

Understanding the language of trusts

A glossary of trust types and terms

Trust types

Asset protection trust — Irrevocable trust that provides protection of assets from creditors' claims. The grantor is allowed to serve as investment advisor and receive income and distributions of principal for reasons related to health, maintenance, education and support.

Charitable lead trust — Irrevocable trust wherein a charity is the income beneficiary for a fixed number of years and the remainder passes to noncharitable beneficiaries. Assets can be passed to the noncharitable beneficiaries at a reduced gift- or estate-tax value.

Charitable remainder trust — Irrevocable trust that provides current income to the noncharitable beneficiary(ies), usually the grantor, for life or a term of years; at termination, the assets are distributed to one or more charities. Usually the trust is funded with highly appreciated assets, which are sold to produce income for the beneficiary(ies). No capital gains taxes are paid as long as the trust is properly established as a tax-exempt trust.

Delaware trust — Irrevocable trust designed to take full advantage of the trust laws of the state of Delaware. Specific types of Delaware trusts include an asset protection trust, directed trust and dynasty trust.

Directed trust — Delaware trust wherein investment decisions are made by either an investment company or an individual designated by the grantor instead of the trustee. In a directed trust, the trustee has no liability with respect to investment decisions.

Dynasty trust — Delaware trust designed to avoid estate taxes for the longest possible amount of time allowed for the benefit of future generations. In a dynasty trust, a grantor usually uses his/her unified credit/applicable exclusion and generation-skipping tax (GST) exclusion to fund the trust free of estate, gift and GST taxes. Typically, the dynasty trust is managed and administered to achieve maximum asset growth. Since Delaware has abolished its "Rule Against Perpetuities" with respect to

personal property, the trust allows for the preservation of assets for multiple generations free from transfer taxes.

Generation-skipping trust — Trust designed to hold assets qualifying for the generation-skipping tax (GST) exclusion without incurring a transfer tax. The beneficiary is usually a grandchild.

Grantor retained trust — Irrevocable trust that enables the grantor to retain some use of the transferred assets for a limited time before the assets are passed to the ultimate beneficiary(ies). The value of the assets is discounted for gift-tax purposes, depending on the length of time before the assets pass to the named beneficiary(ies). Normally, the longer the time period until distribution, the lower the value of the gifted property for gift-tax purposes. The grantor must survive the trust's term for the property to be excluded from his/her estate for federal estate-tax purposes.

Grantor retained annuity trust — Trust where the grantor is paid a fixed dollar amount (annuity) for a stated number of years.

Grantor retained unitrust — Trust where the grantor is paid a percentage of the assets' value, valued annually, for a stated number of years.

Inter vivos (living) trust — Trust established during the grantor's lifetime. Inter vivos trusts may be revocable or irrevocable.

IRA rollover trust — Trust allowing a person to transfer qualified retirement assets to a new trustee as well as to defer taxation on distributions from qualified retirement plans. The IRA rollover trust is an effective way to avoid the higher income-tax burden of a large distribution.

Irrevocable life insurance trust (ILIT) — Trust that owns an insurance policy on the grantor's life and removes the value of the death benefit from the grantor's estate. At death, the insurance proceeds are paid to the trust to provide a source of liquidity for estate taxes and other administrative expenses. This type of trust is also referred to as a "Crummey trust."

Irrevocable trust — Trust that may not be altered or canceled. This type of trust may provide income- and/or estate-tax benefits. The grantor gives up complete control over the assets and trust decisions.

Qualified domestic trust — Trust designed to delay the payment of federal estate tax when property passing from the decedent is transferred to a resident non-U.S. citizen surviving spouse.

Qualified terminable interest property (QTIP) marital trust — Trust designed to take advantage of the estate-tax marital deduction while controlling the disposition of the assets at the surviving spouse's death. This type of trust is often used in second marriages to ensure that property passes to the decedent's children from a previous marriage. The surviving spouse is entitled to all income from the trust for life and, if desired, may receive principal at the trustee's discretion.

Revocable living trust — Trust wherein the grantor may retain complete control over the assets and may serve as trustee. Upon his or her death, the assets are not included in the grantor's probate estate. However, they are included in the taxable estate and pass to the beneficiaries according to the trust document.

Spendthrift trust — Trust with a specific provision (usually called a "spendthrift clause") that prevents the beneficiary(ies) from assigning their interest and prevents a beneficiary's creditors from taking his or her interest. This trust is intended to protect beneficiaries who would otherwise spend the trust's assets too quickly, but it can also help protect a beneficiary from personal injury lawsuits, divorce disputes, catastrophic medical expenses and other unforeseen debts.

Split-interest trust — Trust that has classes of beneficiaries: "current" (or "income") beneficiaries, who receive income generated by the assets, and "future" (or "residual") beneficiaries, who will benefit from or receive the assets at a future date.

Testamentary trust — Trust created by a will.

Unified credit trust — Trust established at the death of a spouse to use the decedent's unified credit/applicable exclusion for federal estate-tax purposes. Usually, the surviving spouse and/or children are beneficiaries.

