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What is a Trust?

By Richard M. Morgan & Loraine M. DiSalvo

For this month's newsletter, we go back to basics. What is a trust? As estate planners, we use trusts for many different purposes, it is our 'Swiss army knife." We wanted to make sure you have a basic understanding of what we were taking about since trusts may end up playing such a significant part of your estate plan and the estate plans of so many others you may know.

We normally describe what a trust is in two different ways. First, it can be described as a 3-party contract. The first party is the person that owns property and will be the one creating the trust. This person is known by different names, such as Trustor, Grantor or Settlor. The second party is a fiduciary, called a "Trustee." The third party is the person(s) that benefit, known as the beneficiaries. So, the Settlor transfers assets to the Trustee, whose job it is to take care of and use the assets for the benefit of the beneficiaries.

The second way we describe a trust is that it is simply a fiduciary relationship where a Trustee (fiduciary) takes care of and deals with property for the benefit of the beneficiaries, in accordance with the terms of the trust.

The simplest form of this fiduciary relationship is a custodianship. You may have placed a minor child's money birthday presents and some college savings in a custodial account of the child since a minor child cannot legally own property until age 18. The account is set up with you, the parent, as the custodian. The property can only be used for the child's benefit but you, as the custodian, is in charge to make sure it is taken care of and used only in proper ways before any remaining custodial account assets are turned over to the child upon coming a legal adult.

Depending on the purpose of the trust, these three parties (Trustor, Trustee and Beneficiaries) can all be the same person, they can all be different people or any other desired mix and match. For example, a Revocable Living Trust ("RLT") (cite to our RLT section or newsletter) is normally structured to have the same person, you, to hold all three positions until the earlier of your incapacity or death, at which point your successor Trustee takes over control of the Trust for you. The RLT benefits you during you during your life and acts like a Will (but outside the probate process) at your death. During your life, the RLT is easily changed or revoked and it has no income tax effect. Another example are Trusts used to make lifetime gifts. These types of trusts are irrevocable, may have significant tax effects, and are not easily changed. With these trusts, the Trustor can normally not be either a Trustee or Beneficiary, so this type of Trust could have you set it up as the Trustor with your spouse as the Trustee for the benefit of your spouse and your children.

For more information on this topic, see the Wikipedia discussion at http://en.wikipedia.org/wiki/Trust_law