taxes.
- A Dynasty Living Trust can protect your non-retirement assets for generations and protect your heirs' inheritance from future ex-spouses, lawsuits, and other claims. (See below for more information on Dynasty Living Trusts.)

What is a Living Trust?

A Living Trust can put your wealth to use in exactly the way you wish, accumulate assets for retirement or for your beneficiaries, and much more. It is a misconception that only wealthy individuals benefit from Living Trusts. In fact, Living Trusts have significant flexibility and can provide for a combination of needs, circumstances, and objectives as described in the following examples:

Business owners and individuals who wish their financial affairs to be private

A Living Trust can be the owner/member of a corporation or limited liability company with you acting as the Trustee of that Living Trust. Because of their private nature, Living Trusts can also hide assets and their disposition from the public. On the other hand, not having a Living Trust subjects your business to the open and public forum of probate. This gives competitors access to confidential information about a business you worked hard to build.

Dependents

A Living Trust can be used to provide regular income to dependents. You can use a Living Trust to control mandatory or discretionary payments to your dependents to accommodate for their education, medical, and varying support needs. It can also provide for the passage of your property without the expense, delay, or publicity of probate which may be of greater concern when dependents are your beneficiaries. The Living Trust can provide professional investment management for

family members, including dependents, who lack this skill. Restrictions on dependents can eventually be lifted, or they can eventually become Trustees when they reach a certain age.

Spouses in second marriages

A Living Trust can be used to protect the interests of children from a previous marriage.

Parents of children with special needs

A Living Trust can ensure that children and others with special needs will have their financial concerns properly addressed.

Individuals concerned about becoming ill

A Living Trust can ensure that your financial affairs will be handled properly if you become ill or mentally incompetent. A Living Trust permits you to name a Successor Trustee to oversee these responsibilities when you can no longer act as Trustee. This allows for a smooth transition and avoids any pushback with the use of a power of attorney document.

Unmarried couples and close friends

A trust can provide a "significant other" with income for life while keeping assets in the Trustmaker's family. Upon the death of the loved one, assets can revert back to a family member or to a specific charity.

How to Use a Living Trust

A Living Trust is used to ensure the orderly and private transfer of property to another individual and to provide for loved ones. Living Trusts can help avoid probate costs and protect assets from creditors' claims of your beneficiaries. They provide a structured way to administer your personal and financial affairs should you become incapacitated, and are also used to make tax-advantaged charitable gifts. You can rely on the Successor Trustee of your Living Trust to manage assets for the benefit of your heirs and other beneficiaries. Additionally, Living Trusts can be used to avoid unnecessary capital gains taxes and manage your estate tax exposure.

When a Living Trust is established, you should transfer assets from your name into your Trust's name, which you control. Legally, you do not own these assets as they are owned by your Trust. Therefore, there is nothing for courts to control when you die or if you become incapacitated, allowing your estate to avoid probate.

Whether a Living Trust contains \$100,000, \$700,000, or \$2 million, it can make an immeasurable difference in the lives and circumstances of individuals with varying financial needs and considerations.

Types of Wills and Trusts

BASIC WILL: A basic or simple Will generally gives everything outright to a surviving spouse, children, or other heirs. The assets will be subject to probate administration unless assets are under the state probate exemption amount.

WILL WITH CONTINGENT TRUST: Frequently, married couples with minor children will pass everything to their living spouse. If there is no living spouse, then everything will be passed to a trust for their minor children until they reach a specified age. The "contingent trust" is a testamentary trust that is created after the testator passes away. Although this trust may have provisions incorporated in it for federal estate tax planning, a will with a contingent trust does not avoid probate proceedings.

POUR-OVER WILL: A "Pour-Over Will" is used in conjunction with a Living Trust. It picks up any assets that are not transferred to the Living Trust during the Trustmaker's lifetime and "pours" them into the Living Trust upon death. The assets will be subject to probate administration, however, which is one reason it is so important to properly fund a Living Trust.

LIVING CREDIT SHELTER/QTIP TRUST: By adding another trust to the credit shelter trust, the first spouse to die can determine the beneficiaries of his or her estate after the surviving spouse dies. For example, the income earned on assets in the QTIP Trust must be given to the surviving spouse for his or her lifetime, but can then pass to the children of the first spouse to die.

REVOCABLE LIVING TRUST (Inter Vivos Trust): As discussed in this Guide, a Living Trust is a legal agreement created during a person's (Trustmaker's) lifetime when he or she transfers a property interest to a Trustee (themselves, another person, or a corporation) to be held for their benefit or the benefit of others (Beneficiaries). When the Trustmaker retains the right to dissolve the Living Trust, it is a Revocable Living Trust.

A Successor Trustee is named in the Living Trust to handle your personal finances in the event you become incapacitated and can no longer handle your affairs, and after your death.

