LWM Insights

CONNECTING THE HEAD & THE HEART OF WEALTH MANAGEMENT

Do I Need a Trust?

- Basic Elements of a Trust
- Benefits of Having a Trust
- Costs Associated with Trusts

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Historical Perspective

Trusts trace their origins to the feudal system in thirteenth-century England. The use of a trust grew out of the king granting use of his land to feudal overlords. The idea of giving to another person the legal ownership of property, not for the benefit of the recipient, but rather for the benefit of others has evolved over the centuries into what has become known as a trust.

Today, the use of trusts has become an enormously popular tool in financial and estate planning, especially with the development of modern trust laws.

The Basic Elements

All trusts will generally have the following components:

- The person creating the trust, commonly known as the grantor. Other names may include settlor, donor, creator or trustor.
- The person responsible for managing the trust fund, known as the trustee, and the legal owner of the fund.
- The trust fund, which is the property the grantor transfers to the trust for the trustee to manage.
- The person(s), known as the beneficiary(s), who will benefit from the trust fund that is held and administered.

Trusts will fall into two basic categories: revocable and irrevocable. A revocable trust gives the grantor complete control over the funds held in the trust. Here, the grantor has not given anything away as he reserves the

right to amend, revoke or terminate the trust at any time and thereby reclaim the funds transferred to it. This means there is no gift for transfer tax purposes and upon the grantor's death the funds are includible in the grantor's gross estate for estate tax purposes. With a revocable trust, any income earned on the funds flows to the grantor's personal income tax return.

An irrevocable trust is created when the grantor does not retain the right to revoke or reclaim the property. In this case, the grantor has given away the funds transferred to the trust and there is a gift for transfer tax purposes. A gift tax return may need to be filed if the transfer is made during the grantor's lifetime. Unlike the revocable trust, at the grantor's death, the irrevocable trust will not be included in the grantors' gross estate for estate tax purposes. Any income earned on the funds in the irrevocable trust is reported on an income tax return filed by the trustee. The income may flow to the grantor or may be taxed to the beneficiaries depending on the type of irrevocable trust.

Trustee(s)

he most critical decision you will make in creating a trust is who you will identify as the appropriate trustee(s) to oversee the trust property. Family, friends, advisors, institutions are typical choices most people make. Professional trustees, whether it is an accountant, attorney, financial advisor or corporate institution, can add significant managerial value by ensuring proper record keeping, adequate attention to detail and proper implementation. Family and friends should have a clear understanding of the grantor's wishes. A combination of these choices may be the best solution. The advisors at Lexington Wealth can help you make this decision having helped many clients with it in the past.

Benefits

Historically, planners have used trusts to save taxes. The generation skipping trust is the most common transfer technique used to escape gift or estate tax. Sometimes called a "dynasty trust," these trusts are designed to continue as long as the law allows for the benefit of the grantor's descendants. The grantor's children can enjoy the benefits of a dynasty trust even though the name generation skipping implies otherwise.

In addition to saving taxes, a grantor can design a trust for anything he or she desires as long as it is not illegal or against public policy. The emphasis nowadays is on wealth preservation. Clients are creating trusts to preserve assets from a variety of risks, such as, mismanagement of investments, spendthrift or wasteful beneficiaries and disabled beneficiaries.
Some practitioners also argue more clients should use trusts rather than making outright bequests to family members during lifetime or at death. Again, the reason being asset protection. Please remember outright bequests to a family member can become subject to a judgement should your family member get sued by a creditor or a divorcing spouse.

At first blush, you may be reluctant to use trusts for transferring wealth because you believe it may restrict the control and beneficial enjoyment of the property left in trust. Furthermore, you don't want to be perceived "as ruling from the grave."

Modern trust law provides great flexibility to enable beneficiaries to obtain a high degree of control that usually only comes with outright ownership. This enjoyment can be managed by including provisions that:

- use independent trustees that have broad discretionary powers,
- give beneficiaries a limited power of appointment to dispose of trust property, and/or
- segregate the traditional trust functions into separate roles. For example, naming an administrative trustee (maybe an institution), to fulfill the traditional administrative role including maintaining records and filing tax returns, naming an investment trustee to be in charge of investments, naming a distribution trustee (maybe a professional & family member) to be empowered to make distribution decisions and a trust protector to oversee the trustee's administration of the trust including removing trustees.

Competent legal counsel will be required to properly achieve the dual objectives of wealth preservation for future generations and flexibility found only with outright ownership.

Costs

Trust don't come without some costs and administrative complexities. So, you must weigh the benefits outlined above with the following costs & complexities:

- legal cost for initial document drafting, future document changes & any dispute resolution costs
- annual trustee and tax preparation fees
- administering investments and distributions in accordance with fiduciary standards beneficiaries.

Conclusion

Costs are easy to tally up and may discourage you from using a trust. However, the tax saving you may enjoy over generations and the funds that may not be depleted due to lawsuits, divorce and mismanagement can be enormous.

Please contact your Lexington Wealth advisor to ask your questions about trusts.

About the Author - Mark Carley, AEP®, CPA,PFS

"I'm passionate about helping clients successfully navigate through the complexities associated with their wealth. Our open and independent-minded environment at Lexington Wealth provides us flexibility in serving our clients."

As a Director of Family Wealth & Estate Planning at Lexington Wealth Management, Mark guides clients in many areas of wealth, including investments, financial planning, and estate planning. He brings more than 30 years of experience to his work with clients and is an active voice on Lexington Wealth's investment committee.

Previously, Mark served for 14 years as a Director and Family Wealth Advisor in Wells Fargo's Boston Family Wealth office (formerly Calibre Financial Services). He led client engagements with a specialization in financial and tax planning, working with families that extended into the ultra-high-net-worth category.

He has served as Director of the Personal Financial Services group for Coopers & Lybrand in Boston. He was affiliated with Price Waterhouse for 14 years, where he was the lead personal financial planning and individual tax specialist for their Hartford office.

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