First State Trust Company — Women & Wealth

TYPES OF TRUSTS

Below is a collection of different types of trusts and their definitions. For additional questions or details, please don't hesitate to contact your Trust Officer.

REVOCABLE VS. IRREVOCABLE TRUSTS

Trusts may fall into a variety of categories based upon their structure, the type of beneficiaries, how long they will last and so forth; however, all trusts fall into two broad categories – revocable and irrevocable.

REVOCABLE TRUSTS

A revocable trust is created by the grantor during his or her lifetime. The grantor may change the trust at any time, including terminating, or "revoking", it altogether. The grantor also has access to the assets of the trust. This type of trust is primarily used for incapacity planning purposes and to avoid probate at the grantor's death, thus reducing court costs and providing privacy. These trusts do not have creditor protection or tax savings benefits.

Revocable Trusts	Also called a "living trust" or "inter vivos trust", a Revocable trust is created during the lifetime of the Grantor. A revocable trust may be established to manage assets or protect Grantors should they become ill or incapacitated. They allow the Grantor to revoke or amend the trust during the Grantor's lifetime. These trusts do not help avoid estate tax because of the power to revoke or amend and the assets continue to be includable in the Grantor's estate.

IRREVOCABLE TRUSTS

Irrevocable trusts are usually created by the grantor to benefit others, often children and grandchildren. Once established, these trusts generally cannot be changed in any meaningful way without court involvement. Irrevocable trusts are often used to hold lifetime gifts from the grantor for the beneficiaries and to receive assets following the grantor's death. Such trusts may allow the grantor control through the terms established in the trust document. Assets transferred into an irrevocable trust are held outside the grantor's estate. Tax planning and asset protection are two reasons these trusts may be created. Irrevocable trusts are often in place for multiple generations. Examples of Irrevocable Trusts include the following:

Qualified Personal Residence Trust (QPRT)	A qualified personal residence trust of QPRT is an estate planning tool that can be used to reduce the amount of gift tax that is incurred when transferring assets to a beneficiary. This type of trust allows you to transfer ownership of your primary home or second home to exclude its value from your taxable income. A QPRT might make sense if you have a home of substantial value that you want to pass on to future generations on a tax-advantaged basis.
Intentionally Defective Grantor Trust (IDGT)	An estate planning tool used to freeze certain assets of an individual for estate tax purposes, but not for income tax purposes. The intentionally defective trust is created as a grantor trust with a purposeful flaw that ensures that the individual continues to pay income taxes, as income tax laws will not recognize that assets have been transferred away from the individual. For estate tax purposes, however, the value of the grantor's estate is reduced by the amount of the asset transfer. The individual will "sell" assets to the trust in exchange for a promissory note of some length, such as 10 or 15 years. The note will pay enough interest to classify the trust as above market, but the underlying assets are expected to appreciate at a faster rate.
Grantor Retained Annuity Trust (GRAT)	An irrevocable trust for which the grantor retains the right to receive a fixed annual dollar amount or percentage of the initial assets deposited at least annually from the trust. The grantor usually transfers appreciating or income producing property to the trust in exchange for this "fixed annuity" type payout feature for a set number of years.

	Characteristics of a GRAT: After the initial transfer of the property (gift) into the trust, no other additions are permitted. An excellent way to remove property from an estate utilizing the gift tax exclusion amounts. Provides a steady reliable income steam for the grantor for a set number of years. When the term of the GRAT ends, the remaining assets are transferred tax-free to the named beneficiaries. If the grantor does not out live the term of the trust, all of the property is brought back into the grantor's estate.
Grantor Retained Income Trust (GRIT)	A tax-saving trust in which a grantor transfers property to a beneficiary, but receives income until termination, at which time the beneficiary begins receiving the income.
Grantor Retained Unitrust (GRUT)	An irrevocable trust where the grantor retains the right to receive funds annually from the trust based on a fixed percentage that is recalculated annually based on the new value of the trust. The grantor transfers property into the trust in exchange for a "variable annuity" type payout feature where the annual income stream will vary from year-to-year, depending on the value of the trust. *Characteristics of a GRUT:* The grantor can make the initial gift and additional gifts to the trust. An excellent way to remove property from an estate utilizing the gift tax exclusion amounts. Provides a variable income stream to the grantor for a set number of years or for life. When the term of the GRUT ends, the remaining assets are transferred tax-free to the named beneficiaries. If the grantor does not out live the term of the trust, all of the property is brought back into the grantor's estate.

