A CLIENT'S GUIDE TO TRUSTS

Over the years, many clients have asked us to recommend a guide to help them understand the trusts which they have created or which have been created for them. This Guide is designed to provide general guidance on the creation and administration of trusts under New Hampshire law.

New Hampshire adopted the Uniform Trust Code in 2004, now called the New Hampshire Trust Code. Although many other states have also adopted this Code, the laws of each state may differ. Further, this comprehensive law is only applicable when a trust does not expressly provide otherwise. Prior to the adoption of this law, New Hampshire generally followed common law trust principles.

This Guide does not constitute legal advice or create an attorney/client relationship. If you have any specific questions about your trust, please ask us.

Selected terms have been **highlighted** throughout this Guide to help you to locate the topics of interest to you.

CREATING A TRUST

A **trust** is an agreement between a grantor and a trustee for the management and distribution of property held for the benefit of one or more individuals or charities. An **express trust** is simply a written trust. A **constructive** or **resulting trust** is a trust which is implied by the circumstances when property is transferred to a person for a specific purpose or for the benefit of another person or charity. This Guide will only address the creation, administration and distribution of express trusts.

The **grantor** is the person who creates the trust. A trust may be created by more than one grantor. A trust created by a married couple is often called a **dual grantor trust**. The word "grantor" is synonymous with the terms **settlor** and **trustor**.

The terms of the trust may be written in the form of an agreement between the grantor and the trustee, directing the management and distribution of trust property. Although trusts historically required a trust agreement to designate an independent trustee, it is now common for the grantor and the trustee to be the same person or people.

A trust may also be declared by a trustee on behalf of the grantor. In this case, the grantor's property is transferred to the trustee and the trustee signs a **declaration of trust**, outlining the terms of the agreement for the management and distribution of trust property. A declaration of trust establishes the agreement of the trust in the same manner as a trust agreement, other than the manner in which it was created.

Many laws, such as the New Hampshire Trust Code adopted in New Hampshire, also dictate the terms of a trust, if the trust agreement does not provide otherwise. Accordingly, to fully understand a trust, you always need to begin with the terms outlined in the trust agreement, and then consider the application of state and common law. Federal tax laws are also applicable to the administration of a trust.

The **trustee** is the person who manages the trust. The trustee may be one or more individuals, including the grantor or a beneficiary of the trust, or the trustee may be a bank or trust company authorized to administer trusts in the state where the trust is to be governed. Some trusts restrict the appointment of certain individuals as trustees. The selection of trustees is covered in greater detail later in this Guide.

A trust may govern the management and distribution of real and/or personal property. Trusts are often created with the transfer of a nominal amount, such as $10, referenced on a separate schedule. Probate avoidance trusts often include an assignment of tangible personal property (such as furniture, furnishings, jewelry and similar items) as the initial funding of the trust. In New Hampshire, the designation of the trust as the beneficiary of a life insurance policy or as the beneficiary of the grantor's Will is sufficient to satisfy the requirement that the trust will govern the distribution of the designated property.

The **beneficiary** of the trust may be the grantor, the trustee and others. Often, a trust is created for the benefit of several individuals, simultaneously and consecutively. New Hampshire law requires that a trust involve more than 1 person as a trustee, current beneficiary and/or future beneficiary. By example, a person may create a trust for her own benefit during her lifetime, passing to her son at her death, with her son as the trustee.

In most trusts, the grantor is the initial trustee and the primary beneficiary of the trust during his or her lifetime. Successor trustees will administer the trust after the lifetime incapacity or death of the grantor/trustee and designated beneficiaries will receive the property after the death of the grantor. The trust agreement anticipates these changes and outlines the distribution of the trust at each stage.

Other trusts are initially created for beneficiaries, other than the grantor. These trusts typically reflect irrevocable gifts from the grantor to another person or people.

TRUST BENEFICIARIES

Beneficiaries are the designated individuals or entities who may be entitled to receive a distribution of income or principal from a trust, currently or in the future. One of the most critical issues in the creation and distribution of a trust is to identify the beneficiaries and the rights which they will have in the trust.

If the trustee has discretion to distribute income or principal to a beneficiary, distributions are permissive, and not mandatory or required. In this case, the trustee *may* make the distributions, or the trustee may decide *not* to make the distributions. A beneficiary cannot force the trustee to make a **permissive distribution**.

