THE IMPORTANCE OF TRUST ADMINISTRATION: A TRUST PRIMER

Corient Trust Company is equipped to serve as trustee on all trust types including those described in this Trust Primer, offering expert administration and fiduciary support tailored to each client's needs.

What is at risk if a trust is not properly administered:

01. Breach of Fiduciary Duty

Trustees have a legal duty to act in the best interest of beneficiaries. Failure to do so (e.g., mismanagement, self-dealing, or neglect) can result in personal liability.

02. Loss of Tax Benefits

Mishandling certain trust types (e.g., ILITs, CRTs, GRATs) can cause the loss of intended estate, gift, or income tax advantages.

03. Inclusion in Grantor's Taxable Estate

Improper administration (e.g., retained control over ILIT assets) can pull trust assets back into the estate, increasing estate taxes.

04. Government Benefit Disqualification

Mismanaging a Special Needs Trust can cause the beneficiary to lose eligibility for Medicaid or SSI.

05. Failure to Follow Distribution Standards

Making distributions outside of the HEMS standard or the trust terms can violate the trust and trigger legal disputes, asset protection issues, or tax issues.

06. Litigation and Family Conflict

Ambiguity, poor recordkeeping, or perceived unfairness can lead to lawsuits or lasting family rifts.

07. Creditor Exposure

Improperly structured or administered trusts can allow creditors or divorcing spouses to access trust assets that were meant to be protected.

08. Delayed or Denied Distributions

Inaction or delays by trustees can financially harm beneficiaries and create legal exposure for the trustee.

***Corient Trust Company* offers expertise and operational support to ensure trusts are administered properly, in full compliance with legal, tax, and fiduciary requirements.**

Trust Basics:

Parties to a Trust

All trusts are made up of the same key parties:

- **Grantor** (also called **Settlor** or **Trustor**): The individual(s) who create the trust.
- **Trustee** (or **Co-Trustees**): The person or institution responsible for holding and administering trust assets in accordance with the trust document.
- **Beneficiary(ies):** The individuals or entities for whom the trust is established.
- **Successor Trustee:** The individual or institution designated to take over trust administration in the event of the trustee's removal, resignation, incapacity, or death.

The Grantor transfers legal title of the trust assets to the Trustee, who holds and manages them for the benefit of the Beneficiaries.

Trustees and Beneficiaries

The trust document names the parties and outlines the rules for distributing assets to the beneficiaries. These distributions may be either mandatory or discretionary.

For example:

- A trust may require that beneficiaries receive all net income.
- Alternatively, the Trustee may have discretion to make distributions of income or principal according to a specified standard. The most common standard is HEMS: *Health*, *Education*, *Maintenance*, and *Support*.

The Grantor may establish any standard of distribution to suit their goals and family circumstances.

Family-Specific Planning Examples:

- **Substance Abuse:** A Grantor with a child battling addiction may require negative drug test results or physician certification as a condition of distribution.
- **Unequal Needs:** A Grantor with a disabled child and two other children may create a **sprinkling trust**, allowing the Trustee to allocate funds among the children based on actual needs rather than equal distribution.

Trusts provide flexible tools for addressing a wide range of family and planning scenarios.

Types of Trusts

All trusts fall into two main categories:

Revocable vs. Irrevocable

- **Revocable Trusts:** Can be amended or revoked by the Grantor during their lifetime.
- **Irrevocable Trusts:** Generally, cannot be changed or revoked once created. (*But See Exception—"13 Reasons Why South Dakota is the #1 Trust Jurisdiction."*)

Another basic classification of trusts:

Living vs. Testamentary

- **Living (Inter Vivos) Trusts:** Created while the Grantor is alive.
- **Testamentary Trusts:** Created through the Grantor's Will and take effect after probate—a public legal process.

Revocable Living Trust

One of the most common types of trusts is the Revocable Living Trust. Created during the Grantor's lifetime, this trust is designed primarily for convenience and probate avoidance.

Typically, the Grantor is also the Trustee and the primary Beneficiary during their life. This structure allows the Grantor to continue buying, selling, and managing assets without interruption. They continue filing taxes using their Social Security number, and assets in the trust remain unprotected from creditors, during the Grantor's lifetime.