Trust terms

Annual exclusion — The amount a donor may gift (up to \$13,000 per individual or \$26,000 for a married couple in 2010; indexed for inflation) to each donee each year free of federal gift tax, provided the gift is a "present interest." The donee must be given an immediate ascertainable right to use, possess or enjoy the property interest.

Beneficiary(ies) — Person(s) or organization(s) for whose benefit a trust is created.

Co-trustee — Term used when a trust has more than one trustee.

Crummey powers — A limited, usually noncumulative, power of withdrawal over trust property that lapses within a stated time period. This power qualifies a contribution to a trust for the annual gift-tax exclusion. In 2010, this provides a means for a grantor to contribute up to \$13,000 (\$26,000 for a married couple) for each trust beneficiary each year.

Estate tax — A tax imposed on the right to transfer property at death.

Executor — Individual or corporate fiduciary nominated in a will and appointed by the court having jurisdiction to settle an estate.

Family limited partnership — A partnership to which substantial assets, possibly having greatly appreciated, may be transferred. The asset's donor becomes the general partner and controls the assets. The donor's spouse, and possibly children, become the limited partners and hold the remaining interest in the partnership. This is a useful tool for gifting to family members at a potentially discounted value.

Fiduciary — A trustee, executor, administrator or other person upon whom the law imposes certain responsibilities because of the position of trust afforded to him/her.

Generation-skipping — Laws allowing each person to transfer a predetermined amount, indexed for inflation, to a generation two or more classes beyond his/her own generation (such as grandchildren or great-grandchildren) without incurring a generation-skipping tax. This dollar amount is unlimited in 2010 and scheduled to be \$1 million for the year 2011.

Grantor — Individual who creates and funds a trust. Sometimes referred to as the "settlor" or "trustor."

Intestate — Description of an individual who died without having made or left a valid will.

Power of attorney — The power a person (the "principal") may grant to another (the "agent" or "attorney in fact") to act on behalf of the principal, which may include the power to sign deeds, contracts and checks, and to make gifts. A "durable" power of attorney is valid even if the principal becomes incapacitated or incompetent and is often used to avoid guardianship or incompetency proceedings.

Principal — The property first received by a trustee or other fiduciary and the capital appreciation of the property but not the income from the property. Sometimes referred to as “corpus.”

Probate — A legal process where it is proven that a document is the valid last will of the decedent. After the will is probated, the court (or other official) issues formal documentation empowering the personal representative, executor or administrator to take possession of the decedent’s property in order to carry out the terms of the will. “Probate” is sometimes applied to the entire court-supervised process by which the personal representative is given authority to act on behalf of the estate and under which he or she assembles the decedent’s assets, pays debts and taxes, and distributes what remains according to either the terms of the will or state intestacy laws.

Probate property — Property owned in a decedent’s own name at death or the decedent’s half of community property that passes under either the terms of his/her will or, if there is no valid will, the state’s intestacy laws.

Prudent investor rule — A rule adopted by statute or judicial decision in some, but not all, states that requires trustees, executors and other fiduciaries to invest the funds entrusted to them with the same care that a prudent investor would use with his or her own investments. The rule looks to the risk and return of the entire portfolio, rather than of individual investments, and recognizes the validity of modern portfolio theory practices. The advantage of the prudent investor rule over earlier rules governing the investment responsibilities of trustees is that the trustee can delegate some investment decisions to professional investment managers and can have greater flexibility in maintaining a diversified portfolio.

Situs — The location of a trust, usually considered to be the state in which the grantor was living when the trust was created or where the trustee is located. The situs of a trust may determine which state has jurisdiction over disputes involving the trust or may supervise the administration of the trust.

Successor trustee — Individual or corporate trustee named to act as trustee upon the death, incapacitation or resignation of a current trustee.

Testament — A will. Sometimes referred to as “last will and testament.”

Testate — Description of an individual who died having left a valid will. (See also “intestate.”)

Testator — Person who has made a will.

Trust — A legal relationship whereby one party (the “grantor”) transfers title to property to a second party (the “trustee”) for the benefit of another (the “beneficiary” or “beneficiaries”). Legal title is held by the trustee, who is under a fiduciary duty to use and invest the property for the beneficiaries’ benefit. A trust can be created during life by a written document (called a “deed of trust,” “declaration of trust” or “agreement of trust”) or at death by a will. “Trust” is also used to refer to the document creating the trust.

Trustee — Holder of legal title to property for the use or benefit of another.

Unified credit — Credit against the federal estate tax and gift tax that is available to residents of the United States. The credit applies to taxable gifts during life, and to the extent it is not used during life, it reduces the federal estate tax at death. The applicable exclusion (the amount that can pass free of federal estate tax) is unlimited for estate taxes in 2010 and is scheduled to be \$1 million in 2011. The lifetime credit for gift taxes is \$1 million for 2010 and 2011.

Unlimited marital deduction — Deduction under current law that allows any amount of property to be transferred to a spouse (if a U.S. citizen) during life and at death without gift- or estate-tax consequences. This postpones estate taxes until both spouses have passed away.

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