Using Trusts - Meeting Tax and Non-Tax Goals

Trusts have been used as integral parts of sophisticated tax and financial arrangements for centuries. Exactly how they are used, however, depends on a person's particular goals, currently applicable tax rules, and other factors. We hope this letter will give you a bit of general information about the current use of trusts to familiarize you with some of the things they might be able to accomplish for you as part of your overall tax, financial and estate planning.

Simply stated, a trust is an arrangement in which legal title to property is held by one person who manages it for another's benefit. A trust can be set up to benefit the person who created it (known as the grantor), it can be set up for beneficiaries named by that person, or both. Trusts can be set up to operate during the grantor's life or can be set up to operate pursuant to the grantor's will. They can be revocable (you can change your mind) or irrevocable. In short, trusts are very flexible entities that can be tailored to accomplish many purposes.

Among other things, trusts can:

1. help you to manage your property and investments more easily and expertly;
2. help you to avoid probate costs;
3. keep life insurance proceeds out of your estate;
4. protect the interests of your minor children;
5. preserve an estate tax break for the amount of the unified credit ($1 million in 2002 and 2003);
6. allow you to get the estate tax marital deduction for property that ultimately will go to other beneficiaries you name in your will; and
7. let you get an income tax deduction for a contribution to charity while you continue to get income from the contributed property.

Note: Due changes made in the Tax Relief Reconciliation Act of 2001, in particular to increase in the overall exemption amount that may be excluded from estate tax, the advisability of routinely establishing the types of trusts described in 5. and 6. above, should be carefully reviewed on the basis of your individual circumstances.

The tax consequences are as varied as the uses to which trusts can be put. The creation of a trust for someone else's benefit may be subject to gift tax, but the trust can be set up so that at least some contributions are gift-tax free. As far as income taxes go, trust income can be taxed to the grantor, the trust, or the beneficiary, depending upon how the trust is set up and what it is intended to do. Modest family income tax benefits may be achieved through the use of trusts, although in most situations income tax savings are no longer the main reason for using a trust. Estate tax may or may not be affected.

Finally, trusts, of course, need trustees. So that means deciding on a suitable trustee taking into account the type of trust involved. Sometimes the grantor can also serve as trustee. Or the trustee might be another family member, a friend, a professional adviser, or a financial institution.

We've only hit on some of the most basic aspects of trusts in this letter, but hope that we may have opened up some of the possibilities to you. Don't hesitate to call us if you would like to discuss how trusts can be used to achieve your tax or financial goals.