

Courtesy of: Royalty Owner Help Desk



### By the numbers

- In 2009, the first **\$3.5 million** of an individual’s estate is exempt from estate taxes, and the exemption is not applicable in 2010.
- Each year, as of January 1, 2009, individuals can make gifts of **up to \$13,000** per person to as many people as they wish without incurring a gift tax.

Source: irs.gov

## Using trusts as part of your estate planning

One of the most common tools in estate planning is the use of a trust, which is an arrangement under which you can place assets that are for your and/or someone else’s benefit (the beneficiary) under the control of a trustee. There are advantages and disadvantages to using a trust as an estate planning tool.

While this information sheet provides an overview of several types of trusts and the reasons why they may or may not be beneficial for you, you should meet with a professional advisor to discuss your individual financial situation and to understand all of the consequences of establishing trust arrangements.

Depending on your goals, the use of a trust can be an effective way to achieve your estate-planning objectives. Trusts are usually categorized in one of two ways:

### 1. Inter vivos trust (also known as a “living trust”)

- is created during your lifetime as a contract between you and a trustee
- may be revocable or irrevocable

#### If the trust is revocable

- the trust’s assets could be returned to you at any time

- it is subject to income taxation on the ordinary income and capital gains earned by the trust
- the trust’s assets are included in your taxable estate at the time of death
- it is generally be set up to retain control over assets rather than for estate tax reasons

### Key points

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#### Trusts could help you

- lower estate taxes
- protect your family’s assets
- ensure your wishes are carried out after your death
- avoid probate

Which trust may be right for you will depend on your specific objectives.

Meet with your estate planning professionals to determine if a trust is the best option for you.



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**If the trust is irrevocable**

- you may enjoy certain estate tax advantages because the assets held by the trust may be considered a gift and not subject to estate tax

**Potential disadvantages**

- Not all items may be easily transferred into a trust.
- The federal estate tax allows an estate to use a year other than a calendar year as the “taxable year” used in tax deadlines. Trusts are not allowed the same flexibility.
- Trusts are required to make estimated tax payments, while estates are exempt from this requirement for the first two years.
- Unlike wills, revocable trusts are not automatically revoked or amended on divorce. If you do not amend the trust, an out-of-date beneficiary could receive unintended benefits.

**2. Testamentary trust**

- is created as part of your will
- comes into existence at the time of death
- is always irrevocable
- provides control over how your heirs will receive the assets
- may provide certain tax advantages

In an estate plan, trusts can serve a variety of purposes, such as

- conserving property for your beneficiaries
- helping manage your investments
- avoiding guardianship requirements applicable to property transfers to minors and other legally incapacitated persons

- minimizing probate costs by transferring property before death
- reducing or eliminating estate taxes for beneficiaries of your estate
- keeping arrangements private by avoiding the public probate process
- providing creditor protection

**Potential disadvantages**

- A trust may bind the beneficiaries to an agreement after familial relationships have broken down. If the beneficiaries can no longer agree, a trust may have to be wound up.
- Individuals feeling unfairly excluded from a share of an inheritance may be motivated to challenge a testamentary trust in court.

Once you have determined what your estate planning objectives are, you may want to consider establishing one or more of the following types of trusts.

**OBJECTIVE**

to provide for a surviving spouse during his or her lifetime but ultimately pass assets on to other beneficiaries

**Charitable remainder trust**

A charitable remainder trust allows you to provide for your surviving spouse, donate assets to charity, and avoid federal transfer taxes. The trust works like this: Income from trust assets goes to your surviving spouse. After your spouse’s death, trust assets are transferred to the charity, and no federal transfer taxes are incurred.

**Potential disadvantages**

- Because the donor and heirs do not have access to the trust principal during their remaining lifetimes, they cannot make any personal use of the trust’s property other than to receive income payments.
- Donors should consider carefully whether they have other capital resources that will be sufficient to meet their future needs.

**Bypass trust**

A bypass trust (also known as a credit shelter trust) allows you to create a trust upon your death that benefits your spouse and at the same time is shielded from estate tax upon your spouse’s death. The bypass trust is funded with an amount equal to your applicable credit — the maximum amount that is allowed to be transferred from an estate without payment of federal estate taxes. Your surviving spouse may be the beneficiary of income from the trust and continue to have the economic benefit of the trust assets. Because your spouse does not own the trust assets, the assets are not included in your spouse’s estate at the time of death.

The applicable credit amounts are as follows:

Tax year	Applicable credit (tax-free amount)*
2009	\$3,500,000
2010	N/A
2011	\$1,000,000

\* These amounts were set by the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and are scheduled to expire after December 31, 2010. Unless extended by Congress before then, these provisions will revert back to tax laws in effect prior to the passage of EGTRRA, as shown in the figures for the year 2011.

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**Potential disadvantages**

- The surviving spouse does not have full access to the deceased spouse’s estate, which may be a drawback for a surviving spouse in financial need.
- The trust may be responsible for paying income tax on the amount of trust income that a trustee with discretionary authority over income distributions elects to accumulate.
- The transfer to the trust is irrevocable upon the first spouse’s death and cannot be altered to suit changing circumstance.

