Practical Uses for Practical Trusts

Trusts are valuable tools that can help you and your family achieve a variety of financial and estate planning goals. As you plan your long-term strategies, you may find many practical ways to use trusts to manage your investments, retirement, business interests, charitable goals, and your estate. Let's look at several types of trusts that may be helpful to you.

Qualified Terminable Interest Property (QTIP)

QTIP trusts are valuable estate planning tools for married couples looking to provide income to surviving spouses, to maximize the use of the unlimited marital deduction, and to designate beneficiaries for transferred assets. For illustrative purposes, let's suppose that you predecease your spouse. A QTIP trust could be created upon your death, according to your wishes. Assets transferred to the trust, which must be income producing, provide income to your spouse for his or her lifetime and, upon his or her death, will pass to beneficiaries you designate, such as your children. Properly structured, QTIPs are designed to minimize estate taxes by using the unlimited marital deduction. This type of trust also allows you to have complete control over the final disposition of your property.

QTIPs can be useful to those who have children from a prior marriage and wish their property be left to those particular heirs. Establishing a QTIP trust requires careful planning. If your QTIP is funded with unproductive assets that do not generate cash flow, it may not be able to satisfy the surviving spouse's annual income requirements, and the marital deduction could be lost.

Grantor Retained Annuity Trust (GRAT)

With a GRAT, you can put all or part of your assets into an irrevocable trust that pays you a fixed income for a specified number of years. Since the trust is irrevocable, once you place assets into the trust, they are there for good, or until the GRAT terminates and the assets pass to your designated beneficiaries.

Assets transferred to the trust are considered a gift for gift tax purposes. GRAT gifts do not qualify for the annual exclusion because the beneficiaries have a future interest, not a present interest, in the gift. Since you retain an income interest, the gift's value is discounted, reducing your total gift tax liability. However, any income is taxed to you as the grantor.

An applicable federal interest rate determines your annuity value. Your beneficiaries will receive any appreciation free of estate and gift tax, provided you survive the trust term. It is important to emphasize one major drawback to using a GRAT: If the grantor dies before the trust term expires, then the trust's full value falls back into the grantor's estate. It is important to plan for a trust term you expect to outlive.

Charitable Remainder Trust (CRT)

A CRT can ultimately benefit the charity of your choice. A CRT starts with a contribution of assets—preferably those that are highly appreciated—into an irrevocable trust. Once the trust is funded, the trustee pays the non-charitable beneficiaries (selected by the donor upon establishment) an income each year for their lifetimes, a term of years (up to 20), or a combination of the two. Income beneficiaries must receive a minimum percentage payout each year equal to at least 5% of the trust's assets, not to exceed 50%. When the trust terminates, the remaining assets will pass to charity and must be equal to at least 10% of the original assets in the trust.

Because a CRT is tax exempt, the trustee can sell highly appreciated assets on a *tax-free* basis and reinvest the full proceeds in other assets more likely to meet the growth and income objectives of the trust. Assets donated to the trust are removed from the donor's taxable estate, potentially avoiding significant future estate taxation.

The charitable deduction available to a donor may be limited according to: the type of property donated; the kind of organization ultimately receiving the gift; the donor's overall tax status; the ages of the income beneficiaries; and the trust's income payout provisions. If a deduction is limited for the current year's tax return, Internal Revenue Service (IRS) rules allow unused amounts to carry forward for up to five additional consecutive tax years.

There are numerous ways to use trusts to accomplish a variety of estate planning and financial objectives. For specific guidance, consult your financial, tax, and legal professionals.