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The Use of Trusts in Estate Planning

Property held in a trust is available to trust beneficiaries as provided in the trust instrument and is administered and distributed by a trustee. The trustee can be an individual or an institution such as a bank or trust company. Each trust is individually tailored to fit the needs of the beneficiaries, but many fall into one of the general categories described below.

REVOCABLE TRUSTS

Revocable trusts are trusts which function as the alter ego of the creator of the trust. The creator, called the “grantor”, is the trustee as well as the beneficiary. Trust income and principal is available at any time to the grantor. The trust uses the grantor’s social security number and no separate tax return is required. These trusts are usually created to accomplish one or more of the following objectives:

- To avoid probate.
- To defer receipt of property for beneficiaries who are disabled, minors, of an age which the grantor believes is too young to manage the property without assistance or in a situation which it would be inadvisable to have direct access to a significant amount of money. The latter can result if a child has creditors, is in or anticipating divorce proceedings or has difficulty handling his or her financial affairs.
- To hold family property within the family line passing it down through generations to protect against divorce or creditor’s claims.
- To provide for unified management of assets by a knowledgeable or perhaps professional trustee.
- To reduce estate taxes.
- To provide management of assets for the grantor’s benefit should he or she become disabled.

As the applicable exemption amount increases, a substantial amount of wealth will pass to succeeding generations. Many individuals may desire to protect their estates from their children’s creditors, from the possible financial ravages of a child’s divorce and many will want to insure that the wealth that they have created continues in their family line.

Consequently, revocable trusts continue to be viable estate planning options and, in the era of repeal, they become the vehicle of choice. For estates less than \$1.3 million, a funded revocable trust could provide the decedent’s family with direct access to property with no costly probate for legal fees and no delay in distribution to the grantor’s heirs. For estates exceeding this amount, if the modified carryover basis rules are enacted, they provide a convenient base for the executor to comply with reporting requirements and the allocation of the step-up basis exemption.

IRREVOCABLE LIFE INSURANCE TRUSTS

Life insurance trusts continue to be viable, particularly during the interim period while the estate tax is applicable. Funding such trusts with term insurance can be a cost-effective way of hedging one’s bets but only the very optimistic should consider a policy without a provision allowing conversion to permanent insurance. Certainly

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life insurance, in or out of trust ownership will continue to play an important role in providing liquidity for estate debts and expenses other than estate taxes.

SPECIAL NEEDS TRUSTS

Special trusts for disabled family members continue to be an excellent way to hold assets for the benefit of a disabled family member. These trusts, if properly drafted, can allow medical and other benefits to continue uninterrupted while providing the individual with goods and services which would not otherwise be available. Many creative solutions can be designed to accommodate the individual needs of beneficiaries, while insuring that the trust itself will not be exhausted by paying for the devastating medical and housing expenses that these individuals sometimes require.

CHARITABLE REMAINDER TRUSTS

Charitable remainder trusts remain an important planning vehicle for those individuals with appreciated property who wish to generate additional income while benefiting a favorite charity at their death. Wealth replacement in the form of life insurance remains an excellent way to replace the property eventually paid over to charity while generating a current income tax deduction. Though most advantageous in a higher interest economy, these trusts should not be overlooked by those individuals selling low basis property such as a farm, business or art work as they can be most effective in delaying capital gain if statutory requirements are met.

Income Only Trust

An Income Only Grantor Trust is designed to allow an individual, i.e., the grantor, to transfer the principal residence (or, indeed, any other assets) to a trust which provides that the property is available for the grantor's exclusive use while living and then distributed to designated beneficiaries upon the grantor's death. Because a grantor trust is treated as the grantor for income tax purposes, during the term of the trust, the home may be sold without capital gain tax consequences, replacement property may be purchased with 100% of the sale proceeds in the sole discretion of the trustee. See IRC Section 121.

The grantor may, but need not, retain the right to receive income from the replacement property. In addition, the grantor may also retain the right in his or her Last Will and Testament to designate trust beneficiaries after death. The grantor does not have access to trust principal, but principal may be distributed to the children or other remainder beneficiaries in the discretion of the trustee if the trust instrument permits.