Morgan Stanley

How Can Trusts Help Me Achieve My Wealth Goals?

Trusts can help pass along family values as well as wealth, avoid future conflicts about how assets are distributed, protect your heirs from creditors and preserve assets by reducing tax liabilities. Trusts also generally bypass probate, which can help avoid public attention and expedite distribution of assets.

Q. What is a trust?

A. Legally, a trust is a contract that determines when and how certain assets are to be administered, by whom, and for what specific purpose. In practice, trusts are versatile planning instruments that allow you to be very specific about what you want your assets to accomplish in the future. They come in many forms, and can be structured to meet a wide variety of needs.

Q. Who participates in a trust?

A. All trusts include the following three elements:

- **GRANTOR** — This person or institution transfers the assets into the trust. If you choose to create a living trust for your children that is funded with stocks or other assets, you become the grantor.
- **BENEFICIARY** — Each person or institution receiving money or other assets from the trust, according to the terms established in the trust documents, is known as a beneficiary.
- **TRUSTEE** — A person or institution must be designated with the duties of administering, investing and distributing assets in the trust. This responsibility falls on one or more named trustees. The trustee is the legal owner of the trust assets.

Q. Do the parties to a trust ever overlap?

A. Yes, quite frequently the same person or institution may be grantor as well as a trustee and / or beneficiary of the trust.

Q. Aren't trusts just tools for use by the very wealthy?

A. Actually, trusts can solve common problems that many people face, not just the wealthy. From helping to reduce estate taxes to assuring a fair distribution among family members, trusts are tools that work for almost everyone. ▶

Q. Does it matter where my trust is established?

A. Your trust will generally be subject to the laws and jurisdiction of the state in which you set up the trust. There are important differences from one state to the next. For instance, some states:

- are more flexible in that they allow for the creation of multigenerational dynasty trusts;
- provide greater investment management flexibility through the creation of directed trusts;
- offer the additional tax advantage of imposing no state fiduciary tax; or
- allow a higher level of privacy.

Privacy, Protection and Control

Q. Will a trust protect my financial details?

A. Under a conventional will—a public document—the assets left to a spouse and/or family members become a matter of public record during the probate process. Assets placed within a trust stay private.

Q. How can I protect my family from creditors?

A. Asset protection trusts and spendthrift trusts can be created to protect assets from creditors.

Q. How much control can I retain in a trust?

A. There is a trade-off between tax advantages and control. You have complete control with a revocable living trust—a flexible estate planning tool with the primary purposes of helping individuals avoid probate and having a plan in place in the event of incapacity or death. This kind of trust becomes irrevocable upon the grantor's death. Please note that other types of revocable trusts generally do not become irrevocable on the disability of the grantor. These revocable trusts are included in the grantor's estate and if the grantor is subject to the estate tax, the assets held in the trust would be included in the calculation of the grantor's estate tax.

An *irrevocable* trust can serve as a tax planning tool. Assets placed within an irrevocable trust are generally not counted as part of the grantor's estate, which saves on estate taxes and allows the assets to remain confidential. The trade-off is that the grantor must accept strict limits on control and use of the

Commonly Used Strategies for Family Giving

Gifting wealth within the family is a common way individuals transfer their estate. Trusts are flexible enough to allow you to plan for multiple members of your family and even across multiple generations. As grantor of a trust, you would have ways to facilitate the transfer of assets to family members while retaining some control over the process and use of the assets. For example:

QUALIFIED TERMINABLE INTEREST PROPERTY (QTIP) TRUST—A trust for the benefit of the spouse that qualifies for the estate tax marital deduction. This type of trust allows provision of lifetime income for a spouse without the grantor losing control of the ultimate distribution of trust assets among the beneficiaries. This trust is commonly used in the case where the grantor is in a second or third marriage and desires to provide for the current spouse but wants to eventually leave the asset to the children of a prior marriage.

GRANTOR RETAINED ANNUITY TRUST (GRAT)—A sophisticated gifting strategy employed by wealthy individuals, this irrevocable trust "freezes" the value of assets transferred to the trust for tax purposes at the time the trust is established. Grantors retain an interest in the assets transferred to the trust, while the "gift" is the remainder interest in the trust assets (the "remainder interest" is equal to the growth in the value of the assets held in trust during the term of the GRAT that exceed the IRS assumed rate of return for assets held in a GRAT). The entire original principal of the GRAT, together with the IRS assumed rate of return, is distributed to the grantor as the annuity.

QUALIFIED PERSONAL RESIDENCE TRUST—As one of the largest components of an estate, a home may be an estate tax liability all by itself. A qualified personal residence trust may allow an individual to remove the home's value from his or her estate while maintaining the right to live in the home for a number of years before ownership is transferred to the trust beneficiaries.

CREDIT SHELTER TRUST—The purpose of a credit shelter trust (also called a bypass, unified credit, family or A/B trust) is to ensure utilization of a spouse's exemption from estate taxes. These trusts often pay income to the surviving spouse for life.

The need for these trusts was minimized under the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010. The legislation allows for the unused portion of a spouse's exemption to be available to be used at the death of the surviving spouse. The 2012 Tax Payer Relief Act extended this benefit making the federal exemption portable.

Some may conclude that portability eliminates the need to set up a credit shelter trust. However, a credit shelter trust is still useful to remove appreciation from the estate of the first spouse to die and to address state exemptions, affirmative election, complications upon remarriage, creditor protection and additional exclusions for gift or generation-skipping taxes.

