



## Price & Farrington's **Consider This!**

*Timely News and Information About  
Estate Planning and Family Wealth  
Counseling Strategies*

### ***THE POWER OF TRUST PLANNING***

**W**hat you are about to read illustrates how our law firm explains—in plain english—techniques that permit you to keep wealth in the family through the use of trusts.

**TRUSTS** have a universal importance in estate, tax and financial planning. They can be used to accomplish a broad array of planning goals, not least of which is saving thousands of dollars from **TAXES**, professional **FEES**, probate **COSTS**, creditors **CLAIMS** and **SPENDTHRIFT CHILDREN**.

Rather than the “panic and panacea” approach (“terrible things will happen if you don’t buy this book, rip out and fill in the boilerplate trust forms and all your problems will disappear in an instant with no thinking or outside help required”), you should take an objective approach to the subject of trusts. Trusts aren’t right or necessary for everyone. By consulting with a qualified estate planning attorney, you’ll find out if a trust is right for you and, if so, what type of trust and trust provisions you should consider.

At Price & Farrington, PLLC, we provide you with the detailed information you need to make a well-informed, intelligent decision whether or not a trust is the appropriate vehicle for your personal planning and how that trust can best be implemented to accomplish your goals.

### **Consider This!**

is presented by

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## TRUST

Picture in your mind a box. Let's call that fictional box a "trust." Into that box you can put cash, stocks, bonds, mutual funds, the deed to your home or even life insurance. You can put almost any asset into a trust.

When you put property into the box, you are "funding" the trust. Additional assets can be put into the trust at some later date. For example, you can even name the trust as the beneficiary of your group or personal life insurance, your pension plan or your IRA so at your death the trust will be funded.

A trust is a legal relationship that enables one party, the "trustee," to hold money or other property (trust "principal") transferred to the trust by a second party (call the "grantor," "settlor" or "trustor") for the benefit of one or more third parties (the "beneficiaries") according to the terms and conditions of a written document called a "trust agreement." That document spells out: (a) *how* the assets of the trust are to be managed and invested; (b) *who* will receive income and assets from the trust; (c) *how* that money is to be paid out; and (d) *when* principal or income is to be paid (for example, at what ages or upon what circumstances each of the beneficiaries will receive his or her share).

The key is that the trustee—for investment, management and administration purposes—*holds legal title* to the property in the trust. But the trustee may only use the property—and the income it produces—for the benefit of the beneficiaries you have selected (which may include yourself).

## TRUSTEE

You need someone to safeguard and invest the assets in the "box" and pay the income and/or principal from those assets to the people you specify. This obligation may last only a few years or it may run for generations. The party (or parties) you select to shoulder those responsibilities is called a trustee. You can have more than one trustee. In fact, you can name two or three trustees and backup trustees in case the one you've named cannot serve or for some reason refuses to serve. You can name one or more individuals and/or a corporate trustee (e.g., a bank) as trustee. When several parties are named, they are called "co-trustees." Co-trustees make decisions jointly (and are jointly liable for mistakes). You could, for example, name your child as a co-trustee of a trust share along with a professional trustee.

## BENEFICIARIES

The people for whom you've set up the trust (which may include yourself) are called the trust's "beneficiaries." They receive income from trust assets and/or principal at the ages and under the terms and conditions you specified when your attorney drafted the trust. (The most foolish thing you could try to do—next to do-it-yourself brain surgery—is draft your own trust.) The first people to receive distributions from the trust are called the "primary beneficiaries." For instance, if you said in the trust instrument that you were to be paid all the income for as long as

you live, you would be the primary beneficiary. If you stated that your child was to receive what remained in the trust at your death, he or she would be the *remainder person*.

## **LIVING TRUST**

If you set up a trust during your lifetime, it would be a “*living*” (“*inter vivos*”) *trust*. This type of trust could hold assets you put in during your lifetime, which would allow those assets to avoid probate, or the trust could receive assets you own when you die. Your will could “pour over” assets you own at death into the previously established trust. This “pour-over” will would trigger a probate for the assets it controls.

## **TESTAMENTARY TRUST**

If the trust is designed to spring into existence when you die, it is called a “testamentary” trust. Assets you own in your own name would pass from your will or living trust into this trust. Attorneys use a testamentary trust to reduce the number of documents; with a testamentary trust both your will and trust are in one document. The drawback of placing a testamentary trust inside a will is that if the will is not probated or is successfully attacked the testamentary trust might never come into existence. Testamentary trusts save neither income nor estate taxes because at the time of your death you own the assets and the income those assets produce.