If the trustee is directed to make a distribution, however, then distributions are mandatory. By example, if the trust directs that a trustee *shall* distribute certain property to a beneficiary upon the occurrence of a certain event, the trustee cannot delay the distribution for more than a reasonable period of time after the designated event has occurred. Unlike a permissive distribution, a beneficiary can force the trustee to make a **mandatory distribution** if it is not made in a timely manner.

If a trust provides for the lifetime benefit of a beneficiary or for a period of time, eventually passing to another beneficiary, the ultimate beneficiary is called a **remainderman**. By example, a trust may provide for discretionary distributions of income and principal for the benefit of a person during his or her lifetime, passing to the children of the beneficiary when he or she dies. In this case, the beneficiary is a permissive **current beneficiary**. The children of the beneficiary are remaindermen.

The interests of a beneficiary may be vested or contingent. The rights of a **vested beneficiary** are certain. The rights of a **contingent beneficiary** will only arise in the future, upon the occurrence of a specific event, such as surviving another beneficiary or being married to a beneficiary. A trust should specifically indicate whether a beneficiary must survive the grantor, another person or a specific event in order to receive the contingent gift.

Beneficiaries may be designated by name, relationship or class. If a beneficiary is specifically named, the distribution will be made to that person even if she changes her name, either by marriage or divorce. If a beneficiary is designated by relationship, such as "the grantor's husband," the distribution will be made to whoever is the grantor's husband at the time of the distribution, unless the trust is expressly limited to a specific husband. A class of beneficiaries would include all members of the class, such as "the grantor's children," even if they are born after the date of the trust, unless expressly limited by the trust.

Distributions may be directed to the issue of a deceased beneficiary **per stirpes** or **by right of representation**. This direction means that the descendants of a deceased beneficiary will receive the deceased beneficiary's share, along family lines. By example, if the grantor has 2 children, and 1 of them predeceases the grantor leaving 3 children (who are the grantor's grandchildren), a direction to distribute the trust to the grantor's issue per stirpes would require ½ of the trust to be distributed to the grantor's living child and ½ of the trust to be distributed to the children of the grantor's deceased child, in equal shares. (1/6th of the trust would be distributed to each of the grantor's grandchildren who are descended from the grantor's deceased child.)

A trust may provide for the benefit of several beneficiaries at the same time. These distributions may be either mandatory or permissive. By example, during the lifetime of the grantor's surviving spouse, the trustee may be directed to distribute trust income to the spouse, and the trustee may also have discretion to distribute principal to the grantor's spouse and children. This is sometimes called a **spray and sprinkle** trust, since the grantor's spouse and children are permissive beneficiaries at the same time.

After the death of a grantor (or after the death of a grantor and the surviving spouse), a trust may continue for the benefit of the grantor's children until a certain event, such as the attainment of a certain age, or the completion of a college education, if sooner. The trustee may have discretion to distribute income and/or principal to any of the grantor's children who are then living. Similar to a spray and sprinkle trust, this type of trust is often called a **common trust** or **common pool trust** for the benefit of the grantor's children.

Alternatively, the trustee may be directed to divide a trust into separate shares for each of the grantor's children who survive the grantor (or for each of the grantor's children who survive the grantor and the surviving spouse.) In this event, a **separate share trust** is created for each child, with mandatory and/or permissive distributions to each child from the child's share of the trust.

A trust may combine both approaches, starting with a common pool trust until the occurrence of a specific event (such as the youngest child attaining a certain age, all children completing high school, or the oldest child entering college) and then dividing into separate shares for the children of the grantor who are living at that time.

Permissive distributions may be made in the discretion of the trustee. Often, the trustee's discretion is limited to the education, support in reasonable comfort or maintenance in health of the beneficiaries. These limitations are considered to be an **ascertainable standard** under federal tax laws. If the trustee may distribute income or principal for the happiness or comfort of a beneficiary, or if there are no restrictions on the trustee's exercise of discretion, distributions are not considered to be limited by an ascertainable standard for tax purposes. The grantor of a trust may provide further guidance to the trustee, directing distributions for stated purposes (such as the purchase of a home property or starting a business) or goals (such as encouraging the beneficiaries to contribute meaningfully to their community.)

