PRIVATE WEALTH MANAGEMENT

The family guide to trusts.

Learn about the basics of trusts and how they can fit within your legacy plan, beginning with questions to ask before you get started.

Transfer your wealth at the right time to the right recipient.

That's what trusts can solve for you and your family.

Trusts let you pass wealth along in a strategic way—when you want, to whom you want, and how you want it to be distributed. Some people worry about uncontrolled wealth in the hands of young adults, or their wealth being accessed by unintended parties, like creditors or their children's divorcing spouse. Some may even be looking for a way to mitigate exposure to estate or inheritance taxes. It's important to understand how trusts might be a worthwhile tool as you plan for your legacy.

Before you begin your estate planning, ask these questions:

- Who will inherit my assets, and when do I want them to inherit?
- If it happened tomorrow, are my heirs/children ready to receive their inheritance outright?
- If my children get married, do I worry about a divorce or a creditor threatening their inherited wealth?
- Who will manage my assets if I am incapacitated or unable?
- If I die and my spouse remarries, how do I ensure that assets will reach our descendants?
- Is there a way to reduce the potential taxes that will be owed by my estate?

Trusts: The basics

A trust is a legal way for you, the “grantor,” to transfer property to a third party or “trustee” for the benefit of a third person or charity (the “beneficiary). As the grantor, you write the terms and rules that govern how the trust operates, including what it is to do, and when it is to do it. If the trust is revocable, you may change the rules at any time and can even designate yourself as the trustee and beneficiary. If a trust is irrevocable, the terms cannot be changed once executed. The trustee manages the property for the beneficiary in accordance with the terms of the trust document and governing law.

Choose trustees wisely for greater success

A trustee’s primary responsibility is to carry out the duties given to them in the trust document. When choosing successful trustees, it’s important that they have the ability and skill to make the numerous complex legal, investment, and fiduciary decisions needed. They also must be committed and capable of impartial, prudent decision-making according to your wishes. While a trustee may delegate some administrative functions to external parties (such as an accountant or investment manager), the ultimate decision-making and liability generally fall on the trustee.

Trustee responsibilities and best practices

- **Custody assets**
  Title accounts in trustee’s name
  Use a bank or trust company to hold assets and do bookkeeping
- **Investments**
  Prudently invest and review periodically
  Consider income, principal growth, and risk
  Consider using an investment advisor
  Be bound to fiduciary –duty—treat all beneficiaries fairly
- **Bookkeeping and taxes**
  Keep accurate records and retain financial statements
  Maintain distinction of income and principal
  Prepare, file, and keep copies of income tax returns
  Provide reports and tax information to beneficiaries (Form K-1)
- **Make distributions** (income and/or principal)
  Follow the trust instrument
  Exercise discretion and due diligence when evaluating beneficiaries’ needs
  Balance the needs of multiple beneficiaries
- **Pay expenses**

Trusts can accomplish many goals for your family

- Gifting in support of groups, individuals, and institutions
- Protecting assets from creditors and bad marriages
- Reduction of tax liabilities
- Maintaining control over the assets you gift
- Avoiding probate
- Keeping your wealth within your family

Qualities to consider in a trustee

- **Familiarity with trust assets and beneficiaries**
  A well-qualified trustee is sensitive and empathetic to your motivations and genuinely interested in the well-being of your beneficiaries. Think: Who appreciates my goals and values, and knows the people in my life whom I want to benefit?

- **Availability and willingness to serve the term of the trust**
  People and organizations that are geographically near the trust property or beneficiaries, and who can serve for the duration of the trust term or who can be trusted to choose appropriate successors are good choices. Think: Who can I trust who lives nearby and has available time to serve?

- **Investment, accounting, and tax planning expertise**
  Financial activities are at the core of trust administration. Accordingly, it's vital for a trustee to have experience in these disciplines. Trustees do not need to be experts, but should know when and how to ask for help. Think: Whom do I know who is responsible, exercises good judgment, and knows when to seek help?

When a single trustee isn't enough

Given the wide range of skills that a qualified trustee will need, it's hardly surprising that, at times, a single candidate may be inadequate. For trusts that are broad in scope of goals, assets, or beneficiaries, one solution is to capture the strengths of professional and nonprofessional trustees by appointing co-trustees. With more than one trustee, it's critical to think through how decisions will be made—unanimously, by majority, or allowing one trustee to decide on certain matters alone. While a co-trustee arrangement introduces its own set of challenges, careful planning can overcome them.

For example: You select your sister as the initial trustee for your son's trust during a period when he is too young to make important decisions. At an appropriate age (say, 30 or 35), your son can become a co-trustee to be mentored by your sister about the responsibility of having and maintaining wealth. Eventually, your son could have the option to become the sole trustee of his trust, where he makes his own decisions about using trust income and principal for his health, education, maintenance, and support needs. He can also enjoy added protections built into the trust that provide increased protection against creditors.

Why would I want to consider using a trust?

