The Trust Toolkit

Trusts are often referred to as powerful tools, but we find that they are more like a toolkit, especially for families with significant wealth. It is not likely that a single trust can solve for the many financial and life issues that arise in families. Therefore, a combination of trusts is usually required to meet all the goals of a long-term (often multigenerational) wealth plan.

Below are some examples of how different types of trusts can be used to solve address issues or concerns. Keep in mind that these are very general examples. We would be happy to talk to you about your specific situation to explore how trusts could provide a solution.

Rationale for Trusts

- **To Control and Protect Your Assets**

  You can specify when and how your assets are used during your lifetime to support you (and your spouse), and then your heirs and favorite causes after you are gone.

- **To Guard Your Privacy**

  The language of a trust document and the assets that it holds remain private after you are gone (unlike a will).

- **To Be Efficient**

  Assets in a trust avoid the probate process, which can be costly in terms of money, time, and family harmony.

- **To Establish Your Legacy**

  The trust instructions and the beneficiaries you name reflect what you value and how you want to be remembered.

- **To Save On Taxes**

  Trusts can be used to reduce federal and state estate taxes and some state income taxes.

Q: I want to provide for my children through a trust but want to be able to change my mind about when and how.

Lee-Norah: One of the most common trusts we work with is a “revocable” trust, which you can change or cancel at any time. This type of trust is ideal for people who want to remain flexible about the terms of the trust while they are alive (when the person funding the trust dies, the trust can become irrevocable). Revocable trusts also are used by people who have assets in different states or abroad to streamline the probate process. Or who want to keep their ownership of assets private. Or who want a trustee who can step in to manage their assets should they become incapacitated.

Here’s an example: Jim and Jane own a vacation property in Hawaii, condos in New York, and a primary residence and business in Washington State.

If they transfer ownership of all these assets to the “Jim and Jane Revocable Trust, in WA State,” they can continue to manage them during their lifetimes. After they’re gone, their children won’t have to deal with probate court in three different states, and they’ll benefit from the income or the sale of the assets in the trust, as Jim and Jane have specified.

Q: Our vacation property keeps going up in value. How can we transfer it to our children in a tax-effective way?

Kristi: A Qualified Personal Residence Trust (QPRT) – pronounced “q-pert” – is a way to gift your house (or vacation property) to your kids at a lower value than it has now. Here's how that works. You transfer the house to a trust benefiting your children, which is in effect for a term that you specify, say 10 years. During the term of the trust, you retain the right to live in the house. The longer this "live-in" period is, the lower the current gift value of the house.

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When the trust term ends and the house transfers to your children (or to a trust for your children) you can continue living in the house, but you must pay rent to the new owners — your children. This transfers additional money to the next generation, further reducing the size of your estate.

Here's the catch: If you pass away during the term of the trust – in this case within 10 years – the current market value of the house counts as part of your estate.

Q: Our family business is going strong. How can trusts help with transferring this to the next generation?

Lee-Norah: For a variety of assets likely to appreciate significantly over time – a business, equity portfolio, etc. – a good solution can be a Grantor Retained Annuity Trust (GRAT).

A GRAT allows you to zero-out the current value of the asset for gift purposes. That's because after you transfer the business to the GRAT, you get back a series of annual payments that over time add up to the value of the business when transferred. Let's say you have a small business currently valued at $5 million and choose a 10-year term. For 10 years, you would then get annual payments of $500,000 plus a specified rate of interest.

At the end of 10 years, if the annual payments to you were funded with cash flow from the business, the business will be owned by your heirs and will not be counted as part of your estate. Even if the annual payments are a return of some of your share in the business, at the end of the 10 years some portion of the business should be owned by your heirs (and out of your estate). Just as important: If the business has increased in value more than 5.6% annually (the current IRS specified rate), that gain will have passed on to your heirs without gift taxes.

Two risks with GRATS: If you pass away before the annuity term ends, the assets in the trust go back into your estate. And, if the asset you put in the trust loses value, the strategy of passing on the appreciation to your heirs does not work.

