Key Wealth Institute

Trusts 101: An Estate-Planning Primer

Trusts provide a versatile tool to achieve various estate-planning goals. They can help you reduce estate taxes, shield assets from creditors, and distribute assets to your beneficiaries according to your wishes. But while trusts offer many benefits, they are also complex legal instruments with several potential negatives. It is important to consider your needs and goals carefully before creating a trust.

The objective of this article is to present a primer on trusts, explaining how they work, outlining the different types of trusts, and examining their pros and cons so you can begin to determine which, if any, might be best suited to achieve your goals.

Before you make any decisions, though, KeyBank recommends consulting with an experienced attorney to help ensure that your trust is drafted correctly and meets your specific needs.

What Is a trust?

A trust is a legal arrangement in which one person transfers ownership of assets to a trustee, who manages and distributes those assets on behalf of designated beneficiaries.

These are the key terms used in the trust process:

- **The maker of the trust,** also referred to as the trustor, donor, or grantor. (We will use grantor.)
- **The trustee,** the person or entity who carries out the trust's provisions.
- **The beneficiary or beneficiaries** of the trust.
- **The assets** in the trust.

The trustee has legal ownership of the assets, but the beneficiaries are the ones who enjoy the advantages provided by the trust. The law and formalities for validly executing a trust vary by state law, but any competent person 18 or older may establish a trust.

In certain circumstances, a trust may be named a beneficiary of retirement assets such as individual retirement accounts (IRAs). Still, the trust itself cannot be the owner of your IRA. That would trigger a significant tax penalty. In some jurisdictions, joint trusts are common. Always check the law in your state.

How do you fund a trust?

Trusts can be either funded or unfunded during the grantor's lifetime.

In a funded trust, the assets are transferred into the trust immediately upon its creation. Those can include:

Cash and investments
Stocks, bonds, mutual funds, savings accounts

Real estate
Primary residence, rental properties, land

Business interests
Shares in a private company, partnerships

Insurance policies
Life insurance, whole life, term insurance

Tangible Assets
Artworks, jewelry, collectibles

An unfunded trust establishes the framework but does not receive any assets initially. It is often funded through the grantor's will or life insurance policies after death.

What are my options?

The world of trusts offers a broad spectrum of options. Here's a closer look at some of the most common trust types:

Revocable trusts
Often called "living trusts," their grantors retain control over the assets and can modify or dissolve the trust as they deem fit. Revocable trusts do not save on estate taxes but may help beneficiaries avoid probate.

Irrevocable trusts
The grantor relinquishes control over the assets once placed within the trust, making changes more difficult. In return, the beneficiaries may reap substantial tax benefits and asset protection.

Testamentary trusts
These are created through a person's will and come into effect only after death. They often manage assets for young children or beneficiaries requiring specific care.

Charitable trusts
Set up to benefit charities or nonprofits, they can generate tax benefits for the grantor and support philanthropic causes.

Special needs trusts
These trusts hold assets for individuals with disabilities while allowing them to qualify for government benefits.

Spendthrift trusts
Beneficiaries of these trusts are protected from creditors or their own poor spending habits.

Generation-skipping trusts
These trusts allow for tax-efficient estate wealth transfer to grandchildren or later generations

What are the advantages of trusts?

A properly managed trust can provide:

Control over asset distribution
A trust allows you to stipulate exactly how and when your assets are distributed.

Probate avoidance
Trusts usually allow heirs to bypass this sometimes lengthy and costly court process, which generally involves hiring a probate attorney. In many states, the probate process regularly lasts two years, much longer if the inheritance is contested.

Potential tax benefits
A trust can minimize estate and gift taxes.

Asset protection
A trust can shield assets for your beneficiaries from creditors and lawsuits.

Privacy
Unlike wills, trusts are not public documents.

Professional management
Appointing a professional trustee ensures expertise in asset management.

Are there disadvantages to trusts?

Trusts can be complex instruments with potential pitfalls, including:

Costs
Complex trusts often require ongoing administration and legal fees.

Loss of control
You give up ownership of assets in an irrevocable trust.

Difficulty contesting
Beneficiaries may find it difficult to contest the terms of a trust, even if they feel treated unfairly.

Is a trust right for you?

Deciding whether a trust fits your financial plan requires careful consideration. Here are some factors to think about:

Size and complexity of your estate
Larger or more complex estates usually benefit more from trusts, but even smaller estates of $100,000 or more might benefit from a trust.

Need for control
Consider your desire to retain control over assets during your lifetime.

Tax considerations
Explore how trusts may minimize estate and income taxes.

Beneficiary needs
Trusts are ideal if your beneficiaries require special care, protection, or staggered asset distribution.

Irrevocable or revocable? What do you trust?

Your priorities should also help you determine if you want to put your assets in one of the two most common types of trusts: irrevocable or revocable (living).

An irrevocable trust can offer benefits for your heirs, including minimizing taxes on income, capital gains, estate taxes, etc., by removing future appreciation from your estate. When you create an irrevocable trust, you legally transfer ownership of assets to the trust. Since the assets are no longer yours, any appreciation in their value also occurs outside of your estate. This reduces the overall value of your taxable estate.

Irrevocable trusts also can provide protection from future creditors.

Most revocable trusts do not offer those potential tax savings nor do they usually protect your heirs from creditors or lawsuits.

While the grantor is alive, however, the revocable trust offers much more flexibility and ease of administration. The trust can receive or transfer assets, be amended, or be terminated. Typically, grantors serve as the initial trustee of their revocable trusts. If the grantor trustee becomes incapacitated, a designated successor trustee takes over the administration of the trust, continuing to pay bills, etc.

For more information, please contact your advisor.

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