Marital Trust	For the benefit of a surviving spouse and the married couple's heirs. Also called an "A" trust, a marital trust goes into effect when the first spouse dies. Assets are moved into the trust upon death and the income generated by the assets goes to the surviving spouse. Under some arrangements, the surviving spouse can also receive principal payments. When the second spouse dies, the trust passes to its designated heirs. This is often the "A" in an "AB Trust"
Qualified Terminable Interest Property (QTIP)	A type of trust that enables the grantor to provide for a surviving spouse and also to maintain control of how the trust's assets are distributed once the surviving spouse has also died. Income is required to be distributed to the surviving spouse, and sometimes principal, to ensure that he or she is taken care of for the rest of his or her life. QTIP stands for Qualified Terminable Interest Property.
Qualified Domestic Trust (QDOT)	A QDOT (Qualified Domestic Trust is used to allow a non-U.S. citizen who is the spouse of a U.S. citizen to qualify for the unlimited marital deduction to keep the estate from being subject to federal taxes upon the first death. In order to protect the spouse that is not a U.S. citizen, a QDOT is set up; however, it must meet certain qualifications. At least one trustee must be a U.S. citizen or domestic corporation. The trust must not allow a distribution of principal unless the U.S. citizen trustee has the right to withhold estate tax on the distribution. The trustee must keep a sufficient amount of the trust assets inside the U.S. to ensure the payment of federal estate taxes. The executor of the citizen spouse's estate must elect to have the marital deduction apply to the trust.
Credit Shelter Trust	A type of trust that allows a married investor to avoid estate taxes when passing assets on to heirs. The trust is structured so that upon the death of the investor, the assets specified in the trust agreement (up to a specified maximum dollar value) are transferred to the beneficiaries named in the trust (normally the couple's children). However, a key benefit to this type of trust is that the spouse maintains rights to the trust assets and the income generated during the remainder of his or her lifetime. This type of trust is also referred to as the "B" in an "AB Trust", a Family Trust, or a Bypass Trust.

Irrevocable Life Insurance Trust (ILIT)	An irrevocable trust set up with a life insurance policy as the asset, allowing the grantor of the policy to remove the asset from his or her taxable estate. Once the life insurance policy is placed in the trust, the insured person no longer owns the policy, which will be managed by the trustee on behalf of the policy beneficiaries when the insured person dies. The insurance trust, or irrevocable life insurance trust (ILIT), is often used to set aside cash proceeds that can be used to pay estate taxes, as the life insurance policy should be exempt from the taxable estate of the decedent.
Dynasty Trust	Long-term trusts created to pass wealth from generation to generation without incurring transfer taxes such as estate and gift tax. The dynasty trust's defining characteristic is its term. The trust can survive for 21 years after the death of the last beneficiary who was alive when the trust was set up, and it can theoretically last for more than 100 years. The beneficiaries of a dynasty trust are usually the grantor's children, and after the death of the last child, the grantor's grandchildren or great-grandchildren generally become the beneficiaries. The trust's operation is controlled by the trustee who is appointed by the grantor. The dynasty trust is irrevocable, which means that once it is funded, the grantor will not have any control over the assets or be permitted to amend the trust terms.
Directed Trust	An investment trust in which the trustee is directed by a number of other trust participants in implementing the trust's execution. That trustee is referred to as the “directed trustee”. Examples of other trust participants include a distribution committee, trust protector, distribution advisor or investment advisor. A directed trustee's role often includes: following distribution and investment instructions, holding legal title to the trust assets, providing fiduciary and tax accounting, coordinating trust participants and offering dispute resolution among those participants. Typically, these duties and the other participants in the trust are defined and governed by the trust document itself.

