Estate Planning Tips: Trusts Are Key

By Jeanne Goussev, J.D., CTFA and Kristi Mathisen, CPA, J.D.

Many people think that trusts are not something they would ever consider. “Too complicated,” “Too costly,” “Not necessary,” are the comments we often hear. Not so fast, we say.

Having worked with trusts for decades, we know that trusts can be as simple and as cost-effective as you want them to be. And they can be used to solve a lot of different concerns and problems, such as those in the box at right.

To give you an idea of how trusts might be useful, we came up with some examples of how different types of trusts could be used to solve issues or concerns. Keep in mind that these are meant to be general examples. We would be happy to talk to you about your specific situation to explore how trusts could be a solution.

Q: I want to provide for my children through a trust but I want to be able to change my mind about when and how.

Jeanne: One of the most common trusts we work with is a “revocable” trust, which you can change or cancel at any time. This type of trust is ideal for people who want to remain flexible about the terms of the trust. However, revocable trusts also are used by people who have assets in different states or abroad. Or who want to keep their ownership of assets private.

Here’s an example: Jim and Jane own a vacation home in California, a rental property in Arizona, and a house and small business in Seattle.

If they transfer ownership of all four assets to the “Jim and Jane Revocable Trust, in WA State,” they can continue to manage them during their lifetimes. After they’re gone, their children won’t have to deal with probate court in three different states, and they’ll benefit from the income or the sale of the assets in the trust, as Jim and Jane have specified.

Some Instances When a Trust Might Make Sense

- You want to keep what you own private, now and after you are gone
- You own assets in multiple states or abroad
- You own high-payout life insurance the proceeds from which will be taxed as part of your estate
- You want to provide for a family member with a disability
- You believe your heir(s) won't be ready to manage money
- You want your loved ones to be fully taken care of when you pass away
- You are concerned about becoming incapacitated and unable to manage your assets
- You have high exposure to federal and state estate taxes
- You want to support your favorite causes and charities and also your heirs
- You have highly valued assets (financial, real estate, a business, collectibles) that would would result in high capital gains if sold
- You want control over what your spouse can do with your assets when you pass away

Q: The house we live in keeps going up in value. How can we transfer it to our children in a tax-effective way?

Kristi: A Qualified Personal Residence Trust (QPRT) – pronounced "q-pert" – is a way to gift your house (or vacation home) to your kids at a lower value than it has now. Here's how that works. You transfer the house to a trust benefiting your children, which is in effect for a term that you specify, say 10 years. During the term of the trust, you retain the right to live in the house. The longer this "live-in" period is, the lower the gift value of the house when the trust term ends and the house transfers to your children. If you continue living in the house after that, you must pay rent to the new owners — your children. This transfers additional money to the next generation, further reducing the size of your estate.

Here's the catch: If you pass away during the term of the trust – in this case within 10 years – the current market value of the house counts as part of your estate.

Q: Our family business is going strong. How can trusts help with transferring this to the next generation?

Jeanne: For assets likely to appreciate – not just a business, but also stock portfolios, or investment properties — a good solution can be a Grantor Retained Annuity Trust (GRAT).

A GRAT allows you to zero out the current value of the asset for gift purposes. That's because after you transfer the business to the GRAT, you get back a series of annual payments that over time add up to the value of the business when transferred. Let's say you have a business now valued at $5 million and choose a 10-year term. For 10 years, you would then get annual payments of $500,000 plus a specified rate of interest.

Why a Trust?

- **To Control What Happens With Your Assets**

  You can specify when and how your assets are used during your lifetime to support you (and your spouse), and then your heirs after you are gone.

- **To Guard Your Privacy**

  The language of a trust document and the assets that it holds remain private after you are gone (unlike a will).

- **To Be Efficient**

  Assets in a trust avoid the probate process, which can be costly in terms of money, time, and family harmony.

- **To Define Your Legacy**

  The trust instructions and the beneficiaries you name reflect what you value and how you want to be remembered.

- **To Save On Taxes**

  Trusts can be used to reduce estate taxes and even income taxes.

