

The language of trusts

Many professions and disciplines have their own vocabulary. As an example, think about the terminology used in medicine and law. Often this vocabulary defines complex ideas, yet just as often “terms of art” can be defined with relative ease to a layperson.

Such is the case with much of the language associated with trusts. Below we provide a few of the key terms that you are likely to come across, defined in a way that should aid in your understanding of the estate planning process.

Elements of a trust

Think of a *trust* as a container, a place to hold assets (for instance, cash or securities). More formally stated, it is an arrangement in which the ownership of assets is given to someone else, the *trustee*—usually a financial institution such as ours, but sometimes an individual. The trustee keeps possession of and control over the assets in the trust and is said to have *legal title* of these assets, which allows the trustee to exercise most property rights. The trustee’s responsibilities and duties with regards to the trust’s assets are delineated in the *trust agreement*.

The trustee manages the assets in the trust for the *trust beneficiaries*, the recipients of the trust’s income and principal (sometimes referred to as the *corpus* of the trust). The beneficiaries are considered to have *equitable title* to the trust’s assets, meaning that they have the right to benefit from the assets managed by the trustee.

For whom trusts are established

The most common term to describe the person who establishes a trust is *grantor*. On the flip side, beneficiaries are referred to as *grantees*. (You also may hear the terms *settlor* or *creator* to describe the person who sets up a trust.)

An *income beneficiary* is someone who is entitled to receive only the income generated from the trust’s assets. A *remainder beneficiary* is someone who has been named to receive the assets in the trust after the interest of a prior beneficiary has been terminated (for example, through death).

Beneficiaries also may be described as either *primary* or *secondary*. A primary beneficiary is someone who is entitled to receive immediate benefits from the trust’s assets.

A secondary beneficiary's interest in a trust is postponed or subordinated to that of the primary beneficiary.

Descriptions of trusts

Trusts can be described in a variety of ways, based upon when they are established, as well as the way that they operate.

For example, trusts are referred to as either *inter vivos* or *testamentary*. An *inter vivos* trust—more commonly described as a *living trust*—is established during the grantor's lifetime. A trust is *testamentary* when it springs into life after the grantor's death, through his or her will.

Trusts may be *revocable* or *irrevocable*. A *revocable* trust is the more flexible of the two. The grantor can make any changes to the trust that he or she feels are warranted, at any time, and can cancel the trust altogether, if necessary. An *irrevocable* trust is set in stone. The trust agreement may not be changed or cancelled. It does, however, have one big plus over a *living trust*: tax advantages.

Sometimes a trust is referred to as a *grantor* or *nongrantor* trust. The status of a trust as *grantor* or *nongrantor* affects the grantor's federal income and estate tax liability. In a *grantor* trust, the grantor holds such a degree of control over the trust's assets that he or she is considered the owner of the assets for tax purposes. An *intentionally defective grantor trust* is a trust created in a manner that allows the grantor to be treated as the owner of the trust for income tax purposes, but not for estate, gift or generation-skipping transfer tax purposes.

Grantor retained annuity trusts (GRATs) and *grantor retained unitrusts* (GRUTs) provide special tax benefits. The grantor transfers highly appreciating assets to a trust at less than their full value, removing the threat of estate tax on the assets (as well as any tax on their future appreciation). With a GRAT the grantor establishes a set amount of income to be paid each year. With a GRUT payments are equal to a fixed percentage of the value each year of the assets in the trust.

Kinds of trusts

Sometimes a trust is defined by the purpose for which it has been established or for the kind of assets contained in the trust. We'll mention just a few of the more common ones.

1. A *charitable remainder trust* is a trust established to allow the grantor or someone whom he or she designates to receive the income from the trust for the beneficiary's lifetime or for a period of years. When the income beneficiary's interest ends, the trust's assets pass to the designated beneficiary.

2. A *charitable lead trust* mirrors the charitable remainder trust. The charity receives the income from the trust and the trust assets later pass to the beneficiaries named by the grantor. In order to take advantage of the charitable deductions associated with the gifts made, charitable trusts are required to adhere rigorously to a set format.

3. A *life insurance trust* is an irrevocable trust in which a life insurance policy is the chief asset. At the grantor's death, the policy's proceeds pass to the trust for distribution to the beneficiaries according to the directions outlined in the trust agreement. The key advantage: As long as the grantor has given up all of his or her "incidents of ownership" in the policy, the proceeds are not considered part of his or her estate for federal tax purposes.

4. A *qualified principal residence trust (QPRT)* is an irrevocable trust in which the grantor's principal residence or a vacation home is the chief asset. The grantor retains the right to live in the residence for a fixed number of years. Although a taxable gift is made when the property is transferred to the QPRT, if the taxpayer survives until the end of the trust term, the residence will go to the beneficiaries that the grantor has named, often his children, with no further tax consequences.

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