Talk to your tax advisor for information on how the specific provisions apply to you.

DYNASTY TRUST—A dynasty trust may last for several generations by taking advantage of specific state laws that allow such trusts, for instance, in Delaware. It can help minimize estate taxes in each generation and provides a potential tax benefit. Age-based distributions may be set up. For example, one-third of the trust for each beneficiary might be paid out when that beneficiary reaches age 30, another third at age 35 and the remainder at age 40.

assets placed within the trust. The grantor would generally have no control over an irrevocable trust and the assets would no longer be considered to belong to the grantor for any reason.

Passing Wealth Down to Your Children

Q. What if only one of my children wants to run my business?

A. A trust can help you divide assets equitably. Say an entrepreneur has four children and wants each to have an equal share of his estate. However, only one child wants to run the business and the others would rather cash out their interests. If the entrepreneur simply leaves equal portions in his will, the business might have to be sold for the three children to get their shares. Instead, the business owner can create a trust and purchase life insurance, with the trust owning the policy. When the entrepreneur dies, three heirs receive a cash payment from the policy and the fourth uses his or her share to help buy the business from the others.

Q. What about selective treatment of other assets?

A. If only one child has an interest in keeping a family summer home, sailboat or some other large asset, a trust can allow you to gift individual assets to each child according to his or her interests while keeping the overall distributed value equal. While this could be done with a will, a will is a public document and therefore these gifts would technically be public knowledge.

Q. Can a trust help me provide for my special needs child?

A. Trusts are frequently used for this purpose. Outright gifts to people with disabilities can jeopardize a special needs child's government benefits. Special needs trusts can fund certain types of expenditures without putting benefits at risk.

Providing for Your Favorite Charities

Q. Can I reserve an asset for a charity but still draw an income?

A. Yes. Planned giving arrangements not only ensure that a favorite charity or institution benefits from a trust, but they also can allow the possibility of current income for you or your family while providing immediate tax advantages. For example, a charitable remainder trust is an irrevocable trust created to provide income or annuity payments for a beneficiary (often the grantor). When the trust expires, the remaining assets are transferred to a charitable organization, which is usually determined by the grantor. Aside from ensuring a substantial contribution to a favorite charity, this type of trust can help wealthy individuals and families defer capital gains taxes, increase spendable income from unproductive investments, qualify for charitable income tax deductions and reduce or eliminate estate tax liabilities.

Q. Can I give income but not the asset to a charity?

A. Yes. A charitable lead trust is the opposite of a charitable remainder trust. This trust uses either an annuity or unitrust income payout structure to pay chosen charities first. At the end of the trust's term, remaining assets are usually transferred to the donor's beneficiaries. Significant income tax deductions may be achieved if the donor creates the trust during his or her lifetime.

Deciding When Professional Trust Management Makes Sense

Q. What are the responsibilities of a trustee?

A. The many responsibilities of trust administration — making payments to beneficiaries, paying taxes, ongoing reporting — require an eye for detail. The job may last for decades and often involves many difficult decisions about how best to balance complex family and financial matters. Here are some of the most common tasks a trustee will be required to perform:

- Manage accounting functions such as quarterly reporting, allocation of receipts and expenses, filing of tax returns and segregation of income and principal
- Disburse payments to beneficiaries
- Collect income
- Oversee investments, either by 0investing independently or by hiring a reputable outside manager
- Maintain a fiduciary commitment to act solely in the best interests of the trust

Q. How do I choose a trustee?

A. Since trustees are charged with carrying out both the spirit and the letter of the trust, it would seem to make good sense to choose a trustee from among family members. In practice, however, the demands of administering a trust can become cumbersome and the risks can be significant — sometimes including considerable financial liabilities. When considering selection of a trustee, it is particularly important to convey your views about the needs of the family and your perspective about the dynamics within the family. You want the trustee to have enough information to fully understand the responsibilities involved so that the trust can be administered effectively. You may be best served by having a seasoned professional to shoulder these responsibilities. A professional trustee has the time, expertise, impartiality, continuity and administrative skills and resources to properly manage your trust. Your Morgan Stanley Financial Advisor can connect you with a trust specialist who can assist in reviewing the needs of your trust and guide you to a number of solutions that may ensure that the provisions of the trust are met.

Key Trust Terms

Trusts are commonly described according to when they come into effect and by what they are primarily designed to do. Some terms to keep in mind include the following:

AN IRREVOCABLE TRUST is a trust that, once created, generally may not be revoked or amended by the grantor. Most trusts used for income, gift or estate tax planning are irrevocable; this is generally necessary to gain and preserve intended tax advantages.

A REVOCABLE TRUST is a trust that is subject to being revoked or amended by the grantor. This type of trust often is used when the primary objective is to maintain privacy during the grantor's life or at the time of distribution.

A LIVING TRUST (INTER VIVOS TRUST) is any trust created during the grantor's lifetime. An example would be a revocable living trust created to protect an estate should the grantor lose competence.

A TESTAMENTARY TRUST is a trust created as part of a last will and testament that takes effect after the grantor dies.

A UNITRUST is a type of trust in which a certain percentage of the annually assessed fair market value of a trust property is paid to the trust's beneficiary. This term should not be confused with the common British term "unit trust," which is defined as an open-ended mutual fund.

AN INSURANCE TRUST is an irrevocable trust that holds life insurance policies on one or more individuals. This type of trust is often used to exclude life insurance proceeds from estate taxes. When the insured dies, the trust receives, manages and/or distributes the proceeds.

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