

# The Financial Edge™

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## TO TRUST OR NOT TO TRUST part one

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**In this issue you will gain knowledge about:**

- What is a trust
- What is a trust used for
- Different classifications of trusts ... part one



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### Introduction

It has been said that the best inspiration usually comes from things that occur in our everyday lives. And so it is this whim came upon me to write this article on trusts. While having a conversation with an acquaintance, we will call this person John, John exclaimed, "I have decided to have a trust done and put everything in it". "Oh really, what kind of trust?" I asked. "A Living Trust," said John. "Oh that's great, it's excellent that you are working with an Estate Planner to plan for the orderly administration and disposition of your assets after you die". "Huh", said John, "I am just trying to protect myself and my assets while I am living, and I am not working with an Estate Planner. I saw lots of books on it at the bookstore.

They tell you everything you need to know about Living Trusts".

It does not matter how often I come across it, every time I hear "shade tree" methods of asset protection and wealth accumulation strategies it boggles my mind. I will make a long story short and say that after a series of questions designed to ascertain the soundness of John's new found fervor for his personal finances, it was apparent that he had no idea why he was doing a Living Trust or how to make use of it in his asset protection, wealth accumulation and estate planning strategy.

Believe me when I say the topic of Trusts is at least an entire book. Then, when you add all the reasons to use a Trust it is a whole series of books. The situation I talked about above is the usual outcome when

you do not have a complete asset protection, wealth accumulation strategy, and estate plan evaluation. It is impossible to give



this subject the attention it deserves in such a short article, but hopefully it will give you some basic knowledge with which to begin your journey. Also, it just dawned on me to have my Estate Planning Attorney write a series of articles on Trusts, as he is much more versed in the subject than I. However, as I said, I will do my best to give you a basic foundation.

### What is a Trust?

In its simplest form a trust is an agreement by which money or other assets are held and managed by one person for the benefit of another. There are many types of trusts and I do mean many. However, no matter what type of trust it is, it will always have four basic characteristics:

- **An Individual creates the trust.** This person would be called the "donor", "settler", "grantor", or the "trustor". This person is called the grantor because they are the ones who create the trust between themselves (trustor) and the "trustee"
- **Someone else or another entity has to agree to hold money and/or property for the benefit of someone else.** This person is the "trustee." There can be more than one trustee and the trustee does not have to be a person. It can be a corporation with trust powers, such as a bank.
- **Money and/or property must actually be held by the trustee for the benefit of someone else.** This money or other property is called the "principal" of the trust. Some people also call this money or other property the "corpus" of the trust. The principal (or corpus) of the trust never stays the same; some is spent by the trustee, some is invested - earning dividends and interest, and some of the principal appreciates and/or depreciates in value. Collectively, we call all of this money and property the "trust fund."
- **Someone else must benefit from the trust.** We call this person the "beneficiary" of the trust. There may be more than one beneficiary. In that case, they are collectively called the "beneficiaries".



### What is a trust used for?

By distributing your assets appropriately you can minimize your tax burden or that of your beneficiaries. Because you avoid wills, your affairs are kept from the public record giving you a greater degree of privacy. The biggest advantage is to protect your beneficiaries from fraud or mismanagement of your assets, and the continuity to manage your assets appropriately if a life changing event happens.



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### Classification of Trusts

Remember that all trusts have the same four basic characteristics, so the only thing that distinguishes them is the manner in which they are created as well as their purpose. Further remember that "all trusts are not created equal". Just like John in the above example most people classify trusts as either "Living or Testamentary". With all the ads in the newspaper, periodicals, television, flyers and radio, it is no wonder why so many people seem to think by osmosis they have already been through a strategic planning session without ever having to have sat down with someone and ask, "What do I need?" "Since everyone is touting living trust, this must be what I need" is the first thought with many in this country. "I'll worry about why I need it later", must be the other thought. There are three ways that trusts are generally classified.

#### (1) Living Trust or Testamentary Trust what is the difference?

A Living Trust becomes effective during the grantor's lifetime and a Testamentary Trust becomes effective only after the grantor's death. A Living Trust is generally created by a written instrument and a Testamentary Trust is part of the Last Will and Testament. The written instrument created with a living trust will either be called a trust agreement or a declaration of trust depending on the circumstances. If a Living Trust has a trustee other than the grantor, then the written instrument will be called a "trust agreement". It is called a "trust agreement" because the trustee and the grantor have to agree on the terms of the trust. If the Living Trust has a grantor who is also the sole trustee, then the written instrument is called a 'declaration of trust'.

A Testamentary Trust which is part of the Last Will and Testament becomes effective only after death because the Last Will and Testament becomes effective only after death. Living Trusts, if done properly and managed properly during the grantor's lifetime, can avoid probate. In addition,

Living Trusts are less complicated to create, more private because it is not a public document, but can be more costly because you are actually creating a separate



document. Testamentary Trusts do not avoid probate because it goes into effect only after the Last Will and Testament goes into effect. Because Testamentary Trusts are part of the Last Will and Testament they are generally less costly to create and more public.

#### (2) Revocable Trust or Irrevocable Trust?

A Second commonly used form of classification is whether a trust is revocable or irrevocable, which really only applies to a Living Trust because a Testamentary Trust only takes effect after the grantor dies and the Last Will and Testament is admitted to probate. With a Revocable Trust the grantor is reserving the right to revoke, change or terminate the trust after it becomes effective, and with an Irrevocable Trust the grantor is

giving up that right after it becomes effective. Also, because a Testamentary Trust does not become effective until after the Last Will and Testament has been admitted into probate, by design, a Testamentary Trust is always revocable during the testator's lifetime. Since a Testamentary Trust is always revocable until death this form of classification pertains only to a Living Trust.

If a trust is a Revocable Living Trust you have not given up your right to the property. You can:

- Determine who manages the trust and how the property will be managed inside the trust,
- Get the property back,
- Give the property away,
- Change the beneficiaries,
- Change the terms, conditions and benefits being received by the beneficiaries and,
- Sell the property interest.

If a trust is an Irrevocable Living Trust, you give up all rights to the property. You give up the right to amend, revoke, change or terminate any provisions of the trust.

#### (3) .... To be continued

Please see next months newsletter for the remainder of the article.

*Success is not how far you have come, but how far you are from where you started*

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#### Book tip of the month:

A very unique way to educate baby boomers on financial strategies

