Motley Fool's *Rule Your Retirement* Newsletter

The Truth about Trusts

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Step right up, folks! Have I got a deal for you!

Let me propose to you something that could:

- Allow you to dictate how your heirs spend their inheritance — even from beyond the grave
- Spare your heirs the often onerous, expensive, and drawn-out process of fulfilling your final wishes as laid out in your will
- Reduce the chances your family will fight over your money or your body (whether it's incapacitated or deceased)
- Provide support for your kids, grandkids, and pets — now or in the future
- Lower your exposure to estate taxes
- Keep your bequests private
- Help out your favorite charities
- Get extra protection from creditors

All these fabulous benefits aren't just for your heirs; if your relatives also take advantage of this amazing opportunity, you'll benefit now and when you inherit their dough.

All this can be yours through the wondrous magic of ... estate planning!

OK, we know that was an anticlimactic offer. The topic is right up there with insurance and taxes on the excitement scale. (I often call *Rule Your Retirement* the *Eat Your Broccoli* service, because we're often telling you to do things that aren't palatable but good for you. If you actually like broccoli, substitute the healthy but yucky food of your choice. Kale shakes, anyone?)

I actually think "estate planning" is a misnomer, because it conjures up contemplations of death — especially *your* death. I prefer the term "family wealth planning," because many of the steps you should take have nothing to do with joining the Great Tax Shelter in the Sky. Plus, the process shouldn't be just about enriching and easing the burden on your heirs. The more you can get all your relatives on board, the more you will benefit from their planning. Conversely, the less planning they do, the more you might have to pay the price in terms of money, time, hassle, and family strife.

If we still haven't persuaded you to continue reading, perhaps you'll be heartened by the fact that we're not covering *every* aspect of estate planning in this article, just the one tool that prompts the most questions and confusion: trusts.

Pros, Cons, and Professionals

There are all sorts of legal descriptions of a trust, but here's how I think of it: A trust is sort of like an account into which you deposit property of all kinds — e.g., investments, real estate, collectibles — that will be managed by someone else in the near future or years down the road. There are all kinds, often with funny-sounding acronyms, such as QTIP, QPRT, ILIT, GRIT, and CRAT. They have a bewildering variety of purposes and requirements, but most offer these benefits:

- Assets in trust bypass probate, the legal process of validating a will, appraising the assets, paying debts, and distributing the property. This can cost between 2% to 10% of the value of the property that goes through probate, and take six months to several years. (It took 18 years for Marilyn Monroe's estate!)
- The terms of the trust are customizable to a degree.
- You can control how your assets are invested and distributed, even many years after you've passed away.
- Trusts can provide for relatives with special needs, bad habits, fur, or feathers (i.e., pets).
- The workings of trusts are private, as compared to what's passed on via a will, which becomes public record.

But with many things in life, you have to consider the cons as well as the pros. Here are some of the drawbacks of trusts:

- They generally cost more than creating a will, and often have ongoing costs associated with paying someone to manage the trust.
- Because they can be very complicated, they're harder to understand and thus often misunderstood.
- While you should definitely hire a qualified attorney to create your trust, some lawyers exaggerate their benefits and create trusts (costing clients one to several thousand dollars) that weren't necessary.
- Funding a trust requires the transfer of assets, which might involve a change in the property's title or deed. This can range from being merely a hassle to the payment of transfer fees.
- If you've passed away or aren't the trustee for any other reason, you're putting faith in other people to fulfill your wishes. There's no court or other government entity that monitors whether the trust is being managed as intended (though there's legal recourse if shenanigans are uncovered). You should select a person or corporate trustee that you, well, trust to tend to the assets and make sure that distributions are made in accordance with your intent.

Picking up on that "trusts are often misunderstood" theme, not all types of trusts provide *all* of the benefits associated with trusts. Thus, with the help of a lawyer, you need to choose the type that's right for you. You have many choices, but they can be broken down into two broad categories: revocable living trusts and irrevocable trusts.

