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TRUSTS

Popular Trust Structures to Protect Your Wealth

Trusts are among the most powerful, common, and flexible legal tools used to protect wealth in the United States. Trusts can serve a variety of purposes, from minimizing estate taxes to shielding assets from creditors, predators, future ex-spouses, and oftentimes from beneficiaries themselves. You can use trusts to identify how you would like assets to be distributed to your heirs, often with a great degree of specificity. Using trust structures can help you reduce the tax burden on you and your heirs, avoid your estate going through probate (a public process), and ensure a smoother process for heirs.

There are a wide variety of different trust structures, each with different purposes and advantages. This article explores commonly used trust structures and discusses when each may be appropriate.

What is a Trust?

A trust is a **legal arrangement** in which a person (the **grantor** or **settlor**) transfers assets to a **trustee**, who manages those assets for the benefit of one or more **beneficiaries**. All trusts fall into one of the following two categories: **revocable** (modifiable) or **irrevocable** (generally unchangeable once established), and they can be tailored to meet a variety of financial or personal objectives.

Types of Commonly Used Trust Structures

>> Revocable Living Trust

OVERVIEW:

A revocable living trust is one of the most common trust structures for estate planning. It allows the grantor to retain control over the trust and its assets during their lifetime. They can change the terms, add or remove assets, or even revoke the trust entirely. These trusts are sometimes called Inter vivos trusts (Inter vivos means “between living persons”) and they often include provisions that outline how the grantor would like to be cared for at the end of their lives. It is common for married couples to have joint revocable living trusts.

BENEFITS:

- **Avoids probate:** Assets in a revocable trust do not go through probate court, which can save time, reduce legal fees, and enhance privacy.
- **Continuity:** In case of incapacitation, a successor trustee can step in without court involvement.

DRAWBACKS:

- **No asset protection:** Because the grantor retains control, the assets are still subject to creditors and lawsuits.
- **Assets need to be retitled:** The revocable trust only controls those assets which are held by the trust. This means the grantor must take the appropriate steps to re-title real estate, bank accounts, investment accounts, and any other assets he or she would like to have controlled by the trust terms. Failing to retitle assets to the name of the trust could result in assets being subject to probate, and even worse, potentially transferring to unintended beneficiaries at the grantor’s passing.

BEST FOR:

- Individuals seeking simple estate planning, privacy, and ease of asset transfer at death. Married couples seeking an efficient, private way to transfer control during their lifetime and to transfer assets at death. These trusts can also be an efficient way to transfer real estate located in states other than the state in which the individual lives.

>> Irrevocable Trust

OVERVIEW:

An irrevocable trust, once established, generally cannot be changed or revoked without the permission of the beneficiaries. Gifts to these trusts are considered completed gifts for Federal Estate/Gift Tax purposes and cannot be unwound. The finality of these gifts is what makes an irrevocable trust effective for asset protection; Since the grantor no longer owns the assets, creditors generally cannot make a claim on them.

BENEFITS:

- **Asset protection:** Since you no longer own the assets, creditors generally can't reach them.
- **Estate tax reduction:** With most irrevocable trusts, the assets are removed from your taxable estate.
- **Medicaid planning:** Properly timed transfers can help one to qualify for long-term care assistance.
- **Liquidity at death:** Irrevocable trusts often hold insurance policies that pay cash to the beneficiaries upon the grantor's death. These trusts can be critical in paying estate tax liabilities in families where the majority of the wealth is in real estate, a closely held business, or some other non-marketable asset.

DRAWBACKS:

- **Loss of control:** Once you transfer assets into the trust, you can't get them back.
- **Complexity and costs:** Requires careful planning and legal assistance.
- **Highly scrutinized:** These trusts can be very technical, as the provisions are based on decades of case law and IRS rulings. It is important that families follow the rules of these trusts when using them to minimize tax liability or exposure of the assets to creditors.

