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May 22, 2018

INTRODUCTION TO TRUSTS MEMO

1. INTRODUCTION.

1.1. **Estate Planning.** Estate planning involves many considerations and various legal devices to make sure your heirs (**Beneficiaries**) receive your property according to your wishes. This Memo is intended to provide you with general information about trusts, a popular — but sometimes complex — estate planning tool. The contents are based on trust statutes of the State of Washington

1.2. **Defining A Trust.** A **Trust** is an agreement under which **Property** is held and managed by one person for the benefit of another. Different types of **Trusts** accomplish different, specific goals. Each type of **Trust** varies in the degree of flexibility and control it offers.

1.3. **Types Of Trusts.** This Memo only discusses **Living Trusts** and **Testamentary Trusts**. Other types of “trusts” are not covered.

1.4. **Options.** There are many options for creating your **Estate Plan**. Each option has advantages and disadvantages. There are several documents to consider, depending on your age, marital status, wealth and capabilities of your **Heirs**, people available to administer your **Assets**, etc. The primary ways to plan for your estate is by **Will** or by **Living Trust**.

1.5. **Disclaimer.** This Memo is a brief introduction into using a **Trust** as part of a comprehensive estate plan. You should not rely on this Memo in making estate planning decisions. This Memo is not a substitute for a deeper understanding of the various issues. Each person’s situation is unique and requires specific planning. You should use professionals, such as Sonkin & Schrempp and accountants, in creating your estate plan. You should refer to this Memo from time to time as a review.

2. DEFINED TERMS. Defined terms (capitalized and/or in bold) have the following meanings:

2.1. **Beneficiary(ies).** Any person entitled to receive any economic benefit from the **Trust** through gift, devise or bequest.

2.2. **Grantor.** The person(s) who contribute(s) the assets that create the **Trust**. The **Grantor** is sometimes referred to as the “Donor” or the “Settlor.”

2.3. **Living Trust.** A **Trust** established while the **Grantor** is alive. A **Living Trust** is sometimes referred to as an “Inter Vivos Trust.”

2.4. **Party(ies).** The **Grantor**, the **Trustee** and/or the **Beneficiaries**.

2.5. **Property.** Property of any type including real property, personal property, tangible property, intangible property, equitable rights and money.

2.6. **Testamentary Trust.** A **Trust** created by a **Will**.

2.7. **Transfer.** To sell, convey, assign, pledge, hypothecate, lease, transfer or otherwise dispose of or encumber all or any **Property**, either directly or indirectly.

2.8. **Trust.** An agreement where Property is held and managed by on person for the benefit of another person.

2.9. **Trustee.** The person appointed to manage the **Trust** for the benefit of the **Beneficiaries**.

2.10. **Will.** Your last Will.

3. TRUSTS - AN OVERVIEW.

3.1. **Creation Of A Trust.** A **Trust** is created by a **Grantor** who transfers title to property to a **Trustee**, who holds title to the property for the benefit of one or more **Beneficiaries**. A person may be designated as one or more of these position. The **Grantor** establishes the parameters of the **Trust**; the **Trustee** manages the **Trust**; and the **Beneficiary** receives the economic benefits of the **Trust**.

3.2. Advantages And Disadvantages Of A Trust.

3.2.1. **Advantages.** A **Trust** offers the following advantages:

- It allows the **Grantor** to control **Property** after **Grantor Transfers** ownership.
- It can protect **Beneficiaries** who may not be in a position to financially protect themselves.
- It can protect **Property** from claims by **Creditors** or spouses of **Beneficiaries**.
- It can allow certain classes of **Beneficiaries** to benefit from certain governmental and/or wealth based programs while adding additional support to the **Beneficiaries**.
- It can provide for multigenerational transfer of **Property**.
- In certain situations, probate may be avoided.
- In large estates, it can save inheritance taxes by allowing the ‘splitting of estates,’ that is allowing a planner to use the inheritance tax exemption to be used by the first to die.

3.2.2. **Disadvantages.** A **Trust** offers the following disadvantages:

- It can restrict a **Beneficiary’s** ability to control **Property** after **Grantor Transfers** ownership.
- There are rules that have to be follow that involve time and expense. Failure to follow the rules can lead to additional costs.
- There is a loss of control regarding decisions affecting **Property**.
- A potential loss of step up in basis of certain **Property**.
- The costs of administration of the **Trust** could easily surpass any savings on probate.

3.2.3. **No Effect.** A **Trust** has no discernible effect on the following:

- Inheritance (aka Death) Taxes.
- Overall Estate costs (probate versus costs)

3.3. **Living Trust.** **Living A Living Trust** may be revocable (the creator can change revoke or change), or irrevocable (once created, it cannot be changed). **Trusts** are big in California due to California’s incredibly high **Probate** fees. When an **Estate** is **Probated** in California, the attorney gets a percentage of the estate as a fee. In Washington, the probate fee is based on the work actually done and is significantly less expensive than in California. We usually recommend a **Living Trust** only in the following limited cases:

3.3.1. To control residential or vacation property out of State. If you own real estate in a different State at time of death, you have to go through an ancillary (additional) probate in that State. Using a **Living Trust** avoids the ancillary probate. If you own commercial or investment property out of State, you should consider different ownership forms, such as a limited liability company.