At the end of 10 years, if the annual payments to you were funded with cash flow from the business, the business will be owned by your heirs and will not be counted as part of your estate. Even if the annual payments are a return of some of your share in the business, at the end of the 10 years some portion of the business will be owned by your heirs (and out of your estate). Just as important: If the business has increased in value more than 2.2% annually (the current IRS specified rate), that gain will have passed on to your heirs without gift taxes.

Two risks with GRATS: If you pass way before the annuity term ends, the assets in the trust go back into your estate. And, if the asset you put in the trust loses value, the strategy of passing on the appreciation to your heirs does not work.

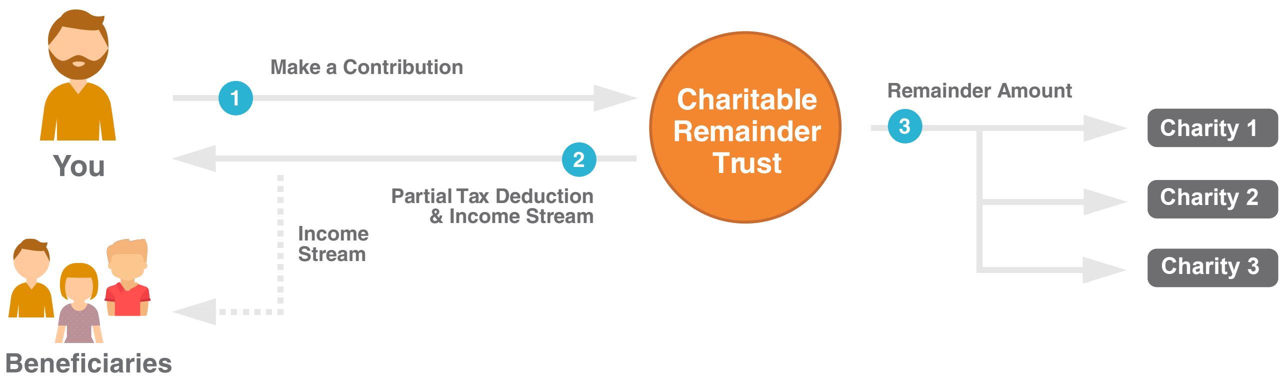
Attributes	Revocable Trust	Qualified Personal Residence Trust (QPRT)	Grantor Remainder Annuity Trust (GRAT)	Charitable Remainder Trust (CRT)	Charitable Lead Trust (CLT)
Can be changed or canceled	**YES**	**NO**	**NO**	**NO**	**NO**
Who benefits from the trust?	YOU; then any beneficiary you name	YOU; then your heirs	YOU; then your heirs	YOU; heirs if you wish; then charities	Charities; then your heirs
Created during your lifetime or upon death?	Lifetime	Lifetime	Lifetime	Lifetime or Upon Death	Lifetime or Upon Death
Term – years in effect	Your lifetime; upon death, trust can continue as "irrevocable"	Variable — you specify upfront	Variable — you specify upfront	Variable or for lifetime	Variable or for lifetime
Income tax deduction?	**NO**	**NO**	**NO**	Partial	Partial, depending on type
Estate tax reduction?	**NO**	**YES**, if you outlive the trust term	**YES**, if you outlive the trust term and the asset appreciates	**YES**	**YES**
Income tax advantage if assets in trust are sold?	**NO**	**NO**	**NO**	**YES**	**YES**, depending on type
Tax on trust income?	**YES**	**YES**, if the trust has income	**YES**, if the trust has income	**YES**, limited to payments received	**YES**, depending on type
Major reasons to consider this type of trust	You want flexibility; you have property in many states or abroad; you want your assets to be taken care of in case you become incapacitated	You want to leave your house to your children and want to limit its value for estate and gift taxes	You want to transfer an appreciating asset to your heirs and minimize gift and estate taxes	You want to minimize capital gains tax and/ or convert an illiquid asset into cash for retirement AND benefit charities	You want to benefit both your heirs and charities

Q: How can we support our favorite charities but also provide for ourselves and our heirs, say with an investment property we have owned for years?

