

THE ABCs OF TRUST PLANNING

In the world of estate planning, trusts are the most powerful weapon in the arsenal, providing asset protection, tax reduction, probate avoidance and more. This article explores how a trust works, why it works and how you may benefit.

I. What is a Trust?

A Trust is a “fictional” legal entity which is created by an agreement, under which three roles are created. First, you, as Grantor, Settlor or Creator of the Trust, dictate the terms of the Trust and decide what to put in it. Second, an individual you select, known as the Trustee, holds and manages property under the terms of the agreement. Third, you name the beneficiaries of the trust, which could include yourself, family members, charities or anyone else you want to benefit.

Thus, a Trust is a legal arrangement through which you give property to your Trustee to manage and use for the benefit of whomever you name.

There are two main types of trusts:

- Testamentary Trusts, which are inside your will and go into effect when you die;
- Living Trusts, which take effect during your lifetime. Living Trusts may also be “revocable” or “irrevocable”, depending upon its purpose.

II. Advantages and Considerations of Living Trusts

There are several advantages to using a Revocable Living Trust instead of relying solely on a Will. A Living Trust can help:

- Manage and protect assets during your lifetime, including in the event of disability
- Provide seamless continuity in the management of your affairs after death
- Control how and when assets are distributed to beneficiaries
- Avoid the delays and public nature of probate
- Maintain privacy in the handling of your affairs
- Reduce taxes and administrative costs when properly designed

While Living Trusts offer significant benefits, there are a few important considerations. A trust involves more upfront planning, cost and implementation than a simple Will.

It also requires assets to be formally retitled into the name of the trust - a process known as “funding” the trust.

However, once established and properly funded, a Living Trust is often more efficient to administer, and it can provide tax advantages and asset protection opportunities that cannot be achieved by relying solely on a Will at death.

III. Types of Trusts

1. Revocable Living Trust

A Revocable Living Trust is a complete Will substitute. It can control all of your assets both during your life and after your death. Here is how it works:

- When you set up your Revocable Trust, you transfer the title of all your assets (stocks, bonds, real estate, etc.) from your name to the name of the trust. You then name yourself as the trustee and beneficiary. This gives you and you alone, total and complete control of all your assets. You can buy, sell, trade, and do whatever you want - just like you do now.
- Here’s the difference, and the real benefit to you. When you die, there will be no assets left in your name, and therefore, no probate for your family to endure. Whomever you name as your successor trustee will immediately gain control of your assets to distribute them according to your exact instructions. With a Revocable Trust your assets will go directly to your beneficiaries after your death. There will be no probate or court costs, and greatly reduced attorney’s fees. There will also be no delay in distributing your assets, and all your estate planning wishes will be completely private. Furthermore, the trustee will be able to ensure continuity of asset management during your lifetime for any period in which you are unable to manage your trust due to incapacity.
- Having your assets owned by a revocable living trust can substantially reduce the risk that a guardianship proceeding will become necessary if you become disabled. You can establish detailed instructions for how your successor trustee is to handle and manage your assets upon your disability. By avoiding guardianship, you will save on the associated fees and preserve continuity of the management of your assets that would be lost with a guardianship proceeding.
- Revocable Trusts can protect children from earlier marriages. Both your current spouse and the children from a previous marriage can receive fair treatment and creditor protection under the terms of your living trust. However, to accomplish this you should leave the property in further trust for their benefit. Depending on your desires, this trust can be so flexible that from your children’s perspective, it is as if they owned the property outright but without the risks associated with outright ownership like creditors or divorce.
- Revocable Trusts can ensure that your wishes are carried out and are not easily subject to attack. Because Revocable Trusts are difficult to challenge, disgruntled heirs will have a much harder time contesting your estate plan.



2. Irrevocable Medicaid Asset Protection Trust

Private Long-Term Care Insurance is the optimal way to plan for home care or nursing home care you may need, but if it is not an option, and personal income and resources are not sufficient to privately pay for long-term care, one planning tool is to transfer assets into a Medicaid Asset Protection Trust. You will retain the income for yourself, and preserve the principal of the assets (the assets held by the Trustee) for your spouse, children or other beneficiaries. When properly drafted, the trust will provide asset protection along with significant tax benefits, including avoidance of gift taxes, and a reduction of capital gains taxes.

