



What to Consider When Creating A Trust

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You've decided to create and fund a trust as part of your overall estate plan. Now, you will need to make decisions that impact who controls the trust, how and when beneficiaries receive trust distributions, and how the trust is taxed. When creating a trust, here are the basic questions you will need to answer:

WHO ARE THE BENEFICIARIES?

- A trust can be for a single beneficiary or for multiple beneficiaries (often called a “pot trust”).
- Sometimes, a pot trust is created for a period of time, and then splits into separate shares at a later date. E.g., mom creates one trust to benefit her children and grandchildren during her life. When mom dies, the trust will split into separate shares for each child’s family “line”.

Practical Guidance: Consider the needs of each beneficiary. If the beneficiaries have drastically different needs, then it may be better to create a trust that benefits only your daughter during her lifetime, and your daughter’s children only after your daughter is gone. Alternatively, the trust document can make clear that your daughter is the primary beneficiary and the trustee can make distributions to your daughter’s children only after the trustees are sure your daughter is well provided for. This will clarify your intent and avoid conflicts amongst the beneficiaries. In addition, if a beneficiary has special needs and/or may be eligible to receive government benefits, a separate trust for that single beneficiary may be best.

WHO ARE THE TRUSTEES?

- Who will be your initial trustee(s)?
- Who will be your back up trustees if the initial trustees cannot act?
- Should trustees receive compensation?

Practical Guidance: An ideal trustee is someone your family knows and trusts, and who has some financial acumen, such as your siblings, a friend, your CPA or financial advisor. Trustees who are family members are typically not compensated, but professional or unrelated trustees may require compensation in order to act.

HOW DO THE BENEFICIARIES RECEIVE DISTRIBUTIONS FROM THE TRUST?

- The trust document can direct the trustees to distribute trust funds to a beneficiary when the beneficiary reaches certain ages.
- The trust document can give the trustees authority to distribute to a beneficiary for any reason whatsoever.
- The trust document can give trustees limited authority to distribute to beneficiary only for expenses related to her health (i.e. medical bills), education (i.e. tuition), maintenance and support (i.e. rent, income replacement, day-to-day living expenses).

Practical Guidance: Often, unrelated/independent trustees have the authority to make distributions for any reason, while a trustee who is also a beneficiary may distribute only for limited purposes. This provides maximum flexibility for distributions to the beneficiary, while keeping the trust out of the beneficiary’s taxable estate and providing creditor protection.

WHEN DOES THE TRUST END?

- Trust lasts for your child’s or grandchild’s lifetime.
- Trust lasts until child or grandchild reaches a certain age.
- Trust continues for as long as governing state law permits.

Practical Guidance: Usually, you want the trust to last for as long as governing state law allows, particularly for larger trusts. This typically reduces overall estate and gift tax, and best protects the trust funds from the claims of a beneficiary’s creditors. For example, if the trust terminates when a grandchild reaches a certain age, whatever the grandchild receives from the trust would be subject to the claims of his creditors, whereas if the trust continues for the grandchild’s descendants, the trust would be protected against those creditors.

WHO PAYS THE INCOME TAX?

- Grantor trust: you report and pay taxes on the trust income on your personal return.
- Complex trust: the trust files its own tax return and pays its own tax from the trust.

Practical Guidance: Paying taxes on grantor trust income is a good way to reduce your taxable estate without gift tax consequences, while allowing the trust to grow income tax free. A trust is a grantor trust if the trust document gives the grantor certain powers. The most common power is the grantor's power to substitute (exchange) trust assets with assets of her own - a power that can also be used to save capital gains taxes in certain circumstances.

Practical Guidance: Because income tax brackets are more compressed for trusts than for individuals, complex trusts usually pay taxes at the highest tax bracket. However, the trust can take income tax deductions for amounts distributed to the beneficiaries and for trustee fees paid.

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