

WILL A TRUST HELP YOU?

WHAT IS A TRUST?

A trust is a legal relationship under which one individual (the “donor” or “settlor”) provides for the transfer of property to another (the “trustee”), who holds and manages the trust property for the beneficiaries.

TRUSTS OFTEN ARE CREATED FOR:

- Avoiding public disclosure of assets and financial data;
- Consistent and uninterrupted management of assets before and/or after the donor’s death, illness or disability;
- Preserving assets by preventing the beneficiaries, or their creditors, from gaining direct access to the trust property;
- Reducing income and/or estate taxes; and/or
- Eliminating or lessening costs and delays associated with probate administration.

There are a number of questions you should consider before creating a trust: What do I expect to accomplish? Will a trust fulfill my wishes? How much will it cost to establish and administer a trust? Whom shall I select as a trustee? Will I fund it during my life or at death?

WHEN TO CREATE A TRUST

You should create a trust only when there is a need or specific advantage, such as:

- Relief from the burdens of financial management;
- Creation of a flexible estate plan and minimizing estate taxes;
- As a vehicle for lifetime gifting;
- Providing support for an elderly or disabled family member;
- Shifting income and tax liability for a period of time;
- Facilitating charitable planning; or
- Avoiding public disclosure of assets in the probate process.

REVOCABLE (“INTER VIVOS” OR “LIVING”) TRUSTS

Perhaps the most common form of trust utilized in modern estate planning is the “inter vivos” or “living” trust. These trusts are revocable and amendable, meaning that you change their provisions or terminate them at any time. If you fund such a trust during your lifetime, the trust will allow you to designate a trustee to administer the assets in the event of your incapacity. This can, in many cases, help you avoid the publicity, inflexibility and expense of a guardianship. In addition, assets that are held in your trust upon your death will avoid probate (although they still will be subject to estate taxes, if applicable). Probate is a very public procedure, which entails disclosing an inventory of your probate assets, as well as the identities and addresses of your beneficiaries. For this reason, many prefer the privacy afforded by a trust, which generally does not entail such public disclosure.

Upon your death, these trusts generally become irrevocable, which means they cannot be changed, and the terms that you have provided will govern the ongoing administration of the funds over an extended period.

IRREVOCABLE LIFETIME TRUSTS

Trusts can be created that are irrevocable during your lifetime. These trusts can be created for the benefit of your spouse, children or grandchildren (or anyone else you would like to benefit). Transfers into irrevocable trusts are generally considered to be completed gifts, and thus can be useful in reducing the size of your taxable estate.

Irrevocable trusts often are utilized for making gifts to minors. These gifts can be utilized for educational funding or many other purposes. Assets can be held for the beneficiary until the beneficiary attains the age of majority or later — even throughout the beneficiary’s lifetime. Assets held in such trusts are generally unavailable to the creditors of the beneficiaries, so the trusts provide a high degree of asset protection (although, under Massachusetts law, you cannot create a trust that will protect you from your own creditors, you can provide this protection for others). Benefits of these trusts include allowing you to name an appropriate trustee to oversee the administration of gifted funds in the event a beneficiary lacks the financial expertise or sophistication to do so.

Irrevocable trusts also are useful for owning life insurance. Many people do not realize that life insurance is subject to estate tax if it is either payable to the estate of the decedent or if the decedent owned the policy upon death. Utilizing an irrevocable trust to own your life insurance can allow your death benefits to be received completely estate tax-free (as well as gift and income tax-free). This can provide your estate with much-needed liquidity. The trustee can purchase the otherwise illiquid assets of your estate at their full fair market value, thus eliminating the need to hold a “fire sale” to cover your tax liability.

TRUSTS AS PART OF ESTATE PLAN

Trusts often are used to minimize estate taxes and to provide ongoing support for the decedent’s spouse and children. Most comprehensive estate plans include a marital (spousal) trust and family (credit shelter) trusts. These two trusts are usually established within the same estate-planning document.

MARITAL TRUST

The marital trust is created (either during lifetime or by will) for the exclusive benefit of one’s surviving spouse and is designed to be exempt from estate taxes due to the unlimited marital deduction (it should be noted that the unlimited marital deduction is not generally available if the surviving spouse is not a United States citizen). The marital trust’s income must be distributed to the surviving spouse for life, and the trustee often is given a discretionary power to use principal for the additional benefit of the surviving spouse. The surviving spouse may

but need not be given rights to demand or receive principal (but there can be no other beneficiaries besides the surviving spouse during his or her life). The first spouse can maintain control over the disposition of the assets upon the death of the survivor — a very useful power in multiple-marriage situations. Alternatively, the surviving spouse can be given the authority to determine the disposition of the marital trust assets upon his or her death.

If the surviving spouse is not a United States citizen, estate taxes upon the death of the first spouse can be deferred by utilizing a special trust called a “Qualified Domestic Trust” or “QDOT.” These trusts, which must have a United States trustee, provide that estate tax is only paid upon the distribution of principal to the survivor. This can be vitally important to the surviving spouse’s financial well-being because it allows full pre-tax investment of the first spouse’s estate in order to generate income for the survivor.