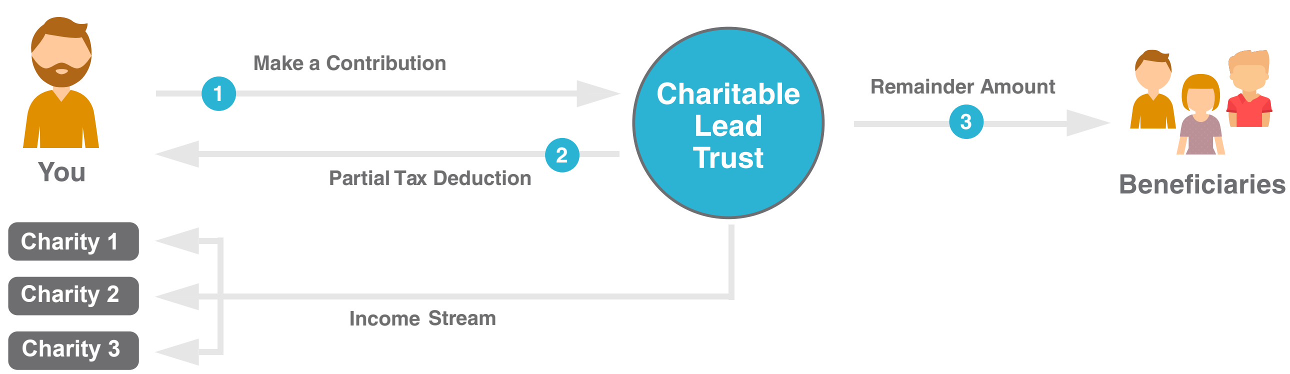
Kristi: There are two good options here, depending on your goals and situation:

1. **You and Your Heirs Benefit 1st, then Charity.** You can transfer assets, in this case the investment property, to a Charitable Remainder Trust (CRT). The trustee would then sell the building, invest the proceeds and make annual payments to you (and your spouse) usually for your lifetimes. When the transfer to the trust happens, you would get a partial income tax deduction, and then pay taxes on the income you receive annually from the trust. After the payments to you end, the charity or charities you specify get whatever remains in the trust.

   Note: If you're willing to give up the upfront income tax deduction, you can have the payments from the trust go to your heirs after you pass, then to a charity.



2. **Charity Benefits 1st, then Your Heirs.** You transfer assets, in this case the investment property, to a Charitable Lead Trust (CLT), which can then sell the property, or keep it for the investment income it generates. The CLT would make annual distributions to your favorite charities for a specified period or for your lifetime. The upfront income tax deduction you get depends on how much control you retain over the CLT and your willingness to pay tax on the CLT's income. Any growth in the trust assets above the IRS "hurdle" rate, which is 2.2% annually for July 2017, usually passes estate-tax-free to your heirs when the term of the trust ends.



Q: We have a daughter with special needs. How do we provide for her and still allow her to receive govenment benefits if necessary?

Jeanne: A Special Needs Trust allows you to set aside assets for the care of someone who is disabled or incapacitated. The assets in this type of trust can be used to pay for personal care attendants, household expenses, out-of-pocket medical and dental expenses, education, recreation, a car and other vehicles, and physical rehabilitation. Because your loved one will have no control over the money, the government does not count the assets in the trust when determining eligibility for programs like Social Security Disability or Medicaid.

Are Trusts for You?

There are many different types of trusts. And the ones mentioned here are just a sample. This is why we work closely with our clients, as well as their accountants and attorneys, to explore which type of trust(s) can best address their goals and concerns. Trusts meld together financial planning and life planning. What does that look like for your situation? We are here to help you find out.

ABOUT THE AUTHORS

JEANNE GOUSSEV is managing director of fiduciary services at Laird Norton Wealth Management. Bringing to her work nearly two decades of experience in trusts and wealth planning, Jeanne oversees LNWM's fiduciary team and manages our largest trust relationships. She is frequently sought out for her expertise on a wide variety of estate, philanthropic and tax planning matters. Jeanne is passionate about working at LNWM and being able to advise multiple generations within client families on behalf of a f irm that has been family owned since 1967. Jeanne has a bachelor's degree in Government and Environmental Studies from Bowdoin College, a Juris Doctor degree from Suffolk University Law School and is a Certified Trust and Financial Advisor. She currently serves on the board of trustees for the Seattle Estate Planning Council and Leave10.

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