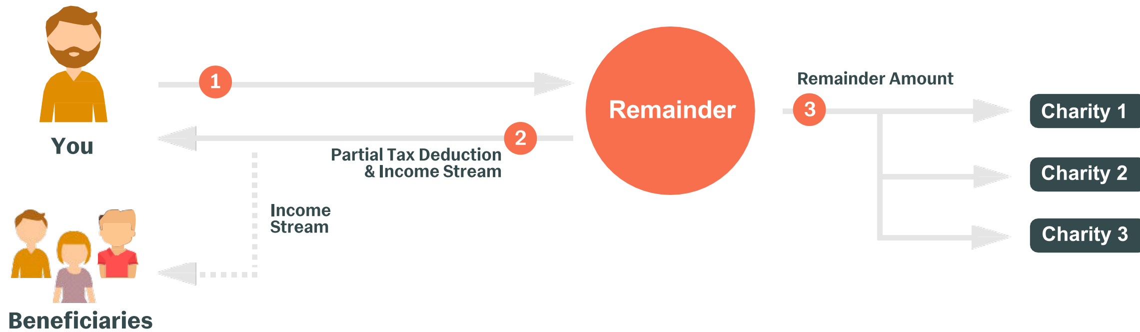
Issues a Trust Can Solve

- You want to keep what you own private now and after you are gone
- You own assets in multiple states or abroad
- You own high-payout life insurance the proceeds from which will be taxed as part of your estate
- You want to provide for a family member facing mental or physical challenges
- You suspect some of your heir(s) may not be financially responsible
- You want your spouse and young children to be financially supported if you pass away
- You want a trustee to manage your assets if you become incapacitated
- You have high exposure to federal and state estate taxes
- You want to support your favorite causes and charities as well as your family members
- You have assets (equities, real estate, a business, collectibles) that would generate high capital gains if sold
- You want control over what your spouse can do with your assets after you pass away

Attributes	Revocable Trust	Qualified Personal Residence Trust (QPRT)	Grantor Retained Annuity Trust (GRAT)	Charitable Remainder Trust (CRT)	Charitable Lead Trust (CLT)
Can be changed or canceled	**YES**	**NO**	**NO**	**NO**	**NO**
Who benefits from the trust?	YOU, then the trust beneficiaries you name	YOU, then the trust beneficiaries	YOU, then the trust beneficiaries	YOU or other trust beneficiaries, then charities	Charities first, then other trust beneficiaries
Created during your lifetime or upon death?	Lifetime	Lifetime	Lifetime	Lifetime or upon death	Lifetime or upon death
Term – years trust is in effect	Your lifetime. Upon death, trust can continue as "irrevocable"	Fixed term that you specify upfront	Fixed term that you specify upfront	Fixed term that you specify or for lifetime	Fixed term that you specify or for lifetime
Income tax deduction?	**NO**	**NO**	**NO**	Partial	Partial, depending on type
Estate tax reduction?	**NO**	**YES**, if you outlive the trust term	**YES**, if you outlive the trust term and the asset appreciates	**YES**	**YES**
Income tax advantage if assets in trust are sold?	**NO**	**NO**	**NO**	**YES**	**NO**, depending on type
Tax on trust income?	**YES**	**YES**, if the trust has income	**YES**, if the trust has income	**YES**, limited to payments received	**YES**, depending on type
Major reasons to consider this type of trust	You want flexibility; you have property in many states or abroad; you want your assets to be taken care of in case you become incapacitated	You want to leave your primary residence or 2nd home to your children and want to limit its value for estate and gift taxes	You want to transfer an appreciating asset to your heirs and minimize gift and estate taxes	You want to minimize capital gains tax and/ or convert an illiquid asset into cash AND benefit charities	You want to benefit both your heirs and charities

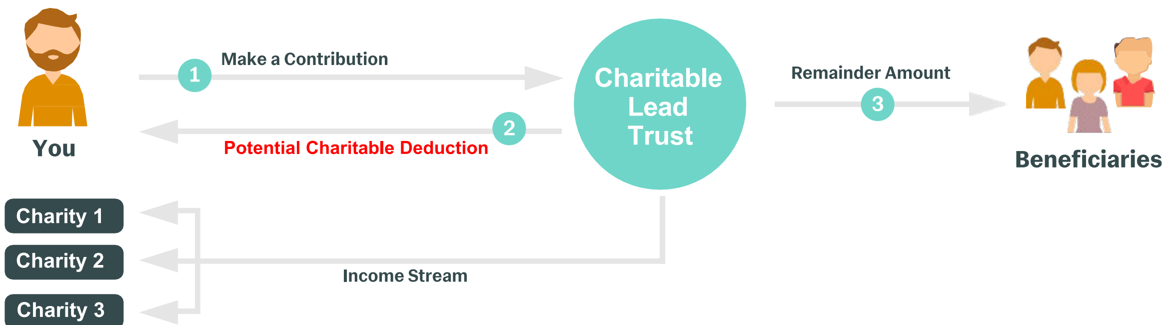
Q: How can we support our favorite charities but also provide for ourselves and our heirs, say with an investment property we have owned for years?

