

## info sheet Using trusts as part of your estate planning

One of the most common tools in estate planning is the use of a trust, which is an arrangement under which you (the grantor) can place assets that are for the ultimate benefit of someone else (the beneficiary) under the control of a trustee. Depending on your goals, the use of a trust can be an effective way to achieve your estate planning objectives. Ask your investment professional or attorney about the following trust options and their appropriateness for your individual needs and goals.

Trusts are usually categorized one of two ways:

- *inter vivos* (created during your lifetime as a contract between you and a trustee)

An *inter vivos* trust may be revocable or irrevocable when created. If revocable, you would retain the ability to have trust assets returned to you at any time. A revocable trust does not offer you any federal income tax advantages because any income belongs to you and is not shifted to the beneficiary. In addition, revocable trust assets would be included in your estate at the time of death. Generally, therefore, you would not set up an *inter vivos* revocable trust for tax reasons but rather to retain control over trust assets.

An irrevocable trust may provide some tax advantages in that the transfer of property to the trust would be considered a gift for tax purposes. Individuals might set up an irrevocable trust in order to shift income or to lower the amount of their estate and, in turn, the estate taxes incurred.

- *testamentary* (created by will upon the death of the grantor)

A *testamentary* trust comes into existence at the time of death and is irrevocable because it is created as part of a will. This type of trust allows you to have control over how your heirs will receive the assets.

In an estate plan, trusts can serve a variety of purposes, including to:

- conserve property for your beneficiaries
- help manage your investments
- avoid guardianship requirements applicable to property transfers to minors and other legally incapacitated persons
- minimize probate costs by transferring property before death
- reduce or eliminate estate taxes for beneficiaries of your estate
- keep arrangements private by avoiding the public probate process

Once you have determined what your estate planning objectives are, you may want to consider establishing one or more of the following types of trusts in order to accomplish your goals.

**GOAL: to provide for a surviving spouse during his or her lifetime but ultimately pass assets onto other beneficiaries**

**TRUST OPTIONS:**

**Charitable Remainder Trust**

A charitable remainder trust allows you to provide for your surviving spouse, donate assets to charity, and avoid federal transfer taxes. The trust works like this: Income from trust assets goes to your spouse while he or she is living. After his or her death, trust assets will be transferred to the charity, and no federal transfer taxes are incurred.

**Bypass Trust (also known as Credit Shelter Trust)**

A bypass trust allows you to minimize your tax bill while still providing income for your spouse. If you place an amount equal to your applicable credit — the maximum amount of an estate that is allowed to be transferred without estate taxes — in a bypass trust, these assets will not be taxed during your lifetime or upon your death. Your surviving spouse may be the beneficiary of income from the trust and thereby continue to have the economic benefit of the trust assets. In addition, because the spouse does not own the trust assets, they will not be included in your spouse’s estate at the time of his or her death either.

Under the 2001 Tax Act, the applicable credit amount will increase as follows:

Year of death	Tax-free (applicable credit) amount
2001	\$675,000
2002	1,000,000
2003	1,000,000
2004	1,500,000
2005	1,500,000
2006	2,000,000
2007	2,000,000
2008	2,000,000
2009	3,500,000
2010	estate tax repealed*

\* Gift tax will apply on lifetime gifts over \$1 million

**Estate Trust**

An estate trust is an arrangement under which the property placed in the trust qualifies for the marital deduction, but you do not wish your surviving spouse to have complete control over the property. While your surviving spouse can distribute the trust assets as part of his or her will, he or she may not direct the use or disposition of the property during his or her lifetime. This type of trust is useful when your surviving spouse does not expect to need the property, or when he or she is incapable of managing the property without assistance. In this type of trust arrangement, the assets have the potential to grow during your surviving spouse’s lifetime. At death, all assets will become part of your spouse’s estate.

**Qualified Terminable Interest Property (QTIP) Trust**

A QTIP trust is useful when the objective is to provide income to your surviving spouse while leaving the underlying property to a different beneficiary. Your surviving spouse’s income interest in a QTIP is not taxed because of your marital deduction, but he or she has no control over the ultimate disposition of the property. QTIP trusts are frequently used in second marriages when the donor wants to provide for the current spouse for the remainder of his or her life, but ultimately wants the property to go to children from a prior relationship.