Characteristics of Revocable Living Trusts

- In most cases, you're the trustee. You can change your mind about any aspect of the trust — including closing it down — at any time.
- Generally more simple and less expensive than an irrevocable trust.
- It can hold just about any kind of assets or property that you own.
- Once you pass away, the trust becomes irrevocable (i.e., can't be modified). The trustee (or successor trustee, if you were the trustee while you were alive) distributes the property. In most cases, the trust then ends.
- The tax consequences — such as income, capital gains, and mortgage interest deduction if you put your home in the trust — are all reported on your tax return.
- Does not lower income or estate taxes, or provide protection from creditors.

Characteristics of Irrevocable Trusts

- Once the trust is created and funded, you can't take the property back. It's also more difficult to modify the terms of the trust.
- Can potentially reduce estate taxes.
- The type of trust most often used by those with altruistic inclinations. Irrevocable charitable trusts are also among the few flavors of trust that can provide income tax deductions.
- Can last for generations, with the income and assets distributed according to the terms of the trust you helped determine. Note that most states have a cap on how long a trust can be around — "law against perpetuities" — so it can last for generations, but not too many generations.
- The trust must file a federal and state tax return each year if income inside the trust exceeds certain thresholds (as low as $600).

Should You Get a Trust?

Armed with all that information, let's discuss some scenarios in which a trust might be appropriate.

You have many assets that could be subject to probate. There are many easy ways for property to avoid probate. For example, accounts and insurance policies with beneficiary designations — including retirement accounts — go straight to those lucky heirs. However, if you don't name specific people, or those people have died, then the money goes through probate. Also, most jointly held investment and banking accounts avoid probate, as do accounts designated as "transfer on death" (TOD) or "payable on death" (POD). It's easy to add those designations to your accounts, and in some states, your home. Once you've taken those steps, the amount of your estate that will go through probate may not be large; in fact, some states let smaller estates (e.g., below $150,000 in California) avoid probate. All that said, if you've taken these steps and you still would have a large probate estate, start with considering a living revocable trust.

You have a relative with special needs, such as a disability. The trust can provide financial support over their lifetime, and in such a way as to not jeopardize any government-provided benefits.

You have an heir who's horrible with money. If you're worried that your heir will fritter away the inheritance on bad purchases and lousy investments, a spendthrift trust could pay the beneficiary in limited amounts over time while the trustee prudently (you hope!) invests the remaining assets.

You are remarried and have children from a previous relationship. A trust can be a good way to provide for a spouse if you predecease her or him, but ensure the property goes to your kids when your spouse joins you in the hereafter.

Your heirs are unwise in selecting life partners. A trust can prevent your assets from being divided if your child ends up getting a divorce.

Your estate will be taxed. Any amount you leave to your spouse won't be subject to estate taxes. But for everyone else, there's a limit (known as an exclusion or exemption). Over your lifetime, you can give away or bequeath a total of $5.43 million (as of 2015), and twice that for married couples, without worrying about federal estate taxes. If your estate is or might be worth that much in the future, consider an irrevocable trust. Note: Some states charge estate or inheritance taxes, and the exemptions are lower than $5.43 million.

The Foolish Bottom Line

We hope we've armed you with new knowledge, as well as a healthy respect for how complicated "family wealth planning" can be. If you don't already have an attorney to guide you through the legal jungle, begin your search for an experienced attorney. Since many of the laws pertaining to estate planning, property ownership, and trusts vary from state to state, you need an attorney who knows your state's laws.

Start by asking people you trust for referrals, including any other financial professionals you know and respect, such as financial advisors, accountants, and lawyers who don't have an estate-planning practice. You can also find experts in your area by visiting the website of the American College of Trust and Estate Counsel. Make sure the attorney you choose has worked with people similar to you, especially if your circumstances are outside the range of normal (e.g., you own a business, you have a relative with special needs, you have a high net worth, your family is absolutely bonkers).

Finally, make sure you update your estate plan and review your beneficiary designations every few years or after a significant life event, such as marriage, divorce, a birth or death in the family, a significant change in net worth, or moving to a different state.