Kahan, Kerensky & Capossela, LLP

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Trusts
Why You May or May Not Need One

Trusts can be important tools in estate planning. They can serve many of the functions of a will, but they do not completely eliminate the need for a will. They can be used to manage your assets after your death, protect those assets from your children's creditors, and provide benefits to your surviving spouse and children for many years. They are not necessary or appropriate for everyone, but in appropriate circumstances, when tailored for individual needs, they can be a highly effective means of carrying out your estate plan.

Before you accept a recommendation for creating a trust, we want to dispel a few misconceptions about trusts.

Placing all of your assets into a trust, in and of itself, will not avoid estate taxes or probate fees, and it will not protect your assets against the payment of nursing home costs. All of the assets in a Revocable Living Trust (the kind of trusts touted every week in dinner seminars) will be fully included on your Estate Tax Return. Furthermore, since Connecticut Probate Court fees are based on the value reported on the Connecticut Estate Tax Return, the probate fees will be exactly the same whether you have a trust or not.

There are some trusts designed for multi-million dollar estates that can reduce estate taxes. An irrevocable insurance trust can remove the value of life insurance proceeds from a taxable estate, but such a trust must be irrevocable, making the transfer of any assets to the trust a gift. Other irrevocable trusts may be used to "freeze" the value of assets which are put into them initially, with the expectation that those assets will grow in value substantially before they are distributed. Such trusts are designed to lower the tax impact by incurring a Gift Tax on the initial value of the assets, rather than an Estate Tax at the same tax rate, but on the appreciated value of the asset in the future. When people speak of reducing taxes by using trusts, they are generally referring to this high net worth planning.

Although most trusts are not tax-savings tools, they still can provide very important benefits. In order to understand those benefits better, let's look at just what a trust is.

A trust is a means of separating the ownership of assets into two components: Title Ownership, which determines who controls the assets; and Beneficial Ownership, which determines who will enjoy the assets and eventually receive them. When a trust is created, the Title Ownership belongs to the Trustees, and the Beneficial Ownership belongs to the Beneficiaries. A trust is created when the Settlor (also called a Grantor) transfers assets to the Trustees under an agreement by the Trustees to hold, manage, and distribute the principal and income of the trust to the Beneficiaries, in accordance with the terms of the trust. Once the assets are transferred to the

[illegible] power to [illegible] Beneficiaries and the Settlor can hold the Trustees accountable to follow the terms of the trust and to carry out the duties of the Trustees (called Fiduciary Duties) in a prudent and impartial manner.

Trusts are created in two ways: in a will (called a Testamentary Trust); or in an agreement (called an Intervivos or Living Trust). A Testamentary Trust does not come into effect until the Settlor dies. It is funded with assets of the Settlor's estate, and will subject the Trustees to the supervision and periodic review of the Probate Court until all of the assets are distributed. A Living Trust goes into effect when the Settlor transfers assets to the Trustees under the Trust Agreement. A Living Trust is not subject to Probate Court supervision (and court costs), unless a Beneficiary, a Trustee or the Settlor so requests. Living Trusts often are not substantially funded until after the death of the Settlor. Although they then receive a distribution of assets from the Settlor's estate, the Probate Court will not have jurisdiction over the Living Trust after that distribution is made, unless one of the parties (Trustee or Beneficiary), requests the court for a review. Continuing Probate Court review is the biggest difference between Testamentary and Living Trusts.

There are many reasons for creating trusts in an estate plan. Separating the Title Ownership from the Beneficial Ownership can be very useful when leaving assets to children or young adults, a spouse from a second marriage, a child with a special need, or any beneficiary in need of asset management.

Parents often want to protect assets for their children beyond the age of majority (18 in Connecticut; 21 if using the Uniform Transfers to Minors Act). Trustees can manage and invest the assets until the children are experienced enough to manage the assets on their own. In the meantime, the Trustee's can provide for the support and education of the children, while protecting the assets from the children's creditors (like a divorced spouse). The Trust Agreement may give the Trustees the discretion to provide the down payment for a house, purchase an automobile, or provide seed money for starting a business. The Settlor may personalize the terms of the trust to suit the needs of each child. Typically, the Trust Agreement will direct the Trustees to distribute whatever remains of each child's share to such child in installments. The most frequent plan that we see is the distribution of one-third at age 30, half of what is left at 35, and the rest at age 40, but the Settlor can choose whatever distribution plan seems best for each child.

Second marriages are also a common reason for creating trusts. The Settlor often wants to preserve assets for his or her own children from a first marriage, but still wants to provide support for the surviving spouse. A trust can carve out a portion of the trust assets to provide income to the surviving spouse for life, then distribute the remainder to the children, while another portion is held for the children, supporting and distributing to them at set ages, as described above. If the income from the first portion will be inadequate for the surviving spouse, it can be enhanced with other benefits described in the trust terms.

Children with special needs are another important reason for establishing trusts. The assets in such a trust may provide benefits above and beyond public and private benefits, without impacting eligibility for receiving government assistance Many parents choose to fund a Special Needs Trust right away, to make sure that the Trustees meet the child's needs as intended.

Each trust may be individually crafted to suit the specific needs of the Settlor and his or her family. By working with one of our experienced Trust & Estates attorneys, you may create exactly the kind of estate plan that you need, often including a well-crafted, individualized trust.

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Attorney Kevin McCann is a partner in the estate planning department at Kahan, Kerensky & Capossela. Attorney McCann is a graduate of Furman University and the College of William and Mary Law School. He also has an LLM from Boston University Law School. ***You may contact Attorney McCann at (860)) 812-1751 or email him at kmccann@kkc-law.com.***