DE Asset Protection Trust	A vehicle for holding an individual's assets to shield them from creditors. Asset protection trusts allow, if it is difficult for a creditor to seize assets, settle with the debtor on favorable terms instead of engaging in costly litigation. This vehicle has complex regulatory requirements, such as being irrevocable and contains a spendthrift clause. An asset protection trust does provide for occasional distributions, but those distributions must only occur at an independent trustee's discretion.
Charitable Remainder Unitrust (CRUT)	Allows a donor to make an arrangement to provide an income interest to a non-charitable beneficiary with the remainder of the trust going to a charitable organization. A charitable trust that can be funded with multiple deposits with the intent to provide variable annual income streams to a non-charitable beneficiary. The CRUT must pay at least 5% of the corpus each year, but the donor can set a higher percent payout less than 50% when the CRUT is drafted. The CRUT value is re-evaluated each year and the new income stream for the year is determined based on the new trust value. *Characteristics of a CRUT:* Variable annuity stream to the donor, fixed percentage. Multiple deposits are allowed. Term of the trust must be a life annuity or period certain (20 years or less). Payout must be at least 5% to a maximum of 50% of initial fair market value (FMV). Payment is re-calculated each year based on the FMV of the CRUT. At the end of the term, remainder interest is paid to the charitable beneficiary. The donor receives an income tax deduction for the present value of the remainder interest.
Charitable Remainder Annuity Trust (CRAT)	A trust that is funded with an initial charitable contribution to provide income to a non-charitable beneficiary. A CRAT pays a fixed annual annuity stream of income (at least 5% but not exceeding 50%) to the income beneficiary for a lifetime or a fixed number of years (cannot be more than 20 years). At the end of the payment term, the remainder in the trust goes to the charity.

	Characteristics of a CRAT: Fixed annuity stream to the donor, fixed percentage. Initial deposit is only allowed. Term of the trust must be a lifetime or period certain (20 years or less). Payout must be at least 5% of the initial FMV to a max of 50%. At the end of the term, remainder interest is paid to the charitable beneficiary. The donor receives an income tax deduction from the present value of the remainder interest.
Charitable Lead Unitrust (CLUT)	The donor can donate an asset's income stream for a period of years to a charity instead of the remainder interest. The remainder interest can then pass to a private party under the direction of the grantor (i.e. grandchild, child, etc.). A charitable annuity that allows the donor to give variable annual amounts to a charity for a limited period of time. The donor transfers property into the trust, then a fixed percentage payout is used to calculate the amount that is sent to the charity each year. Since the value of the investments within the trust will fluctuate from year-to-year, the payment is recalculated each year based on the new value of the trust. *Characteristics of a CLUT:* Variable annuity stream to a charity, fixed percentage. Multiple deposits are allowed. Effectively removes assets from the estate of the grantor. At the end of the term, remainder interest is paid to a non-charitable beneficiary. The donor receives an income tax deduction on FMV of the property transferred.
Charitable Lead Annuity Trust (CLAT)	The donor makes an initial deposit to the CRAT and the charity receives the fixed annual income steam for a fixed number of years. At the end of the term of the trust, the donor's beneficiary will receive the remaining interest. *Characteristics of a CLAT:* Fixed annuity stream to a charity, fixed percentage.

	Initial deposit is only allowed. Effectively removes assets from the estate of the grantor. At the end of the term, remainder interest is paid to a non-charitable beneficiary. The donor receives an income tax deduction on FMV of the property transferred.
NI Makeup CRUT (NIMCRUT)	With a makeup provision, if the trust income exceeds the fixed percentage payout amount, the excess may be paid to the income beneficiary to make up a deficiency from prior years. Trusts with both net income limitations and makeup provisions.
Irrevocable Trust T/U/A	A trust that cannot be modified or terminated. The grantor, having transferred assets into the trust, effectively removes all of his or her rights of ownership to the assets and the trust.
Testamentary Trust T/U/W	A trust created under a Will that cannot be modified or terminated.

Please don’t hesitate to contact your Trust Officer with any questions or call First State Trust Company at (800)554-1364.

Disclosure:
Trusts are not necessarily appropriate for all clients. There are risks and considerations which may outweigh any potential benefits. Establishing a trust will incur fees and expenses which may be substantial. Trusts often incur ongoing administrative fees and expenses such as the services of a corporate trustee or tax professional. First State Trust Company does not provide tax or legal advice. Clients should consult their tax advisor for matters involving taxation and tax planning and their attorney for matters involving trust and estate planning, charitable giving, philanthropic planning and other legal matters.