Kristi: There are two good options here, depending on your goals and situation:



1. **You and Your Heirs Benefit first, then Charity.** You can transfer assets, in this case the investment property, to a Charitable Remainder Trust (CRT). The trustee would then sell the building, invest the proceeds and make annual payments to you (and your spouse) usually for your lifetimes. When the transfer to the trust happens, you would get a partial income tax deduction, and then pay taxes on the income you receive annually from the trust. After the payments to you end, the charity or charities you specify get whatever remains in the trust.

Note: You can still get an upfront income tax deduction, if you have the payments from the trust go to your heirs after you pass, then to a charity.



2. **Charity Benefits 1st, then other Beneficiaries.** You transfer assets, in this case the investment property, to a Charitable Lead Trust (CLT). The CLT would make annual distributions to your favorite charities for a specified period or for your lifetime. The upfront income tax deduction you get depends on how much control you retain over the CLT and your willingness to pay tax on the CLT's income. Any growth in the trust assets above the IRS "hurdle" rate, which is 5.6% currently (November 2023), usually passes estate-tax-free to the designated beneficiaries when the term of the trust ends.

Q: We have a child with special needs. How do we provide for her and still allow her to receive government benefits if necessary?

Lee-Norah: A Special Needs Trust allows you to set aside assets for the care of someone who is disabled or incapacitated. The assets in this type of trust can be used to pay for personal care attendants, household expenses,

out-of-pocket medical and dental expenses, education, recreation, a car and other vehicles, and physical rehabilitation. Because your loved one will have no control over the money, the government does not count the assets in the trust when determining eligibility for programs like Social Security Disability or Medicaid.

Which Trust(s) for You?

Trusts can help align wealth planning with life planning, if created with care and infused with purpose. That is why we work closely with clients as well as their accountants and attorneys, to explore which type of trust(s) can work best for specific needs, goals and concerns. What does that look like for your situation? We are here to help you explore the options and use trusts to attain your goals.

ABOUT THE AUTHORS

Kristi Mathisen serves as a technical resource for LNW wealth managers and analysts, helping to develop protocols for identifying appropriate tax and financial strategies for the benefit of clients, including guidance on philanthropic strategies and trusts and estate planning. An important aspect of Kristi's work is monitoring developments in tax and finance law at the federal and state levels to provide LNW colleagues and clients with proactive analysis and insights.

Prior to LNW and predecessor firm Laird Norton Wealth Management, Kristi was co-director of the tax practice at Bader Martin P.S. for 16 years. Before that, she was a member of the tax staff at Laventhol and Horwath.

Lee-Norah Sanzo has more than 30 years of experience in wealth management and private banking, with most of her career focused on trusts and estate planning. At LNW, Lee-Norah is responsible for advising clients on trust strategies as well as managing trusts, working to ensure trust longevity and adherence to changing tax laws and regulations. She brings to her work extensive expertise in wealth planning, taxation, market analysis and private banking, allowing her to make the most of trust strategies in multigenerational wealth planning. She often works with multiple generations within families, educating and advising trust beneficiaries especially during times of change and transition.

Before joining LNW, Lee-Norah was an advisor at predecessor firm Laird Norton Wealth Management. Prior to that, she was a senior vice president and senior fiduciary advisory specialist at Wells Fargo for more than a decade, responsible for trust and estate planning strategies for ultra-high-net-worth individuals and families. Prior to that, she worked for 15 years at US Bank in Seattle, starting there as a trust associate in 1994 and rising to the position of vice president relationship manager in their private client group. Lee-Norah started her career at Wilshire Associates in California and left the firm as a senior associate working on high-net-worth accounts.

ABOUT LNW

Laird Norton Wetherby (LNW) serves exceptional families and individuals seeking to activate the full potential of their wealth. To help turn lifelong ambitions and multigenerational aspirations into reality, LNW brings to each client relationship a high level of care combined with deep expertise in wealth and legacy planning, investments, and trust and estate services.

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