Trusts are popular, especially because they are customizable to meet your particular goals and objectives. Trusts come in many forms, and the type of trust depends upon what you are trying to accomplish. In addition to a trust being either revocable or irrevocable, it can be created during your life (inter vivos), funded while you are living, or created under your will (testamentary), and funded after death.

Avoid probate and maintain privacy

Probate is the court-supervised process of distributing property according to a will. It can be expensive, time-consuming, and further complicated if you own property in multiple states. Probate exposes the assets and beneficiaries of an estate to the public record, available for anyone to access.

One strategy to avoid probate and maintain privacy is to create a revocable living trust. These trusts can shield assets from the probate process, though they do not automatically achieve tax avoidance benefits.

Protect assets from creditors

A trust is a separate, legal entity. If irrevocable, a trust can significantly protect those assets from various creditors. Carefully drafted language is critical to achieve this objective. To properly protect the assets in the trust for your beneficiaries requires limiting their control or access to trust property.

The role of trusts in estate tax planning

Because of the federal estate tax marital deduction, assets left to a surviving spouse defer the estate tax only until the death of the surviving spouse. Historically, married couples structured their estate plans so that both spouses use their applicable exemption, which shields that amount from estate tax. Left unplanned for, state and federal estate taxes can significantly reduce a robust estate.

Effective estate planning focuses on reducing or eliminating the estate tax once the surviving spouse dies. An efficient way to maximize the use of the estate exemption is to establish a marital deduction trust in the form of a marital and bypass trust (aka credit shelter trust or family trust), often used in tandem. Until that time, however, these trusts can be designed to provide for the surviving spouse and children through distributions of income and principal.

Generation skipping transfer tax (GST):

Designed to tax the transfer of property that skips one or more intervening generations. For example, a grandparent's gift to a grandchild would be subject to GST tax. A GST tax exemption, similar to the estate tax exemption, can be allocated to such gifts (within or outside of trusts) to avoid and reduce exposure to estate tax.

Examples of common trusts:

- **Bypass trust:** Allows assets to "bypass" the federal estate tax that would otherwise be imposed when the second spouse dies.

- **Grantor trust:** The trust creator ("grantor") retains powers over the trust and the income is taxable to the grantor. There are various forms of grantor trusts, including revocable and irrevocable.

- **Grantor retained annuity trust (GRAT):** An irrevocable trust providing annuity payments back to the grantor with the intent of transferring appreciation to non-charitable beneficiaries at minimal or no gift tax cost.

- **Irrevocable life insurance trust (ILIT):** An irrevocable trust designed to hold life insurance policies. The irrevocability provisions and administrative guidelines result in the proceeds escaping estate taxation.

- **Spousal lifetime access trust (SLAT):** An irrevocable trust designed to support the grantor's spouse. Typically, it gives the spouse control over distributions thereby giving the grantor "indirect" access to assets so long as they remain married and spouse is alive.

- **Qualified personal residence trust (QPRT):** An irrevocable trust intended to hold your personal residence for the eventual benefit of another party while retaining the right of enjoyment during your life. The QPRT removes the property from your estate, avoiding estate tax.

- **Intentionally defective grantor trust (IDGT):** Freezes the value of certain assets of an individual for estate tax purposes, but not for income tax purposes. The grantor can also lower their taxable estate by paying income taxes on the trust assets, effectively transferring additional wealth to beneficiaries.

- **Dynasty trust:** Synonymous with an irrevocable grantor trust. Allows its creator to pass wealth to successive generations of descendants (even unborn generations), potentially in perpetuity. Distributions and operation of the trust are controlled by the grantor's terms. May include charities if there are no living descendants.

- **Qualified domestic trust (QDOT):** Typically used when the surviving spouse is a non-U.S. citizen, to preserve the marital deduction.

- **Charitable trusts:** Allow a donor to benefit one or more charities while also financially benefitting themselves and their family. There are two different types of charitable "split-interest" trusts (those that can benefit two classes of beneficiaries)—charitable remainder trusts (CRTs) and charitable lead trusts (CLTs). The trust selected depends on estate planning and wealth preservation priorities, how and when the charity should receive the gift, and even the types of assets donated. With the added potential benefit of estate, gift, and/or income tax benefits, charitable trusts are an attractive vehicle to further your financial, estate, and charitable goals

- **Special needs trusts (SNT)**: Established for a person with special needs who may be eligible to receive benefits from government programs. A properly drafted SNT will allow the beneficiary to receive those benefits while still receiving funds from the trust.

- **Pet trusts:** Created to provide for the care and maintenance of one or more companion animals in the event of the owner's disability or death. As with other trusts, the trustee will hold and manage the property for the benefit of the owner's pets with the ability to pay caregivers as needed.

Transfer your wealth with confidence.

You worked hard to grow and protect your wealth. Though many trust varieties exist, their common thread is the ability to transfer your assets as efficiently as possible, to meet your wishes, and provide for yourself and those you love.

Find out if trusts have a place in your plans.

Visit seic.com/privatewealth or call a member of the Private Wealth Management team at 888-551-7872.

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