A TRUST FOR YOUR NEXT GENERATION

By Kristi Mathisen

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Of the many accounts you can set up for your children/grandchildren (such as 529 Plans for education and custodial bank/investment accounts), none provide the wide-ranging benefits of a properly structured trust. Contrary to the common perception that trusts spoil children, we have seen that trusts can be tools for teaching and preparing young people to handle wealth responsibly, as well as a solution for heirs uninterested or irresponsible when it comes to their finances. First, let's discuss why many high-net-worth families establish trusts for their next generations, and then consider some of the ways a trust can be funded.

4 KEY BENEFITS

1. Control. With a trust, you have maximum control because you determine the terms when it is set up. You can be as specific – or general – as you want. Here are the key reasons control is important:

- **Age of majority is 18 or 21 in most states**. The age of majority is 18 in Washington State, at which time children gain full control over assets in their names, and inheritances that were not made in trust. Custodial accounts set up for minors are transferred to them outright at age 21 (or 25 in certain circumstances). A trust, however, allows you to specify at what age children get trust assets and/or income and for what purposes. This can vary widely, including supplemental lifetime income, an emergency safety net, or to fund major purchases — education, housing, or even to start a new business.

  What if the young person has shown a lack of interest or ability in managing money? A trust can provide a lifetime of financial support but limit his or her ability to deplete the trust.

- **If you divorce, or pass away and your spouse remarries**. In case of divorce, assets placed in a trust for the benefit of the children (either during the marriage or after), belong to and are controlled by the trustee who is normally not either one of the parents. In case of death, you can specify that your property goes into a trust to support your spouse but passes on to your children (or whomever you specify) at your spouse's death. Otherwise, your spouse could do whatever he/she wants with the assets, in ways you had not intended.

- **If the children marry and then divorce**. Assets placed in trust for a child or grandchild are his/her separate property. If the child marries and then divorces, the trust assets won't be given to the spouse, even in community property states such as Washington. This could provide greater asset protection than a pre-nuptial agreement.
- **If a child becomes disabled or incapacitated.** A trust for the benefit of a young person can include language that contemplates a current or future need for a Special Needs Trust. These trusts can fund the living expenses of the beneficiary without disqualifying her/him from receiving government aid, such as Medicaid or Social Security. This could apply to young people who have latent health or behavioral issues; they may be fine now but worse off in five or 10 years.

2. Financial Education/Incentivization. A trust is essentially an investment in your heirs, and the more involved they are in that investment, the more they are likely to appreciate it and guard it. Starting at a relatively young age (teenage years), they can begin attending meetings with the trustee and be encouraged to ask questions. This helps open up discussion about all sorts of financial topics. At older ages, generally over 21, the child or grandchild could become a co-trustee of the trust established for his/her benefit.

Trusts can also be designed to provide incentives, such as paying for graduate school IF the beneficiary maintains a certain GPA in college, or paying for a wedding, a down payment on a first home, and other major life events.

3. Asset Protection. Assets placed in an irrevocable trust (that you don't benefit from) – which is the usual vehicle – are not considered your property, so they are unavailable for legal settlements, with some caveats: the trust cannot be created to defraud creditors, and no funds are transferred to it during the "look-back periods" that allow for the undoing of transactions during bankruptcy proceedings. Creditors of your heirs (the trust beneficiaries) are also usually not able to access assets held in the trust.

4. Privacy. Assets placed in a trust for your descendants and that you don't control usually remain outside of your estate (therefore not included in your federal or state taxable

The Meaning of Irrevocable

Most trusts set up for children/grandchildren are irrevocable, meaning that once they are established, they cannot be dissolved. You, as grantor of the trust, specify at the time of trust creation how long the trust will last and what its purpose and administration will be. In Washington State, a trust can last for as long as 150 years. But many irrevocable trusts are designed to be in effect for much shorter periods, perhaps just a few years until a beneficiary attains a specific age. What if circumstances change? Many states — including Washington — have legal processes that allow trusts to be amended so that their purposes can be accomplished.

The Key Role of Trustee

For the trust to work as you intend, whom you choose as trustee is critical. If the beneficiaries are under 18, multiple trustees are a great idea. A trusted adult family member (your spouse, your siblings or others) can serve as co-trustee along with a corporate trustee, such as Laird Norton Trust Company. This arrangement brings to the trust the experiences of both an individual who knows your family well (values, needs and goals) as well as a financial administrator. You can even add the children as co-trustees as they get older so they learn to manage assets within the trust. If there will be multiple trustees, make sure to specify in the trust document how disagreements between the trustees should be resolved, or designate a different responsibility for each co-trustee.

estate). When you pass away, trust assets avoid the probate process, which is public. Also, you can title a trust however you want. The name of the trust does not have to include your name or the names of the beneficiaries. For instance, it could be "The Evergreen Irrevocable Trust" or any other title that has significance for you and your family.

WAYS TO FUND A TRUST

- **Transfer assets outright to a trust during your lifetime.** What, how much, and when you transfer assets to a trust can vary widely, depending on your finances, the purpose and tax consequences. Anything from stocks and bonds to real estate and even interests in a business can be held in a trust. Under current tax law, up to $11.4 million can be transferred to a trust with no gift or federal estate tax cost ($22.8 million if the grantors are a married couple). This is enough to make gifts intended to benefit multiple generations within a family, creating what is known as a Dynasty Trust. Those assets, as they grow in value within the trust, could provide support or a safety net for descendants, which could last for up to 150 years.
- **Use a life insurance policy to fund the trust.** This is a relatively inexpensive way to fund a trust, especially for younger parents. Basically, you set up an irrevocable trust and transfer enough money to the trust annually (as gifts) to pay for the annual life insurance premiums. This is known as an Irrevocable Life Insurance Trust or ILIT. Upon your death, the life insurance proceeds can be used to support your children and grandchildren and/or to help pay for estate taxes.
- **Fund the trust upon death.** Your will could provide that some or all of the assets you intend for your heirs go into an irrevocable trust. If your estate plan is based on a revocable trust, trusts for children and grandchildren can be established through that trust at your death. You can even make a trust the beneficiary of a "pay on death" financial account, which is one way to speed up access to funds for your heirs.

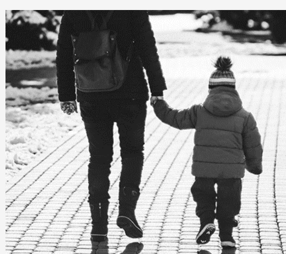
TRUST TAXES

Starting at just $12,750 in annual income, trusts are taxed at the highest individual tax rates (37% on income and short-term gains and 20% on long-term capital gains).

When beneficiaries receive distributions from a trust, part of that payout is taxable to them. Anything not paid to beneficiaries is taxable to the trust. Even though trust taxes are higher than those on individuals, they can be minimized by an experienced trustee through tax-aware investing and an optimized distribution strategy within the terms of the trust.

PUTTING ALL TOGETHER

A well-structured trust is probably the most effective way to control how your next generation interacts with wealth in a way that is positive for all involved. By well-structured, we mean aligned with your family needs, values and goals, as well as your assets and finances. For more than 50 years, we have advised on trust terms and have administered trusts for families now in their 7th generation; we have seen what works well and not so well. We are here to explore with you the trust strategies that would work best for you and yours.



Making Sure a Special Needs Trust Will Be There for Your Loved One

The work we do as trustee can provide peace of mind for you and your loved one.

Find out how

ABOUT THE AUTHOR

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