Since there is nothing to probate with a properly funded Living Trust, trust assets are free from probate costs upon your death. You can playce just about any type of property in a

Living Trust and either withdraw or reinvest all of the income generated by trust assets during your lifetime. Since a Living Trust is a private agreement, information concerning the contents of it remains private. You can also modify its terms, change beneficiaries, or terminate it altogether as your goals and needs change. Depending on your wishes, the trust property can either be disbursed and the Living Trust will cease after your death, or it can continue on for your beneficiaries (Dynasty Living Trust, see section below).

The flexibility of a Living Trust makes it ideal for a wide range of individuals.

IRREVOCABLE TRUST: The terms of an Irrevocable Trust cannot be changed. This type of Trust may save you substantial amounts in federal and state income taxes and estate and inheritance taxes depending on the size of your estate. You can either create an Irrevocable Trust during your lifetime, or provide for one to be established upon your death through the terms of your Will or your Revocable Living Trust.

IRREVOCABLE LIFE INSURANCE TRUST: Irrevocable Life Insurance Trusts keep the proceeds from a life insurance policy out of your taxable estate and provide beneficiaries with the means to pay estate taxes or replenish the assets consumed by taxes. This avoids a distress sale of a business, a farm, real estate, or other special assets, and it is frequently used where a family's assets are large and illiquid. It also offers significant long-term estate tax savings and generation-skipping transfer tax savings for your children and grandchildren.

SPECIAL NEEDS TRUST: A Special Needs Trust is generally established for a specific purpose, such as to meet the varying needs of a disabled child. This need may pertain to the beneficiary or the owner of the Trust.

MINOR'S AND EDUCATION TRUST: A Minor's and Education Trust is used to convey gifts to children or grandchildren without tax to your estate. You may give a minor child an amount equal to the annual gift tax exclusion without filing a federal gift tax return or paying gift taxes. These Trusts also provide significantly more control, flexibility, and benefits than a conventional Uniform Gift to Minors Account (UGMA) or Uniform Transfer to Minors Account (UTMA).

Dynasty Living Trusts



A Dynasty Living Trust ("Dynasty Trust") offers tremendous estate tax advantages as well as significant asset protection for your heirs over countless generations. Dynasty Trusts give you the opportunity to provide for your children, grandchildren, great-grandchildren, and successive generations with wealth that is estate tax-protected and creditor-protected.

Dynasty Trust planning in your revocable Living Trust could first provide for the care of your children's health, education, maintenance, and support. While your child is alive, he or she can also use this money to provide for their own children's (your grandchildren's) health, education, maintenance, and support. Upon the death of your child, the remaining trust assets would then pass to individual trusts for each of that child's children (your grandchildren). This pattern could occur

repeatedly through the generations, subject only to the limits of state law on the duration of the Trust.

Apart from providing for your children and grandchildren, Dynasty Trusts also provide asset protection for your heirs. Your heirs will typically be protected against claims from creditors and ex-spouses since the assets are owned by the Trust and not by your child or grandchild. Additionally, as long as the Dynasty Trust is to be used for the beneficiaries' health, education, maintenance, and support, the assets are not regarded by the IRS as being "owned" by your beneficiaries and therefore not taxed in their estates when they die. This allows a terrific opportunity for the growth of these funds to the extent they are not used to supplement the needs of your beneficiaries.

To see how powerful this could be over a long period of time, consider the following: Based on a 5% growth rate, \$5,430,000 would grow to be over \$438 million in the 90 years it would take for it to pass through three generations (assuming a 30 year age difference between generations). All the while, the beneficiaries would have comfortable access to money and could spend the entire amount if need be for an emergency such as a health crisis. Further, if bought and retained assets are in the name of the trust, they would always have the asset protection of the trust and would allow the trust to grow federal estate tax free over time.

To see what would happen by not using a Dynasty Trust, consider the following: If a family does not create a Dynasty Trust and that \$5,430,000 also grows at 5% over 90 years while each generation is now taxed at the 40% estate tax level, the money would have only grown to about \$188 million at the end of 90 years. Therefore, considering a 90-year interval using conservative growth numbers, the difference between using a Dynasty Trust and not using a Dynasty Trust would be about \$250 million.

How Long Can a Dynasty Trust Last?

A Dynasty Trust can last as long as state law allows. Most states fall within one of three categories regarding the duration of a Dynasty Trust: (1) States that adhere to the common law Rule Against Perpetuities which terminates the trust 21 years after the expiration of living individuals named in the trust; (2) States that have adopted the Uniform Statutory Rule Against Perpetuities (USRAP), which states that a Dynasty Trust can endure for the common law perpetuity period discussed above or, alternatively, for 90 years; or (3) States with no Rule Against Perpetuities which permit a trust to last perpetually.

You can consider the size of your estate when determining whether to implement a Dynasty Trust; however, determining factors and other key considerations are:

1. Whether you want your assets, no matter what the size, to be protected from future divorces and lawsuits that your children and grandchildren may face.
2. Whether you want your assets to grow and pass federal estate tax free through generations.

If you answered “yes” to either or both of these questions, then you may want to consider Dynasty Trust planning.