Any property remaining in the marital trust upon the death of the survivor will be subject to estate taxes in the surviving spouse’s estate if the survivor’s estate is large enough to be subject to such taxes.

FAMILY TRUST

A family trust often is utilized to administer the assets of the decedent’s estate that are not subject to taxes due to the applicable exclusion amount. This is the amount federal taxing authorities allow you to transfer freely to any individual or group of individuals during your life or upon your death. The credit is currently \$1.5 million for transfers at death and \$1 million for lifetime transfers. The estate tax credit will increase incrementally over the next few years (although the credit for lifetime gifts will remain frozen at \$1 million) — eventually reaching \$3.5 million in 2009 unless Congress revisits the issue before that year — which many experts believe to be likely.

The family trust may be administered for the benefit of the entire family or just the surviving spouse. Funds in the family trust will not be considered part of the surviving spouse’s estate so long as appropriate restrictions have been placed on his or her control and use of those funds. A properly drafted family trust may thus provide substantial estate tax savings by allowing for the utilization of the applicable exclusion amounts of both the first spouse to die and the surviving spouse.

After the death of the surviving spouse, the family trust can be administered for the benefit of your children and their issue. The beneficiaries may be given rights to demand principal distributions at certain ages or the trustee may be given the authority to administer the funds over subsequent generations. This can provide significant asset protection benefits as well as substantial tax savings.

CHOOSING THE TRUSTEE

One of the most difficult tasks in the creation of a trust is choosing the right trustee or trustees. You may choose as your trustee or trustees an individual and/or a bank or other entity authorized to exercise trust powers (a corporate trustee). You should name a successor trustee in case a trustee should cease to serve. Factors you should consider in your choice are the trustee's:

- Understanding of what you are trying to accomplish;
- Experience as a trustee;
- Experience in making investments;
- Experience in making trust decisions;
- Experience with your type of situation;
- Understanding of the beneficiary's needs;
- Availability to serve for the full term of the trust; and
- Published fee schedule.

A TRUSTEE'S DUTIES AND FEES

The trust will describe many of the duties of a trustee. The law provides the rest. The trustee must manage the trust assets, invest them, keep records, prepare tax returns, make regular distributions of income (if required) and account to the beneficiaries. The trustee has a duty of loyalty and good faith. The trustee should be available to the beneficiaries to discuss the management and administration of the trust assets as well as the needs and objectives of the beneficiaries.

In Massachusetts, the court ultimately determines the reasonableness of the trustee's compensation. Many corporate trustees (such as banks and trust companies) base their fees on a percentage of the income and a percentage of the principal each year. Banks publish fee schedules, which are available to the public on request.

INSTRUCTIONS TO TRUSTEE

Remember that you are the author of your trust. You define its terms. You provide the guidelines under which the trustee will perform the trustee's duties. Your instructions may be simple or complex, but they should be clear. Provision for the distribution or accumulation of income and/or principal, the terms upon which your trust may be amended, who will be your successor trustee and a host of other issues will be essential components of your trust. Each of these decisions can have far-reaching consequences for yourself and your beneficiaries. These decisions should be made only after consultation with your lawyer and should be stated in a will or trust document prepared by him or her.

TAX ADVANTAGES

There are various types of trusts for you to consider in your individual, family and business planning. There can be significant tax advantages to you, your estate or your beneficiaries with a trust designed specifically for your needs. While not every type of trust is intended to produce a tax benefit, your lawyer can show you how skillful trust planning may help you save or at least defer the high cost of income, estate or gift taxes. If you already have a trust plan that was drawn some years ago, you should have your lawyer review it as these laws change often. When you create a trust, you should keep in mind that tax treatment is only one factor that should be considered together with your non-tax planning needs.

THE LAWYER'S ROLE

Since a trust is part of a comprehensive estate plan, it should be established only after the most careful consideration has been given to its advantages and disadvantages.

A lawyer can help in several ways. A lawyer can help you decide whether a trust will meet your estate planning objectives. The lawyer can prepare the trust documents and explain how it will operate and what the tax consequences of this trust will be. A lawyer can help you with completing the details involved in funding your trust during your lifetime as well as the best way to rearrange your property so that it reaches the trust with a minimum of delay and expense at your death. Your lawyer can help you in your selection of the appropriate trustee and then review with you the trustee's performance to insure that the trustee's duties are properly carried out.

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5:30–7:30 p.m. (617) 338-0610

■ Lawyer Referral Service

Open Monday through Friday, from 9 a.m. to 4:45 p.m., the Lawyer Referral Service helps solve legal problems by referring callers to lawyers or appropriate agencies. The LRS does not offer legal advice. There is no charge to use the service. To contact the LRS, call:

Boston area: (617) 654-0400
Toll-free: (866) MASS LRS (866) 627-7577
TTY: (617) 338-0585
E-mail: LRS@massbar.org
Web site: MassLawHelp.com

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When your attorney's fee is in dispute, call:

Statewide: (617) 338-0552
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