A beneficiary may be given the power to designate individuals or entities who will receive a distribution from the trust, called a **power of appointment**. If the beneficiary may direct a distribution to the beneficiary, the creditors of the beneficiary or the estate of the beneficiary, this power is a taxable **general power of appointment**. If the beneficiary may only direct a distribution to other individuals or charitable organizations, this power is a non-taxable **special** or **limited power of appointment**. In many trusts, a beneficiary is given the limited power to direct distribution of the trust to other descendants of the grantor. If this power is only exercisable by the signing of a new Will, to be effective upon the death of the beneficiary, the beneficiary has a **testamentary power of appointment.** After a beneficiary exercises a power of appointment, the trust may continue for the benefit of the designated individuals or charities.

A **special needs trust** may be created for the benefit of a disabled individual. In this trust, the trustee's discretion to make distributions to or for a beneficiary who receives government assistance for his or her disabilities is limited so that the trust distributions will supplement, rather than substitute for, the government assistance. This trust is discussed in greater detail later in this Guide.

An **incentive trust** provides for permissive or mandatory benefits to be distributed to a beneficiary who completes certain events or engages in specified behavior. By example, the trustee may be directed to distribute a sum of money to a beneficiary who attains a college degree, or to distribute to the beneficiary a sum equal to the wages earned by the beneficiary in any year. Care must be taken to avoid incentives which might be considered to be against public policy (such as requiring a beneficiary to secure a divorce) or which might encourage undesirable behavior.

Alternatively, the trustee may be directed to withhold otherwise mandatory distributions to a beneficiary who engages in undesirable behavior, such as substance abuse or lack of gainful employment. A **protective trust** may be appropriate when the beneficiary has a history of substance abuse or criminal behavior, although it may also require a trustee to be more personally involved in the beneficiary's life.

In addition to the terms of a trust, the effect of state laws must also be considered in order to identify the beneficiaries of a trust. Under New Hampshire law, any gift to the spouse of the grantor of a revocable trust is negated by the subsequent divorce of the parties, unless the trust expressly provides otherwise. Similarly, gifts to the children or other heirs of a former spouse are negated by the subsequent divorce between the grantor and the spouse, unless they were also descendants of the grantor or the trust expressly provides otherwise.

In 2004, New Hampshire adopted the Uniform Trust Code, introducing the new concept of **qualified beneficiaries** who have rights to see a copy of the trust agreement and the annual account of the trust, unless otherwise provided in the trust agreement. Qualified beneficiaries are the beneficiaries who are entitled to receive a permissive or mandatory benefit from the trust, or who may be entitled to receive these benefits after the death of the current beneficiary of the trust. Under New Hampshire law, beneficiaries under the age of 21 may be excluded from receiving a copy of the trust or the annual account of the trust. Many trusts direct that all adult beneficiaries, meaning all beneficiaries who have attained the age of majority (18), will receive the trust information.

Charitable organizations may also be designated as beneficiaries of a trust. In this case, care must be taken to correctly designate the desired charitable organization and the terms on which the gift is to be made. An outright or a restricted gift can be made to a charitable organization. A **restricted gift** would direct for the trust property to be used for a particular purpose by the charitable beneficiary, such as an addition to the charity's endowment fund, to provide for student scholarships or to contribute to a capital campaign.

Similarly, gifts can be made for a specified charitable purpose, without identifying specific charitable organizations. In this case, the trustee must be given guidance on the selection of suitable charitable organizations to receive the charitable trust distribution.

TRUSTEES AND OTHER FIDUCIARIES

The designation of one or more trustees to administer a trust is a critical part of the creation of a trust. The grantor may serve as the initial trustee of most, but not all, types of trusts. Other trustees may be designated to serve simultaneously, as **co-trustees**, or consecutively, as **successor trustees**.

The most important consideration in the selection of a trustee is the "trust" or confidence which will be placed on the trustee to serve in this capacity, to administer the trust in accordance with its terms and applicable law, on behalf of the trust beneficiaries. A trustee is a **fiduciary**, holding assets for the benefit of others.

