THE FACT AND FICTION OF TRUSTS

Trusts have become very popular, especially as fortunes are made in the stock market and baby boomers inherit wealth. At their most basic, trusts are nothing more than a legal vehicle for managing financial assets for the benefit of yourself or someone else. As simple as that may sound, they can be very complex, and there remain many misconceptions about trusts that often lead to their being unused or misused. Here are a few of those misconceptions.

All trusts save estate taxes. Contrary to popular belief, one of the most popular trusts today, the living trust, does not necessarily save estate taxes. Properly designed and executed, it can avoid the expense and public exposure of probate. It can be a good vehicle for managing assets for someone who is not capable of managing the assets. But as often used, a living trust does not save a dime in estate taxes, though with special provisions, it can defer estate tax upon the death of the first spouse.

The purpose of most trusts is to save estate taxes. That's a major purpose for many of the over 50 trusts available, but it's far from the only one. Trusts are also designed to manage assets and control their distribution. Trusts can save income taxes. For example, with a charitable remainder trust (CRT), the donor puts assets in the trust that qualify for an income-tax deduction. At the same time, it removes assets from the estate and thus saves estate taxes. In addition, the CRT pays out regular income to the donor, and then upon the donor's death the assets pass to the charity.

When a person remarries, they might use a bypass trust to ensure that at their death their assets—regardless of whether the assets are subject to estate tax—go to their children rather than the children from the previous marriage of their surviving spouse.

You don't need a trust unless you have a big estate. Certainly trusts are more common for larger estates. However, the estates of middle-income households can be larger than they

realize with today's retirement plans, insurance and escalating home prices—large enough to be subject to estate tax. Furthermore, even if your estate isn't large enough to be taxable, or should Congress eventually eliminate or reduce estate taxes, you may still have reason for a trust. For example, a family with a disabled adult child receiving government assistance for basic living and medical expenses might want to create a special needs trust. Friends and family can donate money to the trust, which in turn uses the money to provide extras for the child such as a vacation or a stereo system. As long as the trust doesn't use the money for basic living or medical expenses, it won't jeopardize government assistance.

Creating a trust means giving up control and flexibility. Any form of revocable trust or living trust remains completely under the control of the trust creator. However, even an irrevocable trust, which can't be changed while you're alive or which is created at your death, can still provide considerable control and flexibility. For example, "incentive trusts" may stipulate that the beneficiary graduate from college or reach a certain age before receiving trust income or assets. Often the worst problem is that irrevocable trusts are drafted with too many restrictions and not enough flexibility for the trustee.

You should always name a friend or relative as a trustee. The job of a trustee is to manage and distribute the assets according to the terms of the trust. Not all relatives or friends are up to that task, particularly for a complex trust. Failure to administer the trust properly can be costly from an investment and tax standpoint. In addition, a long-term trust could outlive family trustees. Thus, professional management may be appropriate either as a co-trustee or the only trustee.

Trusts automatically protect assets from creditors. No, but some trusts are designed to protect assets from creditors. It's a very complicated and expensive area, so only deal with experts. Even trusts set up for asset protection won't protect assets resulting from events that occurred before the trust was formed, such as back taxes claimed by the IRS.

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The Financial Planning Association of Hampton Roads, 2001 recipient of the Gold Level Achievement Award.
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