3.3.2. For life insurance. This could allow for major tax saving benefits. For example, if a wife has life insurance on a husband, and the husband dies first, the value of the insurance proceeds are included in the wife’s **Estate**. If you use a life insurance trust properly, the insurance proceeds would be owned by the trust and kept out of the wife’s estate. The tradeoff is that the wife would have her use of assets in the trust limited.

3.3.3. Where a disabled relative who needs to have their assets controlled due to the disability and because of requirements of certain programs.

3.4. **Testamentary Trust.** A **Testamentary Trust** is created by your **Will**. Once established, it is managed in the same manner as a **Living Trust**.

4. **TRUSTEES.**

4.1. **Trustee’s Duties.** **Trustees** hold legal title to the **Trust Property** for the benefit of the **Beneficiaries**. **Trustee** has discretionary power to acquire, invest, reinvest, exchange, sell, convey, control,

divide, partition, and manage the **Trust Property** in accordance with the standards provided by law, including those set forth in the Washington Trust Act, Revised Code of Washington §11.98.070. The **Trustee** must:

- 4.1.1. Follow the express terms of the **Trust** instrument;
- 4.1.2. Administer the **Trust** for the benefit of all **Beneficiaries** in an impartial manner.
- 4.1.3. Manage **Trust Property** with reasonable care and skill, considering both its safety and the amount of income it produces.
- 4.1.4. Maintain complete accounts and records for the **Trust**, file required tax returns and pay required taxes.

The **Trustee** must administer the **Trust Property** only for the designated beneficiaries and may not use any of it for his or her own benefit. For example, **Trustees** are usually prohibited from entering into any transactions with the **Trust** or otherwise benefitting from the **Trust Property**.

4.2. **Trustee Attributes.** In selecting a **Trustee** you should consider the potential **Trustee's** competence and experience in managing business or financial matters as well as the potential **Trustee's** availability and willingness to serve. In general, for most Trusts, individuals, such as relatives or long time trusted friends may be your best choice to act as **Trustees**. The primary attributes of your **Trustee** should include (in the order listed):

4.2.1. **Integrity.** A **Trustee** must be honest and someone who can be relied upon to act in the best interests of the **Beneficiaries**.

4.2.2. **Common Sense.** A **Trustee** must have and use common sense. He/she must be aware of their limitations and know when to seek advice and services from professionals, such as attorneys, accountant and investment advisors. He/she also needs to balance the immediate needs of the beneficiaries along with their long range future. To spend money currently reduces how much will be left for later.

4.2.3. **Diligence.** The work of the **Trustee** is critical to the well-being of the **Beneficiaries**. Delaying a decision can have adverse consequences.

4.2.4. **Empathy.** He/she has to recognize that the beneficiary is a person with needs that should be met, not

4.3. **Number Of Trustees.** If possible, I recommend that a **Trust** has two **Trustees** with alternates. The reasons for two (rather than one) are:

4.3.1. **Continuity.** To preserve continuity. Should a **Trustee** pass away, become incompetent or not continue to serve for any other reason, a second **Trustee** will be there to carry on. With a single **Trustee**, the new **Trustee** must start from scratch and will be challenged to determine the status of **Trust Property**.

4.3.2. **Back Up.** **Trustees** frequently have difficult decisions to make, usually concerning either investments or distributions. Having two **Trustee** means that a **Trustee** will always have support to make difficult decisions. There will always be someone to bounce ideas off prior to making decisions.

4.3.3. **Security.** Your **Trustee** will always have someone watching over him/her. It will be more difficult to slack off or to act improperly.

5. **TYPES OF TRUSTS.** There are numerous types of **Trusts**, each of which have different attributes and serve different purposes. This Memo will not go into detail as to the types. For brief reference, the main types of **Trusts** for those who are not super wealthy are:

5.1. **Charitable Trusts.** By naming charities as **Beneficiaries**, you may be able to lower inheritance taxes, benefit charities and also benefit your family.

5.2. **Life Insurance Trust.** This type of **Trust** is to provide insurance policy proceeds that meet estate needs but are not part of the estate of the **Grantor**.

5.3. **Special Needs Trust.** If you have a **Beneficiary** with special needs, such a **Trust** will allow you to benefit the **Beneficiary's** standard of living without jeopardizing any program benefits to which he/she may be qualified to receive.

5.4. ***Vacation Trust.*** If you own non-income producing real estate outside Washington (your state of residence) owning the real property in a Trust will allow you to avoid ancillary Probate in the jurisdiction where the real property is located.

Please feel free to contact us regarding any questions or concerns you have.

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