**Qualified terminable interest property (QTIP) trust**

A QTIP trust is useful when the objective is to provide income to your surviving spouse while leaving the underlying property to a different beneficiary. Your surviving spouse’s income interest in a QTIP is not taxed upon your death because of your marital deduction, but he or she has no control over the ultimate disposition of the property, and upon your spouse’s death, the assets are includable in his or her estate. QTIP trusts are frequently used in second marriages when the donor wants to provide for the current spouse but ultimately wants the property to go to children from a prior relationship.

**Potential disadvantages**

- The executor’s election decision is irrevocable.
- A QTIP cannot be amended after the first death to meet changing life circumstances.

**OBJECTIVE**

to save on estate taxes

**Life insurance trust**

A primary estate tax planning objective is ensuring that the proceeds from a life insurance policy are not subject to federal estate taxes. This can be accomplished by arranging for an irrevocable trust to own the policy and serve as its beneficiary.

**Potential disadvantages**

- The grantor’s decision to set up a trust is irrevocable.
- A gift tax could be imposed on the initial transfer.

**Grantor retained annuity trust (GRAT)**

A GRAT is an estate and gift tax planning tool that allows you to give away an asset at a greatly reduced gift tax cost. To create a GRAT, you transfer the assets to an irrevocable trust and retain an annuity interest for a specified number of years. The retained annuity interest is designated as a percentage of the initial value of the trust assets (a GRAT). The remainder interest is designated as a gift to someone. The advantage of making a gift through a GRAT is that only the value of the remainder interest is taxable as a gift.

If the annuity paid to you is large enough, the value of your gift is zero (known as a zeroed-out GRAT). Any appreciation in the assets held by the GRAT over the IRS’ interest rate inure to the benefit of the remainder at no gift tax cost.

**Potential disadvantages**

- Hard-to-value assets (*i.e.*, real estate, closely-held or family held stock, partnership or limited liability company interests) that are used to make annuity payments must be appraised annually.
- The loss of GRAT status for any reason results in a taxable gift of the entire value of assets deposited to the GRAT.

**Qualified personal residence trust (QPRT)**

A QPRT is created when you transfer your personal residence to an irrevocable trust for the benefit of your beneficiaries while retaining your right to use the property for a certain amount of time. The benefits of a QPRT are that it enables you to incur gift taxes based only on the value of the remainder interest and to remove future appreciation on the property from your gross estate. You also will be able to live rent free in your home for the fixed term.

**Potential disadvantages**

- The transfer is irrevocable, and the property is distributed to your beneficiaries, who then have control of your home.
- If the grantor dies before the expiration of the QPRT, the residence’s actual value on the day it is contributed to the trust is included in the grantor’s estate and thus becomes subject to federal estate tax.



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<p><b>OBJECTIVE</b></p> <p>to transfer property to minors</p> <p><b>Crummey trust</b></p> <p>A Crummey trust (also known as a demand trust) is set up with the objective of using your annual gift tax exclusion of \$13,000 per recipient (\$26,000 for a married couple). In this arrangement, you deposit property up to the tax-free gift limit for each year (\$13,000 for 2009, \$26,000 for a married couple) into the trust. Each year, your beneficiary is given a window of time during which some or all of the property can be withdrawn.</p> <p><b>Potential disadvantages</b></p> <ul style="list-style-type: none"><li>• Because of the involvement of an attorney (in drafting the trust document, for example), the trust could incur high setup and administration costs. The annual waiver must be in writing.</li><li>• The trust is treated as an asset of the child for financial aid purposes (high impact).</li><li>• If the donor acts as a trustee, the trust is included in the donor's gross taxable estate. It is best if the trustee is someone other than the donor or the donor's spouse.</li><li>• There is a chance that the beneficiary will not cooperate.</li></ul>	<p><b>Totten trust</b></p> <p>The Totten trust is a type of revocable trust through which you deposit funds in a bank account for a beneficiary. Because the transfer into the account is revocable, only amounts that are actually distributed from the account to the beneficiary constitute a completed gift. A Totten trust does not provide any gift or estate tax benefits, but it is effective as a probate avoidance device.</p> <p><b>Potential disadvantages</b></p> <ul style="list-style-type: none"><li>• If the beneficiary dies before the account owner, probate is required.</li><li>• The beneficiary cannot have any access to the account while the account owner is alive, even if the account owner is incapacitated and needs the beneficiary's assistance in withdrawing funds to pay medical bills. A guardianship or power of attorney is required in that case.</li></ul>	<p>To be effective, trusts generally need to be carefully created and may need to meet requirements not described here. Individuals should meet with a professional advisor to discuss their individual financial situation and needs, to ensure that the trusts are properly created, and to clearly understand all of the consequences of establishing trust arrangements.</p> <p>This material should be used as helpful hints only. Each person's situation is different. You should consult your financial advisor before making any decisions.</p> <p>Contact your financial advisor for more information, or visit <a href="http://mfs.com">mfs.com</a>.</p> <p>MFS® does not provide legal, tax, or accounting advice. Any statement contained in this communication (including any attachments) concerning U.S. tax matters was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code. This communication was written to support the promotion or marketing of the transaction(s) or matter(s) addressed. Clients of MFS should obtain their own independent tax and legal advice based on their particular circumstances.</p>
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