IS A TRUST RIGHT FOR ME?

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For the most part, a trust, whether operable during life or after death is generally used to give its creator the ability to control the flow of a person's property to beneficiaries following death while attempting to minimize if not avoid estate taxes. In today's world, it might not make sense to have a trust instrument because of the $5.0 million applicable exclusion (increased for inflation) for a single person or $10.0 million for a married couple.

With the increase in the Federal Estate Tax exclusion, a trust instrument (like a Last Will and Testament) can provide assurance that a person's assets actually flow to the beneficiaries of their choice and in manner to protect a beneficiary from themselves. However, with every benefit that comes with a trust, there are also issues that need to be addressed that often times are forgotten. This article will cover why you might consider a trust instrument as well those situations where it might not make sense. The major issue covered by this article is controlling where assets go after a person's death and any tax implications that may need considering.

Assume that we are dealing with a married couple (Spouse1 and Spouse2). This is the second marriage for Spouse1 and Spouse2 and both spouses have children from former marriages. Let's also assume that the combined assets of the marriage are approximately $500,000.00 excluding the value of the couples Florida homestead property. Both spouses want to be sure that their children by birth are each afforded a portion of their estate following Spouse1 and Spouse2's death. Because the marriage is in excess of 10 years, the assets have long since been co-mingled. Spouse1 is now terminally ill and wants to know how he or she can provide for his or her children regardless of Spouse2's needs.

A simple solution is to separate some of the couples' assets into accounts in the name of Spouse1 and his or her children's names with right of survivorship or pay on death. But this is fraught with possible consequences such as the account being exposed to the creditors of Spouse1 and his or her children as well as the possible withdrawal by one of Spouse1's children without the knowledge of the others. Moreover, at Spouse1's death, Spouse2 may need those funds for his or her medical needs which won't be available if Spouse1's children withdraw the funds and divide it among themselves. Lastly, Spouse1's estate may be exposed to gift tax issues (although this is unlikely given the size of the estate in this example and today's current federal gift tax laws).

The other possible solution is to create a trust (either in Spouse1's Last Will and Testament or outright via a Revocable Trust). If Spouse1 (the ill spouse) re-titles a portion of the married couples joint assets into Spouse1's trust, those assets are possibly exposed to his or her creditors in the event of a catastrophic event not covered by insurance. The trust assets exposed to creditors will largely depend upon the type of asset re-titled in the name of Spouse1's trust.

Spouse1's trust could contain provisions that fund a separate trust ("Credit Shelter Trust" or "Marital Trust") which can provide income to Spouse2 for his or her life. At Spouse2's death, the remaining principal from the Credit Shelter Trust can be paid out to Spouse1's children. Should there be a need for additional funding to assist Spouse2 during his or her remaining life (e.g. health needs), the Trustee could provide those funds from remaining assets that Spouse1's children would eventually receive. Given the size of Spouse1's estate in this example no Federal or Florida estate tax would be due under the current laws. So far everything seems to be great.

But, suppose Spouse2 lives another 10 years and the value of assets that make up the Credit Shelter Trust grow 10 fold (from $250,000.00 to $2.5 million). Because the Credit Shelter Trust asset had a basis increase at the death of Spouse1 to $250,000.00, and such estate assets were not transferred outright to Spouse2, the children of Spouse1 will not get an additional step-up in basis when Spouse2 dies. When Spouse1's children eventually get the remaining principal balance from the Credit Shelter Trust, they will ultimately be responsible for the capital gain increase from $250,000.00 to $2.5 million upon the sale of those assets. Obviously not what was desired.

As an alternative, Spouse1's assets could be moved to a By-Pass Trust upon his or her death with an independent Trustee taking control of the distributions. Income generated by the By-Pass Trust along with principal could be paid out to Spouse2 at the discretion of the Trustee. At the death of Spouse2, the remaining assets placed in the By-Pass Trust will receive a step-up in basis when paid out to Spouse1's children. The only downside here is that the assets placed into Spouse2's By-Pass Trust will be included in his or her gross estate for purposes of Federal Estate Tax calculation. Given the size of this estate example and the current laws in effect, no estate tax would be triggered.

Other considerations should be taken into account when deciding the type of testamentary documents that are best for you. One of those considerations is the overall expense of purchasing a Last Will and Testament versus that of a Trust. In the author's opinion, if you have an estate where the gross assets are less than $300,000.00, a trust instrument may not make sense, unless you want to be certain that your children (from a previous marriage) receive something following your death and you are willing to risk having your assets exposed to creditors while you and your spouse are living.

No doubt deciding whether a trust is right for you is not a simple exercise and your best option is to visit the attorney of your choice to discuss what you and your spouse want to accomplish upon death. Your attorney can discuss with you the changing estate laws and try to design a plan that will fit your desires and yet be flexible enough to remain valid in the event Congress changes the current I.R.S. income and estate laws. It could be the best investment of time you make.

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