## **REVOCABLE TRUST**

Picture a string on the fictional box we call a trust. That string enables you to pull back the box, reach in and take out what you’ve put in the box. A box with a string on it is a “*revocable trust*.” You can revoke your trust, take back what you transferred to it, alter it, amend it or terminate it. A revocable living trust is not an income tax-saving tool since you (and therefore the IRS) can always “pull on the string.”

## **IRREVOCABLE TRUST**

Cut the string (or create a trust that never has a string) and you’ve created an “*irrevocable trust*.” You can’t get the property back once you put it in the box. You can’t change the terms or alter, amend or revoke an irrevocable trust. These limitations, however, can provide powerful tax-planning and creditor protection since the assets are no longer owned by you (even though you can continue to “control” them).

## WHY SET UP A TRUST?

People set up trusts for many reasons. The top 10 reasons for creating a trust are:

1. You feel your beneficiary is unwilling or unable to invest, manage or handle the responsibility of a large, immediate and outright gift. Families with minor, handicapped, or merely financially or emotionally immature children or grandchildren should consider trusts.
2. You would like to postpone full transfer of ownership until your beneficiary is in a position to handle the property or income properly, or until you (or someone you name) are ready or able to part with it. For example, you may personally want to keep the income from a trust for a given number of years — or for your life — and then at the end of the term or at your death have the remaining principal go to one or more selected individuals or to a charity (a “charitable remainder trust”).
3. You want to spread the financial security of property among a number of individuals but the asset you have in mind (for instance, an apartment house or a life insurance policy) does not lend itself to fragmentation.
4. You have particular dispositive plans in mind and control is essential. For example, you want to prevent your beneficiary (e.g., a son or daughter) from disposing of or losing the family business or family home to persons outside the family (e.g., through divorce or bankruptcy).
5. You would like to protect the assets from the claims of your own creditors.
6. You want to treat your children or grandchildren equally — yet you own some property which may appreciate and some property which may fall in value. By placing both types of property in trust and giving all of your children equal shares of that trust, you can equalize the benefits as well as the risks among them.
7. You want your survivors to avoid the uncertain, public, and sometimes costly probate process at your death.
8. You want to reduce the probability of a will contest or an “election” by a spouse to take a state-mandated portion of your estate (roughly one-third) regardless of what your will provides. (This is called a surviving spouse’s “right of election.”)
9. You would like the details of your finances to be kept as private as legally possible.
10. You would like to relieve yourself of the burden of investing and managing property and want to protect yourself in the event of a physical, emotional or mental incapacity. (You may want a “*step-up trust*,” a trust that steps up and takes over when you don’t want to or can’t manage property.)

In summary, there are many management, conservation and dispositive objectives available

through one or more types of trust that are not possible with a direct gift.

## **TRUSTS THAT DON'T SAVE TAXES BUT DO LOTS OF OTHER GREAT THINGS!**

“Revocable Living Trusts” (“RLTs”), the kind you hear about all the time on the radio and television, do **not** produce income or estate tax savings. Because you can regain (and typically continue to control) the assets you put into a revocable trust, you are taxed on the income the trust assets produce. The principal in an RLT will also be included in your estate, but a properly drawn RLT (or will) can provide effective federal estate tax planning for married couples.

So, if there are no tax savings, why are RLTs so popular?

- ◆ All your assets (such as life insurance, pension plan, IRA and personal property) can be “poured into” an RLT at your death. The trust serves as a unifying receptacle for the collection of assets from a variety of sources. Transferring your real estate to your RLT during your life is particularly important if you own property in more than one state; it may save your heirs a great deal of aggravation as well as avoid multiple probates on your death.
- ◆ Unlike a will, your RLT is a private document, so the amount you leave, the people you leave it to and the terms of your gift to them will be completely private.
- ◆ Setting up a trust during your lifetime gives you the opportunity of seeing how well the trustee manages property — and seeing how well the beneficiaries handle the income or other rights you give them. If you don’t like what you see, you can make changes.
- ◆ A revocable living trust allows you to select a state where the laws will be most favorable to accomplishing your objectives. You don’t have to use the laws of your own state.
- ◆ Your trust assets will be managed for you if you are injured, ill or otherwise incapacitated.
- ◆ You can reduce the likelihood of an attack which is similar to a will contest if you’ve put significant assets into a living trust which is in effect before your death.

Here are some things to consider:

- ◆ Don’t set up an RLT as a cure-all; it *isn’t!*
- ◆ Don’t set up an RLT to save income taxes; it *won’t!*
- ◆ Don’t set up an RLT on your own to “beat the lawyers.” The laws involved are too numerous and a trust is much too complex a document to draft yourself — or to rip out of a form book — unless you are the type of person who buys “one size fits all” clothes or who can successfully perform an appendectomy on yourself. Even with an RLT, you’ll still need an up-to-date will as a backup.

