<u>Trusts - the Good, the Bad, the Ugly</u>
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Susie Orman says that we all need Trusts. I say that you need to understand the Good, the Bad and the Ugly about Trusts before you can decide if it is right for you.

Trusts can be used for multiple purposes, including Asset Protection and Estate Tax Savings, and you must be aware of:

The Good—Trusts are a good way to protect your assets, your family and you.

The Bad—You do have to give up control of your assets to get certain protections; the Trust may pay extra income taxes due to the compressed tax rates for Trusts.

The Ugly—When you give up control, you must have faith that the Trustee will handle matters the way you want—but the Trustee(s) get discretion. The Trustee may not always handle matters as you would.

GLOSSARY of TERMS—sometimes vocabulary makes things seem more complex, this is especially true in Trusts because there are different words that mean the same thing.

Trust-- A Trust is an "entity" or "arrangement" with certain rules that the Grantor creates. The Trustee enforces these rules and the beneficiaries are benefitted from these rules.

Term—How long the Trust is in existence is determined by the rules of the Trust.

Grantor/Settlor—this is the person who creates the Trust and establishes the rules.

Trustee—this is the person who enforces the rules of the Trust and distributes the assets; invests the assets of the Trust (which can be in any almost any type of investment); and files all necessary paperwork, including taxes (Uses a Form 1041 or a K-1).

Lifetime Beneficiary/ies—the person(s) who benefit from the Trust during the term of the Trust, typically during the lifetime of this beneficiary.

Remaindermen (Beneficiaries)—the persons who receive the balance of the Trust when the Trust ends.

Testamentary Trust—this is a Trust created inside a person's Will and is not truly effective until the person dies; therefore, it can be changed at any time.

Inter Vivos/Living/Stand-Alone Trust—this is a Trust created while the person is alive and is generally funded when the person is alive.

Revocable Trust—the Grantor can cancel or change the terms of this Trust at any time.

Frequently, the Grantor serves as the Trustee too. This Trust allows for management of the assets, but more importantly allows the assets to smoothly transition to the back-up Trustee without any Court intervention and without having to transfer assets at “trigger dates”, i.e. when the Grantor dies. This Trust does not protect assets from Grantor’s Creditors, Medicaid or Estate or Inheritance Taxes. It does avoid probate, provided that the Grantor contributed all of his/her assets to this Trust before death..

Irrevocable Trust—The Grantor cannot cancel or change the terms of this Trust. The Grantor should not serve as Trustee. This type of Trust allows for management of the assets, a smooth transition from the Trust to the beneficiaries without court intervention (like the Revocable Trust). It also protects the assets from the Grantor’s Creditors, Medicaid, Estate and Inheritance Taxes (under the right fact patterns). However, the Trust may wind up paying extra Income Taxes (because the tax rates are compressed so that the tax rate hits the highest tax rate if the Trust earns about $13,000 per year.) The assets inside this type of Trust retain the original cost “basis” of the Grantor so that the Trust may pay additional capital gains taxes on the sale of assets because the assets do not receive a Step Up in Basis.

Basis—This is generally what you paid for an asset. It can be adjusted upwards if you improved the asset (like a new addition to your home); or downwards if you received a tax benefit (like depreciating an investment property).

Transfer of Basis—when you gift an Asset, the transferee (your child, your irrevocable Trust) takes that asset at the same basis you had. Note that amount of the gift is the fair market value of the asset, regardless of the Basis. (So, if you make a taxable gift, you must report the fair market value of the asset to the IRS, even if the basis is much lower.)

Step Up in Basis—Generally, when a person dies (provided that the assets are part of the person’s “Taxable Estate”) then the Basis of the asset is “revalued and treated as though the fair market value of the asset at the death of the person is the actual Basis in the recipient’s hands. the asset’s basis is equal to the fair market value of the assets as of the date of death. For example, if you bought stock for $100, the original basis is $100, but when you died, the stock is worth $1,000. If you sell the stock while you are alive, you will pay Capital Gains Taxes on $900 of gain. If you gift this same stock to your child or an irrevocable Trust during your lifetime and the child sells it, the child/irrevocable Trust will pay capital gains taxes on $900. However, if you kept this stock and die and leave this stock to your child or into a testamentary, the Government will treat this as though your child now paid $1,000 for the stock. That is the “Step Up in Basis.” Therefore, there is a savings on Capital Gain Taxes. (This same dynamic applies if you gift your Stock to an Irrevocable Trust).