BEST FOR:

- High net worth individuals seeking asset protection or tax mitigation.
- Families who wish to reduce their taxable estate but are not ready to give their beneficiaries unfettered access to gifted funds.
- Those seeking to maintain eligibility for means-tested public benefits like Medicaid and Supplemental Security Income.

>> Charitable Remainder Trust (CRT)

OVERVIEW:

A Charitable Remainder Trust allows you to donate assets to a trust, receive an income stream for a set period, and then have the remaining assets go to a designated charity.

BENEFITS:

- **Income tax deduction:** Based on the present value of the interest expected to flow to charity at the end of the trust term.
- **Not subject to taxes:** Because these trusts are not taxable, gifting appreciated securities into the trust and then having the trust sell them can be a powerful tax planning strategy. It should be noted that the distributions made to the income beneficiary will be taxed based on the character of the income produced inside the trust, so realization of the gain is not completely avoided by having the CRT sell the asset.
- **Supports a charitable cause:** For those who are already planning to leave a large portion of their estate to charity, this can be an effective way to accomplish that goal while also getting income tax benefits during their lifetime.

DRAWBACKS:

- **Irrevocable:** You cannot change your mind after establishing the charitable trust.
- **Complex set-up and ongoing administration:** It is best to establish a charitable trust through your attorney and/or CPA, as these professionals will have the tools to calculate your charitable deduction in the year the trust is established. It is also good to have your CPA help with the trust tax return and distribution calculations each year, as most investors are not familiar with the inner workings of these trusts.

BEST FOR:

- Philanthropically inclined individuals with appreciated assets seeking to minimize taxes.
- Executives looking to generate a retirement income stream while minimizing taxes due on company stock.
- Families with appreciated securities that are looking to pass assets to children while the parents are alive and able to help the kids learn to manage wealth.

>> Charitable Lead Trust (CLT)

OVERVIEW:

The opposite of a CRT, a Charitable Lead Trust provides income to a charity for a certain period, with the remaining assets eventually going to non-charitable beneficiaries (like children).

BENEFITS:

- **Reduces estate and gift taxes: C**haritable donations reduce the gift tax and estate tax liability of the estate.
- **Supports a charitable cause:** A CLT supports charitable causes while preserving family wealth.

DRAWBACKS:

- **Complex set-up:** Much like Charitable Remainder Trusts, most families find it helpful to lean on their tax and accounting teams to run the trust calculations and file annual tax returns.
- **Must be carefully structured:** The trust must meet specific IRS requirements to qualify for tax benefits.

BEST FOR:

- Wealthy donors who want to provide for charity now while transferring wealth to heirs later. These trusts work well when funded with highly appreciated securities, much like charitable remainder trusts do.

>> Special Needs Trust (SNT)

OVERVIEW:

This trust is designed to benefit individuals with disabilities without disqualifying them from government assistance programs such as Medicaid or Supplemental Security Income (SSI).

BENEFITS:

- **Preserves eligibility:** Special needs trusts are structured to ensure that beneficiaries remain eligible for government benefits.
- **Supplemental support:** SNTs allow for discretionary spending on quality-of-life enhancements (e.g., education, recreation, etc.).

DRAWBACKS:

- **Highly structured:** Strict compliance is required to avoid jeopardizing benefits.
- **Complex:** A Special Needs Trust can be complicated to set up and manage, often requiring legal assistance.

BEST FOR:

- Parents or guardians of individuals with special needs.

>> Qualified Personal Residence Trust (QPRT)

OVERVIEW:

QPRT is a type of irrevocable trust that removes a personal residence from your estate, allowing you to continue living in it for a set number of years.

BENEFITS:

- **Reduces estate taxes:** A QPRT reduces estate taxes by transferring the home at a reduced value. These trusts are commonly established with children as beneficiaries. The value of the home is reduced for estate purposes because the parent is not giving away the entire asset (as they are establishing a period of time during which they will continue to live in the home).
- **Allows continued use:** The grantor may continue to live in the home during the trust term.
- **Allows the value of the home to grow outside of the taxable estate:** Once a property is gifted to a QPRT, the value of that gift is locked in for estate tax purposes. Any price appreciation after the QPRT is established is not included in the taxable estate of the grantor when he or she dies.