**Let us repeat: *An RLT (Revocable Living Trust) is a common, highly useful estate planning***

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*tool, but only when used as part of an overall plan, and only when established and maintained by a knowledgeable estate planning attorney.*

## TRUSTS TO SAVE TAXES

You're probably wondering why tax savings weren't listed among the "top 10" reasons to set up a trust. The truth is, more trusts are set up to achieve non-tax objectives than those set up to merely save taxes.

But the right type of trust can result in **BIG** tax savings. In fact, a properly arranged trust may be the **ONLY** way in some situations to keep wealth *in* the family and *out* of the hands of the IRS.

There are many types of trusts that yield significant tax savings under current law. Two of the most important of these are: (1) the marital deduction trust and (2) the irrevocable life insurance trust.

### **The Marital Deduction Trust**

A marital deduction trust is designed to qualify the property that goes into it for the *marital deduction*" (which eliminates federal estate tax in virtually unlimited amounts on property left to a surviving spouse). Attorneys who draft a marital deduction trust also draft a second "*non-marital*" or "*family trust*," also called the "*Credit Shelter Trust*" (*CST*), a trust that can bypass estate taxes at the death of the surviving spouse.

Why two trusts? It's no great legal trick to save estate taxes when the first spouse of a married couple dies. The federal estate tax law allows a married person to pass an unlimited amount of property to a surviving spouse (assuming he or she is a U.S. citizen) — and pay no federal estate tax — if the assets are left outright (or in a manner tantamount to outright) to the surviving spouse. The marital trust is set up so that whatever goes into that trust qualifies for this very special deduction. Transferring property to this trust, either during your lifetime or at your death, essentially wipes out the federal estate tax no matter how much you place in the trust!

So, the big trick is to minimize taxes when the **surviving** spouse dies. That's when the estate gets hit with "the second death whammy." Since there's no marital deduction when the survivor dies (assuming he or she hasn't remarried), the estate gets clobbered! Federal estate tax rates are commonly more than 40 cents on the dollar and can be as high as 45 cents on every dollar!

The credit shelter trust is where the real taxes are saved; instead of giving the surviving spouse everything you own and having it all taxed in your spouse's estate at higher and higher rates, you hold back an amount roughly equal to a credit allowed to all taxpayers. This is called the "*applicable exclusion amount*." The amount protected is \$2,000,000 in 2007 and 2008. Therefore, up to \$2,000,000 of your assets can go into the CST for the express purpose of bypassing taxation in the surviving spouse's estate.

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Obviously, if you can bypass the estate tax on \$2,000,000, you've saved a considerable amount of taxes. But the savings on the \$2,000,000 (about \$435,000 if your estate is \$2,000,000 after debts and settlement expenses) is only the beginning. If your spouse survives you, by say 10 years and the \$2,000,000 is invested at, say 7.2 percent, the \$2,000,000 will have grown to over \$4,000,000. In 20 years, that \$2,000,000 grows to over \$8,000,000! By using a credit shelter trust, not one nickel of that money will be taxed in *either* spouse's estates. Think of the tax savings at your surviving spouse's bracket!

Of course, there is no free lunch. The price for this incredible tax savings is that the surviving spouse cannot be given unlimited, carte blanche control over the assets in the CST. That doesn't mean your surviving spouse gets no benefit from the assets in the CST. To the contrary, the CST typically pays all income to the surviving spouse for life. The spouse can also be given a power to use trust assets to provide for health, support, maintenance and even education without making the trust assets taxable in his or her estate on death. Best of all, the surviving spouse can be given the tax-free power to use trust assets to make gifts to his or her children or grandchildren under what is called a "limited (some call it a 'special') power of appointment."

So, the classic Marital Deduction/Credit Shelter Trust combination looks like this:

There are two special types of marital trusts that are important. The first is called a "QTIP" ("*Qualified Terminable Interest Property*") trust. Its characteristics are very similar to the CST except that (a) much more than \$2,000,000 can be placed into the QTIP and (b) the assets in the QTIP *will* be included in the surviving spouse's estate.

If the assets in the QTIP will be taxed when the surviving spouse dies, why is the QTIP so popular? Because it qualifies your assets for the marital deduction (so *no* federal estate tax is payable on the amount paid to the QTIP trust when you die), but it does *not* give the surviving spouse the right to choose who will get those assets when he or she dies. *You* make that decision.

One instance where QTIPs are appropriate is in second marriage situations where you want to be sure your property goes to the children of your first marriage but you still want to provide income for your new spouse without jeopardizing the marital deduction.

The second type of special marital deduction trust is called the "*Qualified Domestic Trust*" (QDOT). If your spouse is not a U.S. citizen, transfers to him or her during your lifetime or at your death may *NOT* qualify for the estate tax marital deduction **UNLESS** you transfer the assets to a QDOT.