A MAPT may allow the Trustee to access the principal of the trust during your lifetime for the benefit of children or other beneficiaries, although the Trustee cannot give the principal directly back to you. Most Grantors also choose to maintain the right to change the ultimate beneficiaries of the trust (called a Special Power of Appointment), with the ability to “reappoint” the assets to different family members or beneficiaries in the future. This power retains control for you and prevents transfers to the trust from being treated as taxable gifts.

Under current law, a properly drafted Medicaid Asset Protection Trust that gives a Trustee no discretion to distribute principal to you (the Grantor-Beneficiary), or to your spouse, is a viable long-term care planning tool. Thus, a senior doing estate planning may keep the income from an irrevocable trust for himself or herself, with the principal distributable to specific beneficiaries at the Grantor’s death and qualify for Medicaid (once the applicable lookback or penalty period has expired) without the assets in the trust being considered by the Department of Social Services as available to pay for the cost of long-term care.

3. Beneficiary-Controlled Trusts

If you want to ensure that the assets you’ve accumulated over your lifetime are passed down through your family bloodline, a Beneficiary Controlled Trust, or BCT, accomplishes that goal with powerful benefits. Beneficiary Controlled Trusts allow estate owners to pass their assets to their children with enhanced protection against divorcing spouse, lawsuits from creditors, and Medicaid claims. In effect, BCTs and other estate planning structures give you the strongest possible assurance that your assets will go to the intended beneficiaries with little or no risk of dilution by third-party claims.

4. Standalone Retirement Trusts

Retirement plans such as IRAs, 401(k)s, 403(b)s are often a significant portion of your estate that will pass to your heirs. By far the best option for protecting an inherited IRA is to create a Standalone Retirement Trust (SRT). If properly drafted, this trust offers the following advantages:

- Allows assets to be split among multiple beneficiaries
- Protects the inherited IRA from beneficiaries’ creditors as well as predators, divorce and lawsuits
- Ensures that the inherited IRA remains in the family and out of the hands of a beneficiary’s spouse

- Allows for experienced investment management and oversight of the IRA assets by a professional trustee
- Prevents the beneficiary from gambling away the inherited IRA or spending it all on exotic vacations, expensive jewelry, designer shoes, and fast cars
- Enables proper planning for a special needs beneficiary
- Ensures the IRA “stretch” and assets can stay in trust for minors even after “age of majority”

5. Special Needs Trusts (SNTs)

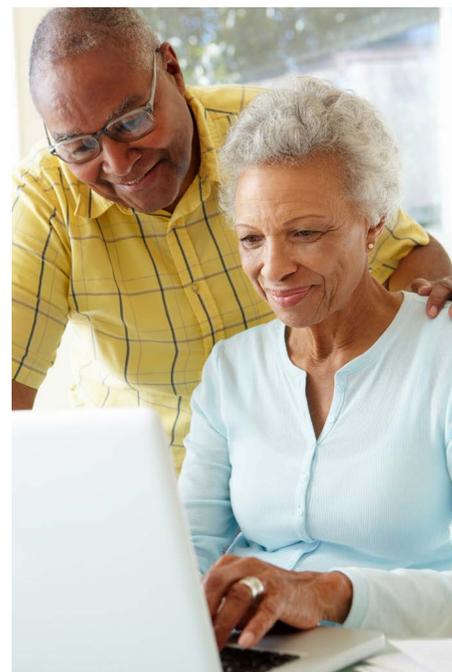
Special or Supplemental Needs Trusts (SNTs) provide a source of funds for people with disabilities. Because of self-imposed limitations on these trusts, individuals can remain eligible for government benefits such as Supplemental Security Income (SSI) and Medicaid. SNTs enhance the quality of life of the person with the disability by purchasing additional support services, therapy and care that are not covered, or are not covered adequately, by the Medicaid program, but which are vital to his or her well-being. In addition, the SNT can provide funds for housing, food, travel, recreational items or special medical equipment. The SNT can be made part of a “Future Care Plan” which includes management of property and arrangements of personal care, vocational services, housing and case management for a loved one with a disability.

6. Minor’s Trust

If you and your spouse both die, a minor’s trust can hold your assets for your children until they reach a certain age, provide management of the assets and pay income and principal as you direct for such purposes as their support, maintenance, health and education.