**GOAL: to save on estate taxes**

**TRUST OPTIONS:**

**Life Insurance Trust**

A primary estate tax planning objective is ensuring that the proceeds from a life insurance policy are not subject to federal estate taxes. This can be accomplished by arranging for an irrevocable trust to own the policy and serve as its beneficiary.

### **Grantor Retained Income Trust (GRIT)**

A GRIT is a type of estate freezing technique. This arrangement usually involves the creation of an irrevocable trust in which you take income from the trust for a period that lasts either for a fixed number of years or until your death. If you survive the fixed term, the property can be distributed or can continue in trust for your beneficiaries, and generally no adverse estate tax consequences relating to a GRIT would arise. However, if you die before the end of the term, the GRIT property is includible in your estate for estate tax purposes.

### **Grantor Retained Annuity Trust (GRAT) and Grantor Retained Unitrust (GRUT)**

GRATs and GRUTs are estate and gift tax planning tools that allow you to give away an asset with a greatly reduced gift tax. To create a GRAT or a GRUT, you transfer the assets to an irrevocable trust and retain an annuity interest for a specified number of years. The retained annuity interest is designated as a dollar amount or, as a percentage of the initial value of the trust assets (a GRAT), or as a fixed percentage of the annual value of the trust assets (a GRUT). The remainder interest is designated as a gift to someone. The advantage of making a gift through a GRAT or GRUT is that only the value of the remainder interest is taxable as a gift.

### **Qualified Personal Residence Trust (QPRT)**

A QPRT is created when you transfer your personal residence to an irrevocable trust for the benefit of your beneficiaries (typically children) while retaining your right to use the property for a certain amount of time. The benefits of a QPRT are that it enables you to incur gift taxes based only on the value of the remainder interest and to remove future appreciation on the property from your gross estate. You will also be able to live rent free in your home for the fixed

term. The major disadvantage is that the transfer is irrevocable and, if you outlive the term of the trust, the property will revert to your beneficiaries who will then have control of your home.

### **GOAL: to transfer property to minors**

#### **TRUST OPTIONS:**

#### **Crummey Trust (also known as a Demand Trust)**

A Crummey Trust is set up with the objective of using your annual gift tax exclusion of \$11,000 per recipient. In this arrangement, you would deposit property of up to \$11,000 per year into the trust. Each year, your beneficiary would be given a window of time during which he or she can withdraw some or all of the property. The beneficiary would be considered the owner of the trust assets and be taxed on the income.

#### **Totten Trusts**

The Totten Trust is a type of revocable trust in which you would deposit funds in a bank account for a beneficiary. Because the transfer into the account is revocable, only amounts that are actually distributed from the account to the beneficiary constitute a completed gift. A Totten Trust does not provide any gift or estate tax benefits, but it is effective as a probate avoidance device.

Contact your investment professional and/or your attorney for help in determining the kinds of trusts that are appropriate for you and your individual situation.

The above information contains only a general description of certain types of trusts. In order to be effective, trusts generally need to be carefully created and may need to meet requirements not described here. MFS does not provide legal or tax advice. Individuals should meet with their attorney or investment professional to discuss their individual financial situation and needs, to ensure that trusts are properly created, and to clearly understand all of the consequences of establishing trust arrangements.

**For further information**

Shenkman, Martin M. *The Complete Book of Trusts*, John Wiley & Sons, 1997, 320 p., \$24.95.

Croke, Frank J. and Croke, William F. *Family Trust: How to Avoid Probate, Save Taxes, Protect Your assets, Provide For Your Family*, Capital Management Press, 1999, 307 p., \$26.95.

Kraemer, Sandy F. *60 Minute Estate Planner*, Prentice Hall, 1999, 304p., \$48.

Randolph, Mary and Clifford, Denis. *9 Ways to Avoid Estate Taxes*, Nolo Press, 1998, 200 p., \$22.95.

Randolph, Mary. *8 Ways to Avoid Probate*, Nolo Press, 1999, 216 p., \$15.95.

Welch, Stewart H. *J.K. Lasser's New Rules for Estate Planning and Tax*, John Wiley & Sons, 2001, 304 p., \$16.95.

Contact your investment professional for more information or to construct a personalized Heritage Planning<sup>SM</sup> Profile to help your parents, your children, or yourself.

This material is not intended to replace the advice of a qualified attorney, tax adviser, investment professional, or insurance agent. Before making any financial commitment regarding the issues discussed here, consult with the appropriate professional.