DRAWBACKS:

- **Death before the end of the term may negate some of the tax benefit:** If the grantor dies before the term ends, the home reverts to the estate.
- **Loss of flexibility:** The grantor’s ability to manage the property may become limited.
- **Irrevocability:** There's no turning back once a QPRT is established. There is flexibility to sell the property and purchase another inside of the QPRT, but the steps are complex and should be done with the assistance of your lawyer or accountant.

BEST FOR:

- High net worth individuals with valuable primary or vacation residences. These trusts are especially useful if the next generation intends to keep the property in the family.

>> Dynasty Trust

OVERVIEW:

Dynasty Trusts are long-term trusts designed to pass wealth across multiple generations without incurring estate, gift, or generation-skipping transfer (GST) taxes.

BENEFITS:

- **Long-term wealth preservation:** Dynasty trusts maintain family wealth across generations.
- **Minimize estate taxes:** Dynasty trusts allow wealth to grow without incurring transfer taxes for generations.
- **Asset protection:** Protects assets from beneficiaries' creditors and divorces.

DRAWBACKS:

- **Complex and costly to set up and maintain:** These trusts navigate the complex world of GST tax. These trusts should be drafted by lawyers with experience in the field and those lawyers may need to be licensed to practice in far-off states like Delaware. The income tax returns can be complex for these entities, so they are best prepared by a knowledgeable CPA.
- **Rule against perpetuities:** Some states have laws requiring that interests vest within a certain period of time; dynasty trusts are subject to state laws on perpetuities, though some states have abolished these limits.

BEST FOR:

- Families with significant wealth who want to create a multigenerational legacy.
- Parents whose children already have assets in excess of the Federal Estate Tax Exemption.

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>> Intentionally Defective Grantor Trust (IDGT)

OVERVIEW:

IDGTs are a unique type of irrevocable trust where transfers of property are considered complete for estate/gift tax purposes but not for income tax purposes. Because the grantor continues to pay any taxes due on income created within the trust, the trust is essentially allowed to grow unencumbered by taxes, allowing for much greater growth potential of assets that will not be subject to estate taxes at the grantor's passing.

BENEFITS:

- **Asset growth:** An IDGT offers enhanced growth potential of assets outside the grantor's estate.
- **May allow for swapping of assets:** If the trust holds highly appreciated stock, the grantor can exchange the stock for cash or any other non-appreciated asset, allowing for the stock to get a cost basis step-up at death.

DRAWBACKS:

- **Tax burden:** An IDGT could place too onerous of a tax burden on the grantor. When deciding on an appropriate amount to fund the trust with, one should make sure that the ongoing income tax burden is factored into the analysis.

BEST FOR:

- Families with large taxable estates who are looking to maximize the growth potential of gifted assets.

Final Thoughts

Choosing the right trust structure depends on your financial situation, goals, state laws, and family dynamics. While revocable trusts are excellent for simplicity and probate avoidance, more sophisticated options can provide powerful benefits for tax planning and long-term security.

Consulting with a team of advisors, including an estate planning attorney, CPA, and financial advisor, is critical. Trusts are highly customizable, and professional assistance can help guide you to select and design the right structure to meet your needs.

Whether you're looking to protect assets, reduce taxes, care for a loved one with special needs, or leave a charitable legacy, there's likely a trust that fits your goals and will provide you with peace of mind. Your Coldstream advisor, along with your estate planning team, can help you explore which types of trust or trusts might help support your family's planning objectives.

Coldstream can help.

Contact us to discuss your family's long-term estate planning goals. Reach out at 452.283.1600 or info@coldstream.com. We look forward to learning more about the legacy you want to create.

Contributors

IAN CURTISS, CFA®, CFP®, CPWA®, CHSNC®
Wealth Manager
Ian.Curtiss@coldstream.com

GLEN GOLAND, JD, CFP®
Wealth Manager
Glen.Goland@coldstream.com

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