

What Is a Trust?

To quote from *Loring, A Trustee's Handbook*, "a... (personal) trust is a complex legal organism that survives on private property. (Derived from English law),... its earlier forms predated even the Norman conquest... (a trust represents)... the product of centuries of evolution. It is an 'institute' of great elasticity and generality; as elastic, as general as a contract.... (and, in fact, the law demands)... that the trustee be absolutely loyal to the trust, and that the trustee act solely in the interest of the beneficiary, and that any behavior on the trustee's part which compromises the trust be subject to judicial sanction. The fountainhead of the trustee's power is the trust instrument. The settlor has the right to include in the trust instrument any provision relating to management of property or to the duties and powers of the trustee provided it is not contrary to public policy, (does not impose an unreasonable restriction on the use of trust property and can be fulfilled)."¹ (Brackets added).

But, in short, a trust is simply a mechanism which you can use not only to control the future and/or present disposition and management of your assets but defend same against creditors as well as provide tax benefits, particularly for your beneficiaries after your death. But what is not always well understood is the fact that the creator of an irrevocable trust will no longer own the assets placed in trust and, in fact, relinquishes control over those assets to his/her designated trustees. Although some authorities suggest that a trust is a 'relationship' rather than an 'entity',² it is nevertheless convenient to view a trust as similar to a corporation or 'artificial person', i.e. an entity separate and distinct from the individuals who 'compose' it - the trust creator, trustees, and beneficiaries - with the capability of continuous existence, taking, holding, and conveying property by gift or for fair value, and even of being sued or suing.

Here are some other interesting facts about trusts. A trust is administered by the trustee(s) for the benefit of both the 'income beneficiaries' who, as one might expect, are entitled to the trust income and 'remainders' who 'take' the trust assets when the trust terminates. A trust is said to 'exist' when drafted and 'operative' when it is funded. A trust will not fail for lack of a trustee because a court can always appoint a successor trustee. Once funded, the trustees - not the trust - take (temporary) 'legal title' to the trust assets and thus control the administration of the trust assets within the parameters set by the trust instrument. For their part, the beneficiaries are said to hold the 'beneficial interest/equitable title to the trust assets but are not regarded as 'owning' the trust property as is the case in certain Commonwealth countries. Indeed the trust property is considered to remain that of the settlor and thus subject to so-called 'dead hand' control.³ The legal and equitable interests must be separate or the trust ceases to exist. (That's the reason a sole beneficiary cannot serve as his/her own trustee!) And unless otherwise permitted under local law, the duration of a (non-charitable) trust is still limited in a diminishing number of jurisdictions by the 'Rule Against Perpetuities' (RAP). That is, any contingent beneficiaries' interest must 'vest' (i.e. no longer be conditioned by a particular event) or otherwise be extinguished within 21 years beyond the death of certain people (known as 'measuring lives') who are alive at the time the contingent interest is created.⁴

Trusts are also either revocable or irrevocable. A revocable trust, for example, the so-called 'living trust', is a trust but in name only because (for one reason) its terms can be changed

¹ Quoted from Charles E. Rounds, Jr., *Loring - A Trustee's Handbook*, (New York: Aspen Publishers Inc. 1999), pp. 3, 4.

² *Ibid.*, p. 42.

³ Dukeminier and Johanson, *op. cit.*, p. 651.

⁴ Rounds, *op. cit.*, p. 254. For further information, see Dukeminier & Johanson, *op. cit.*, pp. 794-796.

without court intervention. But a 'true' trust exists independently of its creator or beneficiaries - i.e. is irrevocable and often cannot be changed or terminated prematurely absent authorization within the instrument without the approval of a court of appropriate jurisdiction - sometimes called a probate or surrogate court. The IRS also distinguishes between 'simple' vs. 'complex' trusts. A simple trust "...requires the distribution of all its income currently, does not provide for payment of any charitable gifts and does not make any distribution other than of current income...all other trusts are complex..." as when a trust is permitted to both accumulate and distribute income. A simple trust can even become a complex trust temporarily "...in its final year and (during) any year in which it makes any partial distribution of corpus."⁵ (Brackets added) For 'legal' purposes, a trust terminates not "... on the happening of an event by which the trust duration is to be measured...(but when)...the trust property has in fact been distributed to the beneficiaries...(nevertheless) for federal income tax purposes, a trust is considered terminated...after the expiration of a reasonable period for the trustee to complete the administration of the trust."⁶ (Brackets added).

Currently, there is a movement in Congress to eliminate estate, gift and generation – skipping taxes (i.e. 'death taxes') as uneconomic and unfair, particularly to owners of small businesses who are forced to direct resources from more productive enterprises into estate planning. Legislation calling for either outright repeal (HR86, S1128) or a graduated phaseout over ten years (HR8, S38) with varying impact on the treatment of capital gains was introduced in 1999. While bipartisan support is strong, action is not expected until 2001 but is virtually assured if Republicans sweep the House, Senate and White House.⁷

⁵ John R. Price, *Price on Contemporary Estate Planning*, (Boston, MA: Little, Brown & Company, 1992), p. 851.

⁶ Regis W. Campfield, Martin B. Dickinson and William J. Turnier, *Taxation of Estates, Gifts and Trusts*, (St. Paul, Minn.: West Publishing Co., 1999), p. 749.

⁷ Charles D. Fox IV, "Repeal of Estate and Gift Taxes: Rising Tide Or High-Water Mark", *Trusts and Estates*, (January, 2000), pp. 56-61.