How to select a Trustee for your Trust

In a revocable Living Trust, you may serve as your own Trustee during your lifetime, but you must name a Successor Trustee to act on your behalf in the event of incapacity and/or after your death. You can choose your Successor Trustee to be:

- **An individual.** You can maintain control by appointing an individual whom you know well, such as a child, friend, or relative. You can even choose multiple individuals, such as two children, to act as “Co-Trustees.”
- **A bank or trust company.** When acting as a Trustee, a bank or trust company will typically charge a fee. The bank or trust company acts as a “corporate fiduciary” and is accountable to a number of state laws and regulations to ensure compliance with the instructions in the Living Trust.

Responsibilities of a Trustee

A Trustee’s main responsibility is to interpret and carry out the instructions you have written in your trust document. This may include managing your assets and distributing trust income and principal to your beneficiaries according to your wishes.

A Trustee’s responsibilities also include:

- Holding trust assets in secure custody
- Accounting for trust assets and income to your beneficiaries, and authorities, as necessary
- Complying with tax laws and filing tax returns
- Being sensitive to the needs of beneficiaries
- Maintaining records of trust transactions.



Trust Terms and Definitions

BENEFICIARY: A person who is entitled to receive benefits (usually money or other property) from a trust.

COMMON TRUST: A Common Trust is set up within a Living Trust and is created after the death of the Trustmaker (or in the case of a married couple, both Trustmakers). It allows for a Trustee to make distributions to a group of beneficiaries based on each beneficiary's specific needs rather than distributing an equal share to each beneficiary.

EXECUTOR/PERSONAL REPRESENTATIVE: The Executor (also known as Personal Representative) refers to the individual named in a Will with the responsibility to administer the estate.

FAMILY TRUST: Often used in a Dynasty Trust or when two separate Living Trusts are created for a married couple, a Family Trust is established upon the death of the first spouse. It includes trust property up to the estate tax exemption amount. The federal estate tax exemption is currently \$5.43 million and the state estate tax exemption varies by state. A surviving spouse may be restricted from the net income and principal based on whether he or she has remarried (with or without a prenuptial agreement). As with the Marital Trust, anything left at the end of the surviving spouse's lifetime must go to the issue of the Trustmaker.

GENERATION-SKIPPING TRANSFER TAX (GST TAX): A tax incurred when there is a transfer of property by gift or inheritance to a beneficiary who is two generations below (grandchild) or more than 37.5 years younger than the donor. It serves the purpose of ensuring that taxes are paid when assets are placed in a trust and the person receives amounts in excess of the generation-skipping estate tax credit.

HEIR/ISSUE: Heir and issue refer to lawful lineal descendants of all generations.

INTESTATE DISTRIBUTION: Intestate distribution is governed by state rules regarding how property must be distributed following the death of an individual without a will or trust (or with an unfunded trust).

MARITAL DEDUCTION: A deduction for estate and gift tax purposes for the amount of property that passes to a spouse.

MARITAL TRUST: Often used in a Dynasty Trust or when two separate Living Trusts are created for a married couple, a Marital Trust is established upon the death of the first spouse. Anything above and beyond what is allocated to the

Family Trust (see above) will be included in the Marital Trust. The surviving spouse has the right to receive the income and, based on the terms of the Trust, can receive principal distributions. Anything left at the end of the surviving spouse's lifetime must go to the issue of Trustmaker.

PER CAPITA: An estate that is distributed "per capita" is divided into as many equal shares as there are children or surviving descendants of deceased children.

PER CAPITA AT EACH GENERATION: An estate that is distributed "per capita at each generation" is divided based on the closest generation with living members. It is divided into as many equal shares as there are living members in that generation and members who died leaving issue. Each living member gets one share, and the issue of deceased members of that generation receive the remaining share(s).

PER STIRPES: An estate that is distributed "per stirpes" is divided into equal shares for each branch of the family.

PROBATE: The procedure in each state required to legally settle the estate of a deceased person and transfer his or her property.

TESTATOR: The Testator is the individual who creates the Will.

TRUST: A relationship in which one person (the Trustee) is the holder of legal title to property (the trust property) to keep or use for the benefit of another person (the Beneficiary).

TRUSTEE: An individual or professional organization that holds the legal title to property for the benefit of another person or persons.

TRUSTMAKER: An individual who creates the Trust. A married couple might create one joint Revocable Living Trust, in which case they will both be the Trustmakers of the Trust. They will also both serve in the role of initial Trustees and as initial Beneficiaries. The Trustmaker can also be referred to as a "Trustor," "donor," "grantor," or "settlor."

UNIFIED CREDIT: The unified credit is a federal tax credit which may be applied toward either gift or estate taxes that may be due. Currently, the unified credit is \$2,081,800, which is equivalent to a \$5,340,000 million dollar exemption.



1745 South Naperville Road Suite 200 Wheaton, IL 60189 Phone: 630-665-2300
Toll Free: 877-TRUST-50 Email: admin@trust-lawgroup.com

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