Lifetime Trust—this is created for the lifetime of a particular person.

Dynasty Trust—this is created for generations of a family. Typically funded with large amounts of money. These typically have Professional Trustees.

Provisions of Trust—depend on the Purpose and goals.

COMMOM PURPOSES/PROVISIONS OF DIFFEERENT TRUSTS:

COMMON ASSET PROTECTION TRUSTS:

1. Minor Child's Trust—typically in your will and can be used for the Health, Education, Maintenance and Support. (HEMS). The term is typically until the child is mature enough to handle the assets—25, 30.

2. Ascertainable Standard Trust--something I am using more of now. The beneficiary and the Trustee are the same person (but not the Grantor). The Trustee can use the Trust to keep the beneficiary in the "style to which she is accustomed". Legal restriction so the integrity of the Trust is protected. This gives the beneficiary more flexibility but still protects the assets from creditors.

3. Medicaid Trust—This must be Irrevocable and the Assets must be in the Trust for at least 5 years before these assets are protected. These monies cannot be used for the potential Medicaid recipient.
    a. Income Only Trust—not used much in NJ and there are many different views on the benefits and the protections. Does allow for the Grantor to receive the income from the Trust and does allow the assets to receive a Step Up in Basis upon the Grantor's death. May be available to Medicaid.

4. Special Needs Trust—created for someone who needs government benefits. Generally, this is designed to protect the assets so that they are not included as an asset of the person applying for Benefits, so the qualifying Trust assets are used for "extra vacation, extra therapy, an aide, etc." However, there are 2 types of SNT

    A Self Settled—the disabled person uses their own money to fund the Trust and there is a requirement that the Trust pay back the government for monies received. There are requirements.

    B. Third party SNT—prepared by a third party—like a parent or grandparent. This does not have to require that the government be repaid for benefits received.

    This Trust can leave remaining assets to other children or grandchildren.

COMMON TAX SAVINGS TRUSTS: Note that due to the current Gift and Estate Tax Laws, most people will not need a Tax Savings Trust, however, tax laws can change. These all must be Irrevocable.

5. Irrevocable Insurance Trusts (ILIT)—these are designed to have Life Insurance Policy in the Trust so that the amount of the insurance proceeds is not part of your Estate and therefore saves Estate Taxes.

6. Credit Shelter Trusts—these protect your Exemption from lifetime gifts and transfers on death. Currently, about $12 million per person; scheduled to reduce to about $6 million in 2027. There is portability so that the couple should get 2 times this value and this law recently has been made more flexible.

7. Spousal Lifetime Access Trust (SLAT). A SLAT is created by one spouse for the benefit of another spouse. The other spouse does have access but with certain restrictions. The

assets are not part of the Taxable Estate when you die, so you save Estate Taxes, but only on the appreciation of the assets. Must be very careful in setting up and funding.

GIFT TAX PROVISIONS TO CONSIDER, there are 3:

A. The Annual Exclusion allows you to gift $16,000 per person/donee. A couple can gift $32,000.
B. Payment of educational or medical expenses is unlimited but must be paid to the provider directly.
C. Lifetime Exclusion is currently about $12 million (just like the Estate Tax Exclusion but you only get one $12 million benefit.)

Note that the gifts retain their basis.

PATON LAW FIRM DISCLAIMERS—

1. Medicaid protection. Medicaid is a Federal Program but administered in each state. So you must confirm all rules with the particular state. Further, these rules can change.
2. As for Tax discussions there are proposals currently in consideration so the tax laws may change.
3. Please call me or another attorney and accountant to review all of the rules and consequences of implementing a Trust before you do so.