The trustee may also be a beneficiary of the trust, such as the spouse or an adult child of the grantor. Alternatively, the trustee may be another family member, such as a parent, brother or sister of the grantor, who is not a beneficiary of the trust. The trustee may be an unrelated individual, such as a close friend or professional advisor of the grantor, or a bank or trust company authorized to administer trusts in the state where the trust is to be administered.

Please note that it is ethically impermissible for the attorney who drafts a trust to name that attorney as a trustee, either directly or by default, unless requested by the client. In this case, the attorney must also have the requisite knowledge and experience to serve as a trustee, the attorney must adequately disclose the legal and practical aspects of this designation, including other alternatives and relative costs.

Certain trusts impose additional restrictions on the selection of a trustee. The grantor and the grantor's spouse should not be the trustee of an irrevocable life insurance trust during the lifetime of the grantor. For other forms of irrevocable trusts, the grantor's rights may be restricted if he or she serves as a trustee. An American citizen or corporate trustee must be appointed to manage a qualified domestic trust for the benefit of a non-citizen spouse. A qualified trustee is required for an asset protection trust. A New Hampshire corporate trustee or resident, other than the grantor, is qualified to serve as a trustee of an asset protection trust. (These topics are discussed in greater detail later in this Guide.)

The designation of trustees, including co-trustees and successor trustees, requires consideration of the tasks and responsibilities which are contemplated in the trust. The abilities of the trustee to manage the trust, including the investment of the trust property, as well as the age, health, and integrity of the trustee will need to be considered. Since fees are paid to professional trustees, such as attorneys, banks and trust companies, the value of the trust as well as the anticipated complexity of administering the trust is often factored into the decision to designate a professional trustee. Potential conflicts between the trustee and beneficiaries should also be considered as should the relationship between the trustee and the trust beneficiaries.

The duties and responsibilities of the trustee are broad. A trustee must administer the trust according to its terms, in good faith and with impartiality, solely for the benefit of the trust beneficiaries. The trustee must segregate trust property, holding it separate from the trustee's own property, and invest trust property as a reasonably prudent person would invest his or her own assets. The trustee must preserve the confidentiality of the trust, to the extent reasonable.

Co-trustees may be designated when any one trustee does not possess all of the qualities which are desired of the trustee. Unless otherwise provided in the trust document or by agreement of the co-trustees, all decisions of the co-trustees require approval by a majority of the trustees at any time serving. Co-trustees may delegate authority to any one trustee to sign checks, make investments of the trust, or perform other actions. Co-trustees cannot, however, delegate all authority to one trustee.

The designation of the grantor's spouse, step-children or their descendants as a successor trustee will be revoked by the grantor's subsequent divorce, unless the trust expressly provides otherwise.

New Hampshire also recognizes the fiduciary roles of **trust advisors** and **trust protectors**. The powers of the trust advisor or protector may be specified in the trust, by agreement of the qualified beneficiaries of the trust or by court order. The powers of a trust advisor or protector are more limited than the powers of a trustee, but may include any of the following powers:

> The power to modify or amend a trust for tax purposes or to take advantage of changes in applicable law.
>
> The power to review and approve a trustee's account.
>
> The power to change the governing law or situs of the trust.
>
> The power to remove and replace a trust advisor or protector.
>
> The power to remove and replace a trustee.
>
> The power to consent to a trustee's action or inaction in making distributions to beneficiaries.
>
> The power to increase or decrease a beneficiary's interest in the trust, to grant, amend or terminate a power of appointment, within limits.
>
> The power to perform a specific duty that would normally be required of a trustee.
>
> The power to advise the trustee concerning any beneficiary.
>
> The power to consent to a trustee's investment action or inaction, including the power to direct the acquisition, disposition or retention of any trust investment.

Trustees, trust advisors and trust protectors are entitled to **reasonable compensation** and to reimbursement for reasonable trust expenses, including investment advisor, attorney and accountant fees. Unlike other states, New Hampshire does not provide for trustee's compensation as a **commission** or percentage of the value of the trust from year to year.

Corporate or professional trustees generally publish a fee schedule or enter into a fee agreement which may be based on the value of assets in the trust and/or the income earned by the trust during its term, payable periodically from income and/or principal, apportioned as the trustee shall determine to be equitable. A minimum annual fee may be applicable for relatively small trusts. Trustee fees may sometimes be negotiated with a corporate trustee, especially if the trust beneficiaries have the power to remove the trustee without cause.