The primary lifestyle change required is that all titled assets must be retitled in the name of the trust, including real estate, bank accounts, and investment accounts.

When fully funded, a Revocable Living Trust avoids probate.

'Pour-Over' Wills & Revocable Living Trusts

A pour-over Will complements a revocable living trust by transferring any assets not already titled in the trust into it upon death.

Advantages of a Pour-Over Will Structure:

1. **Privacy**
   Wills become public at death, while revocable living trusts remain private. Keeping distribution provisions in the trust maintains confidentiality.
2. **Disability Protection**
   If either spouse becomes incapacitated, the trust can provide for their care without court-supervised guardianship.
3. **Avoidance of Out-of-State Probate**
   Holding out-of-state real estate in a revocable living trust avoids ancillary probate in other jurisdictions.
4. **Ease of Amendment**
   Trusts can be amended during life without witnesses and remain private upon death.

Typical Testamentary or Revocable Living Trust Administration at Death

Upon First Spouse's Death:

Assets may be divided into two new trusts:

- **Bypass Trust:** Holds up to the deceased spouse's estate tax exemption (currently $13.99 million). Grows estate tax-free for multiple generations. The surviving spouse and descendants may receive distributions under a discretionary standard.
- **Marital Trust:** Holds remaining assets above the exemption. Distributions of income (and principal under HEMS) go to the surviving spouse. Estate tax is deferred until their death.

If the deceased spouse's estate is below the exemption threshold, only the Bypass Trust is created.

Upon Second Spouse's Death:

Assets typically continue in separate trusts for children.

These trusts offer:

- Asset protection from creditors and divorcing spouses.
- Potential generation-skipping estate tax benefits.
- Continued control over how assets are used.

Why Create a Trust?

Common objectives include:

- Avoiding probate
- Reducing estate taxes
- Providing estate liquidity
- Addressing family needs
- Supporting charitable goals
- Providing asset protection

Examples of Specialized Trusts

Irrevocable Life Insurance Trust (ILIT)

Used to keep life insurance proceeds outside the taxable estate. Policy is owned by the trust, and contributions are subject to Crummey powers (temporary withdrawal rights). If administered properly, the death benefit is estate-tax-free may become a source of liquidity to pay estate expenses or benefit heirs.

Charitable Remainder Trusts (CRTs)

Allow donors to:

- Sell appreciated assets on a tax-deferred basis
- Receive income for life or a term of years
- Gain a charitable income tax deduction
- Remove assets from their taxable estate
- Benefit a charity

There are two main types:

- **CRAT (Annuity Trust):** Fixed annual payment based on original funding value.
- **CRUT (Unitrust):** Variable annual payment based on trust's current value allowing increases due to appreciation.

Charitable Lead Trusts (CLTs)

The reverse of a CRT:

- Income goes to charity during a term or lifetime.
- Remainder reverts to the Grantor's heirs.
- Substantial income tax deduction when the trust is created or as payments are made to charity.

Two types:

- **CLAT:** Fixed annual payments to charity.
- **CLUT:** Variable annual payments.

Estate Tax Freezing Trusts

For clients seeking to remove future appreciation from their estate:

- **IDGT (Intentionally Defective Grantor Trust):** Grantor pays the income tax, allowing more value to grow outside the estate.
- **BIDIT (Beneficiary Intentionally Defective Irrevocable Trust):** Beneficiary pays tax.
- **GRATs, GRITs, GRUTs:** Transfer appreciating assets while retaining income or an annuity for a period.
- **QPRT (Qualified Personal Residence Trust):** Transfers residence to heirs while excluding future appreciation from the estate.

Domestic Asset Protection Trusts (DAPTs)

Designed for clients with liability exposure such as a high risk profession. In jurisdictions like **South Dakota**, these trusts:

- Are irrevocable
- Shield assets from creditors
- Still allow Grantor to be a discretionary beneficiary

Special Needs Trusts

These trusts allow assets to be set aside for a disabled beneficiary without disqualifying them from public benefits such as Medicaid or Supplemental Security Income (SSI). They are structured to supplement—not replace—government assistance.