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Seven reasons to consider a trust

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Depending on your estate planning objectives and the individual characteristics of your intended beneficiaries, you may want to consider forming a trust. A trust is a contractual relationship between an individual, a trustee and a beneficiary for the trustee to hold legal title to property, formerly owned by the individual, for the benefit of the beneficiary.

The two basic kinds of trusts are *inter vivos* trusts, those created by an individual during his life, and testamentary trusts, those that come into being after an individual's death. There are many reasons to set up a trust. For example, the use of a trust can help to:

- **Avoid probate.** A revocable trust substitutes for a will. If, during an individual's lifetime, assets are titled in the name of the revocable trust, upon the individual's death the assets will not have to go through probate. The probate process can be costly and time-consuming, and all your assets will be a matter of public record. Since Wisconsin is a marital property state, a married couple can set up a joint revocable trust to hold all their marital property.
- **Reduce estate taxes.** Remove life insurance proceeds from your estate with an irrevocable life insurance trust. When an individual dies owning a life insurance policy, the amount of the proceeds could be subject to the federal estate tax at a flat rate of 45%. If an existing policy is transferred into an irrevocable life insurance trust and the individual lives for at least 3 years from the date of the transfer, the insurance proceeds are not subject to estate tax. If the individual is applying for a new policy, the trust should apply for the policy to avoid the 3-year rule. Note there may be gift tax consequences to transferring cash into the trust so the trustee can pay the premiums.
- **Provide for a second spouse and children from your first marriage.** You can provide for the surviving spouse in a second marriage while assuring that on the death of the surviving spouse, the remaining trust assets will go to the children from the first marriage using a qualified terminable interest property trust or QTIP trust.
- **Utilize estate tax exemption.** A family trust, a credit shelter trust, or bypass trust allows you to "use up" one spouse's estate tax exemption, provide for the surviving spouse, and avoid estate taxes upon the surviving spouse's death. At death, any assets that go to the surviving spouse are not subject to estate tax. In addition, currently $2 million of assets (scheduled to increase to $3.5 million in 2009) can go to non-spouses without triggering the estate tax.
- **Provide for a disabled child.** Using a special needs trust, you can provide benefits to a disabled child over and above what government assistance covers, without affecting the beneficiary's eligibility for government assistance.
- **Contribute to charities.** A charitable lead trust and charitable remainder trust are possibilities if contributing to charities is a priority.
- **Provide creditor protection.** You can protect your estate from creditors or a divorcing spouse by creating a spendthrift trust.

Flexibility, but at a cost

The income and principal distribution provisions of trusts can be very flexible. For example, the income distribution provisions can call for all the income to be distributed at least annually or for income to be distributed for beneficiaries' health, maintenance, support, and education (an ascertainable standard). A similar standard could be established for principal distributions. Principal distributions could be made when the beneficiaries reach certain ages. Or, you could give the trustee absolute discretion as to when to make principal or income distributions to beneficiaries.

There are, however, disadvantages to trusts, including:

- Upfront costs of drafting.
- Filing of annual income tax returns.

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- Finding a trustee and a successor trustee. Trustees have a fiduciary obligation to administer the trust assets in accordance with the terms of the trust and applicable law, so you will need to name a trustee and successor trustee who understand their responsibilities. Depending on the type of assets in the trust and their value, it may make sense to incur the fees to have a corporate trustee administer the trust.
- The inability to change the trust once it becomes irrevocable.

Conclusion

Trusts can be a very flexible vehicle in meeting your objectives and your and your survivor's income needs. However, you need to balance the flexibility that you have when drafting the income and principal distribution provisions with the additional administrative costs that trusts may require.

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