7. Irrevocable Living Trust: Estate Tax Planning If Over \$6 million

This is a method to gift ownership of an asset without giving the recipient unbridled access to the money or property. If you relinquish all rights to income and principal from the Trust, as well as the power to change the Trust agreement in any manner, the asset will not be part of your taxable estate. You name the recipient of the assets, including income and principal beneficiaries, such as children, spouses or charities. Because the transfer is considered a gift to the Trust, a gift tax may be imposed unless the transfer qualifies for the gift tax annual exclusion (currently \$18,000 per person per year), or you use some or all of your lifetime Exemption Equivalent Amount, currently \$15,000,000 in 2026. Both can be made part of the planning.



8. Irrevocable Life Insurance Trust (ILIT)

A more advanced use of an Irrevocable Trust is to have the Trust own life insurance policies on your life, thereby removing the proceeds of such policies from your taxable estate. Otherwise for policies you own or have rights over, the full death benefit is

taxable. Trust-owned insurance will not be included in your taxable estate, and it will be available to provide liquidity to accomplish estate objectives. The cash may be used to buy non-liquid assets from the estate or loan money to the estate, thereby eliminating any need for distress sales of estate property or excessive borrowing which might be needed to pay estate taxes.

Other trusts which may be useful under certain circumstances include:

9. Charitable Trusts

Charitable Remainder Trusts can help an individual obtain income tax deductions, sell assets and diversify investments without incurring an immediate capital gains tax, increase cash yields generated by assets, and decrease the size of the estate.

They work best for older individuals who find themselves holding low yielding, highly appreciated assets and who have charitable giving objectives. Assets are transferred by an individual to a trust and then sold to be reinvested in higher yielding assets. Generally, an individual and perhaps a spouse receives income for life, with the remainder going to a charity after the death of the last income recipient. The value of the property given to the trust is often replaced for the heirs with a life insurance policy in an irrevocable life insurance trust. A Charitable Lead Trust provides a charity with the income from your principal, paid over a certain amount of time, after which the remainder passes to your heirs at greatly reduced transfer tax costs.

10. Qualified Personal Residence Trust

This trust allows you to transfer your residence or vacation property to a Trustee on a highly leveraged transfer tax basis, while continuing to use the property for the term of the trust. This type of trust is often used to “freeze” the value of estate assets for estate tax purposes.

11. Dynasty Trusts

A Dynasty Trust can hold assets in trust for the benefit of future generations in perpetuity without subjecting the assets that remain in the trust to federal transfer tax (estate tax, gift tax, or generation skipping transfer tax).

Many states have statutes that follow the common law rule against perpetuities, which limits the duration of a trust’s existence. Certain states, including Delaware, Nevada, Alaska and South Dakota, have abolished their statute limiting the duration of a trust’s existence, thus allowing the trust to exist into perpetuity. You do not need to reside in one of these states to take advantage of their favorable perpetuities laws and set up a Dynasty Trust. For wealthier individuals, the ability to create a trust into perpetuity is an invaluable tool in preserving family wealth, protecting assets and creating family legacies.

12. Beneficiary Defective Inheritor’s Trust

A beneficiary defective inheritor’s trust (a “BDIT”) is an ideal structure for businessowners who are looking to remove their business from their taxable estate to save on estate tax while remaining the primary beneficiary of the business proceeds

to maintain his/her lifestyle. A BDIT is an irrevocable trust formed by a third party (e.g., the businessowner's parent or relative) for the benefit of the businessowner. The third party must initially fund the trust with their assets, typically \$5,000. The businessowner can be the primary beneficiary and a trustee of the BDIT, enabling the businessowner to maintain significant control over the business, which under the Internal Revenue Code would not be possible if the businessowner formed the trust for himself.

Although the BDIT is formed by a third party, for income tax purposes the businessowner is taxed on the income, enabling the businessowner to sell his business to the trust income-tax free. Once the business is sold to the BDIT, all future appreciation of the business is outside of the businessowner's estate.

In conclusion, estate and trust planning can be an intricate and multifaceted process, often requiring the expertise of a seasoned trust planning attorney. The complexities involved in structuring and administering trusts, managing assets, minimizing taxes, and ensuring the smooth transfer of wealth across generations necessitate a comprehensive understanding of legal and financial implications.

From drafting meticulous documents to navigating changing laws and regulations, the guidance of an attorney at Pierro, Connor & Strauss can be invaluable. We specialize in providing tailored solutions to meet the unique needs of our clients and invite you to reach out for a free consultation to explore how we can assist you in safeguarding your legacy and securing your loved ones' future.

Call us today for a free consultation at (866) 951-PLAN (866-951-7526)