A QDOT requires that the trustee be a U.S. citizen or U.S. corporate trustee, that all income be paid at least annually to the non-citizen surviving spouse and that certain other tests are met. But the moment the surviving spouse dies, if the QDOT fails any requirement, or if the QDOT distributes anything other than trust income of the surviving spouse, a federal estate tax is imposed on the value of trust assets.

<b>MARITAL DEDUCTION TRUST</b>	<b>CREDIT SHELTER TRUST</b>
INCOME TO SPOUSE FOR LIFE	INCOME TO SPOUSE FOR LIFE
SPOUSE HAS POWER TO CONSUME, USE, GIVE OR LEAVE PROPERTY TO ANYONE	SPOUSE CAN HAVE POWER TO USE OR DISPOSE OF PRINCIPAL
REMAINDER GOES TO PARTY SPECIFIED BY <b>SPOUSE</b>	REMAINDER GOES TO PARTY SPECIFIED BY <b>FIRST TO DIE</b>
ADDITIONAL FLEXIBILITY FOR SPOUSE CAN BE BUILT IN	ADDITIONAL FLEXIBILITY FOR SPOUSE CAN BE DRAFTED IN
ASSETS LEFT IN THIS TRUST <b>WILL</b> BE SUBJECT TO ESTATE TAX WHEN SPOUSE DIES	ASSETS IN THIS TRUST <b>WILL NOT</b> BE SUBJECT TO ESTATE TAX WHEN SURVIVING SPOUSE DIES

### **The Irrevocable Life Insurance Trust (ILIT)**

For the highly successful individual, aside from marital deduction planning, no means exist under current law to transfer large amounts of wealth and provide financial security that are as certain or as dramatic as the “*irrevocable life insurance trust*” (ILIT) (some call it the “Super Trust”).

Here’s why:

- ◆ Federal estate taxes on **millions** of dollars can be avoided — not only when **you** die — but also when your **spouse** dies. That’s right. This trust can bypass taxes in both of your estates. In fact, this trust can even be designed to bypass estate taxes in your children’s and grandchildren’s estates (sometimes called a “dynasty trust”). The tax savings can be staggering!
- ◆ With relatively little or no gift tax, large amounts of life insurance can be created and sheltered from both federal and state death tax — thus leveraging the tax-free estate you can effectively pass to your heirs.
- ◆ There will be no probate expenses, delays or public scrutiny with respect to the assets in the irrevocable life insurance trust.
- ◆ You specify the disposition of the trust assets in the trust document.
- ◆ By making loans to, or purchasing assets from, your (and/or your spouse’s) estate, the trustee can use trust assets at your death to help provide estate liquidity and prevent a “forced sale” (i.e., pennies on the dollar) of your business interests, real estate holdings or investment portfolio.

As is the case with every tool or technique of estate and tax planning, “there’s no free lunch.”

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The price you must pay for the incredible tax advantages of the ILIT is that you must be willing to give up:

1. the income produced by trust assets,
2. the use and enjoyment of trust property,
3. the right to name or change trust beneficiaries,
4. the right to regain the assets in the trust, and
5. the ability to alter, amend, revoke or terminate the trust.

Transfers you make to an irrevocable life insurance trust are technically gifts to the trust's beneficiaries. Fortunately, under current law, with proper drafting and planning, huge amounts can be placed into your trust—leveraged many times over through life insurance — and yet little or no gift tax will be payable.

*Imagine how much can be saved through the multiplying affect of an irrevocable trust!*

## **WHERE DO I GO FROM HERE?**

*We've mentioned only a few of the many types of trusts available in the estate planning attorney's toolbox. There are trusts for minors [2503(c) and 2503(b)], trusts for handicapped children, charitable trusts, trusts that protect assets from creditors, trusts for unique and difficult situations such as drug-addicted children and even trusts for pets.*

*Keep in mind that trusts are among dozens of other estate, tax and financial planning tools and techniques, and there are times and circumstances where a trust is not the proper tool to use — or should not be used alone. No estate planning tool or technique is a panacea; each has costs or downsides, and none should be used in a vacuum — any more than you'd expect a doctor to prescribe pills over the phone to a patient he or she has never met.*

*Insist that your advisors create a plan which (1) measures your needs and objectives, (2) establishes an order of needs and objectives and, most of all, (3) gives priority to those needs and objectives you feel are most important.*

*You probably have lots of questions at this point — such as “Do I need a trust?”, “Which type of trust would work best for me?”, and “What will a trust cost?”, “Who should I name as trustee?” or “Where do I go for competent advice?”*

*A good place to start is to contact us at 425.451.3583. But don't stop there. Educate yourself—and those you love—about the basics of estate planning. We hope this material is a good beginning.*

We wish you good planning!



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