Reasonable compensation for individual trustees is not as easily determined. Unless the trust provides otherwise, a trustee's compensation should take into consideration the circumstances of the trustee's service, including the following factors: the time spent by the trustee, the value of the services provided to the trust, the value of the trustee's time if not spent as the trustee, the risks assumed by the trustee and the urgency of the action required by the trustee. By example, the amount reasonably charged by an individual who is normally paid $100 a day to pay trust bills will be less than the amount reasonably charged by an individual who is normally paid $200 a day to prepare the income tax return for the trust, although both services are necessary and of value to the trust.

Trustee compensation is reflected on the annual account of the trust and ultimately subject to approval by the beneficiaries of the trust. If the beneficiaries object to the compensation paid to a trustee, they can petition the Probate Division of the Circuit Court for a determination that the fees were not reasonable under the circumstances.

In many cases, trustees do not charge any compensation for their services since the trustee or the trustee's family is a beneficiary of the trust. When a trustee intends to receive compensation, detailed time records should be kept reflecting the services performed as well as the time spent. Of course, compensation will be taxable as income to the trustee, and deductible as an expense of the trust.

Similar rules apply to the compensation to be paid to a trust advisor or protector, unless the trust provides otherwise.

The trust protector and advisor roles lead to two additional terms which may require explanation: a directed trust and an excluded fiduciary.

A **directed trust** is a trust where through the terms of the trust, an agreement of the beneficiaries, or a court order, one or more persons is given the authority to direct or consent to a fiduciary's actual or proposed investment decision, distribution decision, or any other noninvestment decision of the fiduciary.

An **excluded fiduciary** is any fiduciary excluded by the terms of the trust or by court order from exercising a power, or relieved by the terms of the trust or by court order of a duty, because such power or duty is given to another person.

TYPES OF TRUSTS

Trusts may be created for many purposes. Different types of trusts are more commonly used for different purposes. Gift, estate and generation skipping transfer tax planning trusts are often more complex than trusts which are simply designed to avoid the probate of the grantor's property at death, or trusts which are designed for the management of property during the lifetime of the grantor or until beneficiaries reach an age of maturity after the death of the grantor. Trusts created for one purpose can also be used for other reasons, however.

Trusts created under a Will are called **testamentary trusts**. The grantor of this trust is the testator or creator of the Will. The terms of the trust are found entirely in the Will. Although a trustee is designated in the Will, the trustee cannot act as such until he or she is appointed by the Court. In New Hampshire, the Probate Division of the Circuit Court has jurisdiction over the appointment of testamentary trustees and this Court supervises the administration of the trust through annual accounts. Historically, we generally did not recommend the creation of a testamentary trust due to the cost of Court supervision, including the filing of annual trust accounts, the surety bonding fees and Court fees. Testamentary trusts are more commonly created in states where probate expenses are not as cumbersome. They can also be useful when Court oversight is desired for a particular reason, or when a surviving spouse may receive public assistance to provide for nursing home care.

Effective January 1, 2012, however, testamentary trusts can expressly waive the requirement for filing an annual account with the Court, and testamentary trusts that do not include this waiver may become exempt from the accounting requirements if all interested persons agree and the Court finds that the waiver does not violate a material purpose of the trust. A waiver of accounting may also avoid surety bonding fees and Court fees. Accordingly, testamentary trusts may become more common for contingent trusts or smaller trusts which may not justify the creation of a separate trust agreement.

Trusts created during the lifetime of a grantor are called **inter vivos** or **living trusts**. These trusts are more commonly created in New Hampshire since they can be written to avoid probate upon the death of the grantor, or upon the death of a trust beneficiary. Often, these trusts are created during the lifetime of the grantor with an intention that they will continue for a period of time after the death of the grantor.

An inter vivos trust can be revocable or irrevocable. To be **revocable**, the grantor must have the right to revoke the trust and to return the trust property to the individual name of the grantor. This right is generally coupled with a right to amend or modify the trust during the lifetime of the grantor. This trust is most often used to avoid probate of the grantor's estate, to the extent that assets are either transferred to the trust during the lifetime of the grantor, or made payable to the trust as a beneficiary upon the death of the grantor. Revocable trusts may also be funded upon the death of the grantor, as a beneficiary of the grantor's pour-over will. (A **pour-over will** simply directs the distribution of individually owned property to the deceased owner's trust, through probate.)

An **irrevocable trust** cannot be revoked by the grantor. The trustee may have discretion to distribute income and/or principal to or for the benefit of the grantor and/or other beneficiaries. The grantor may have other rights in the trust, except the right to revoke the trust or to amend the trust in any way that could give the grantor the right to revoke the trust.

Trusts which are revocable during the lifetime of the grantor will become irrevocable upon the death of the grantor. The name of the trust may or may not change as a result of the death of the grantor. The terms of the trust will dictate the name of the trust.

All revocable trusts will be treated as **grantor trusts** for income and estate tax purposes during the lifetime of the grantor and upon the death of the grantor. Irrevocable trusts may or may not be treated as grantor trusts for income and/or estate tax purposes. The terms of the trust will control its characterization for tax purposes.

For income tax purposes, grantor trust income, deductions and credits will be reported on the grantor's personal income tax return. A revocable trust can report all trust income (including capital gains and losses) directly on the grantor's social security number as long as the grantor is a trustee of the trust. The capital gain exclusion available upon the sale of a primary home will be available to the grantor of a revocable trust which has owned the grantor's home property.

Income will be taxable to the grantor of an irrevocable grantor trust. In some irrevocable grantor trusts, capital gains and losses will also be taxable to the grantor. The capital gain exclusion available upon the sale of a primary home will only be available to the grantor of an irrevocable trust which has owned the grantor's home property, if the trust is written to be a grantor trust for this purpose.

In most cases, the trustee of an irrevocable grantor trust must secure a taxpayer identification number for the trust and prepare an income tax return for the trust. Nevertheless, ordinary income and/or capital gains and losses will be taxable to the grantor of the trust. These rules apply whether or not the grantor is also a beneficiary of the trust, if the grantor has retained certain rights over the disposition of the trust.

When a trust is a grantor trust for estate tax purposes, trust assets will be included in the grantor's estate for estate tax purposes. Under current law, trust assets will get a new tax basis equal to the fair market value on the date of the grantor's death. An irrevocable trust can be written to be a grantor trust only for income tax purposes, not taxable in the grantor's estate at death, in which case the trust assets will not get a new tax basis on the date of the grantor's death. An irrevocable trust must be reviewed by a trust and estate attorney or tax professional to determine if it is a grantor trust for income and/or estate tax purposes.

After the death of the grantor, a formerly revocable or irrevocable grantor trust will need a new taxpayer identification number to report trust income. If an irrevocable trust is not written as a grantor trust for income tax purposes, it will need to secure a taxpayer identification number when it is created. (As indicated above, when some types of grantor irrevocable trusts are created they will also need to secure a taxpayer identification number.)

Trusts may be written to take advantage of the amount that may pass without estate tax upon the death of the grantor. The federal estate tax exemption amount has increased significantly since 2001. Effective in 2018, the exemption from gift, estate and generation skipping transfer tax was doubled from $5,000,000 to $10,000,000. The exemption amount is also indexed for inflation after 2011, bring the exemption for 2018 to approximately $11,200,000. Under current law, in 2026, the exemption reverts to $5,000,000 as adjusted for inflation. A formula clause is often included in this type of trust to reference the estate tax exemption that may be available to the grantor at the time of the grantor's death. When a husband and wife create these types of trusts, they are often referred to as **A/B Trusts** or **credit shelter trusts**. Ansell & Anderson trusts often refer to the credit shelter trust as the **Family Trust** after the death of the grantor, when the trust becomes irrevocable.

After the death of a grantor, a **marital trust** may be created for the benefit of the surviving spouse, qualifying for the federal estate tax marital deduction. This trust may be established as a **qualified terminable interest property trust** or **QTIP trust**. A marital trust must distribute income to the surviving spouse during his or her lifetime and may distribute principal to the surviving spouse, but the balance of the trust will generally pass to beneficiaries selected by the grantor upon the death of the spouse. The spouse is typically not given control over the disposition of a QTIP Trust. Greater rights may be accorded to a surviving spouse in other forms of marital trusts. If the surviving spouse is not an American citizen, a **qualified domestic trust** or **QDOT** must be created to defer estate taxes until distribution of principal to the surviving spouse or the death of the surviving spouse.

Now that the estate tax exemption is over $11,000,000, people who created trusts for estate tax planning may now want to undo them. This can most easily be accomplished by disclaimer planning. When the first spouse dies, his or her trust can be payable to the surviving spouse's trust, unless the surviving spouse disclaims the right to receive this gift within 9 months after the death of the first spouse. A **disclaimer trust** is useful when the couple is not certain about estate tax planning, such as when they might move to a state which has an estate tax, or when the surviving spouse may have creditor issues. In most cases, the spouse will receive the assets and the trust will terminate, but it is useful to have the option to continue it for probate avoidance or management of the assets.

A **revocable trust** may be written to manage trust property during the lifetime of the grantor (especially during lifetime incapacity), to avoid probate of trust property upon the death of the grantor, and to manage trust property after the death of the grantor for the benefit of the designated beneficiaries. Estate tax planning may also be included. These goals are not mutually exclusive.

The grantor of a revocable trust retains complete control over the trust during his or her lifetime. As a result, the assets of the revocable trust are subject to the claims of the grantor's creditors, including providers of long-term health care. These assets are not protected if the grantor or the grantor's spouse should enter a nursing home in the future. The grantor must report all income earned by trust assets on his or her annual income tax return. At the time of the grantor's death, the assets of the revocable trust will be included in his or her gross estate for the purpose of determining federal and state estate tax liability.

An irrevocable trust may be used to give an interest in property to a beneficiary at the time that the trust is created and/or in the future, or to give an interest in property to a number of individuals. As with revocable trusts, these trusts can accomplish several goals at the same time.

An **irrevocable life insurance trust** or **ILIT** is a popular irrevocable trust, to avoid the taxation of a life insurance policy in the estate of the grantor and/or the grantor's spouse. In this case, the grantor creates the trust, naming someone other than the grantor or the grantor's spouse as the initial trustee (due to complex tax issues.) The grantor then transfers an existing life insurance policy into the trust, or sufficient funds for the trustee to purchase a new insurance policy on the life of the grantor. A husband and wife can create this type of trust to hold or purchase a second-to-die life insurance policy on their lives. Each year, the grantor contributes sufficient funds to pay the insurance premiums which may be due. If the grantor dies more than 3 years after the transfer of an existing life insurance policy, or at any time after the creation of the trust if a new policy was purchased by the trustee, the insurance proceeds will be payable to the trust, without taxation in the estate of the grantor. The spouse of the grantor may be a beneficiary of this trust during the spouse's lifetime. Often, this type of trust will continue to be held for the benefit of the grantor's children until they reach an age of maturity after the grantor's death, or for the lifetime of children, eventually passing to the grantor's grandchildren. Complex tax planning is always included in this type of trust.

An ILIT is often written as a **Crummey Trust**, named after the first taxpayer who created this type of trust. In this case, the gift to a beneficiary of the trust will qualify for the annual gift tax exclusion because the beneficiary will be given a present right to withdraw the amount of the gift for a period of time, usually 30 days after notice by the Trustee. This right of withdrawal is referred to as a **Crummey Power**.

A **Qualified Sub-Chapter S Trust** or **QSST** is a trust which may hold stock in a sub-chapter S corporation under federal tax law. All income from this trust must be distributed to the trust beneficiary and principal may be distributed to the beneficiary, but principal cannot be distributed to any other person during the lifetime of the beneficiary under federal tax law.

Another alternative for holding S corporation stock is an **Electing Small Business Trust** or **ESBT**. Unlike a QSST, there may be multiple income beneficiaries and there is no requirement that the trust distribute all income currently. However, ESBTs are subject to special income tax rules. The trust is taxed on its proportionate share of income from the S corporation at a flat tax rate equal to the highest marginal rate then applicable for trusts and estates.

Various forms of charitable trusts may be created to provide charitable gifts, often for estate tax purposes, sometimes coupled with gifts to family members. A **charitable remainder trust** is a trust which will provide a **unitrust** (a specified percentage of the value of the trust) or **annuity** (a fixed dollar amount) to the grantor or to another person for lifetime or for a period of time, with the balance of the trust eventually passing to one or more charitable organizations. A **charitable lead trust** provides an interest to one or more charitable organizations for a period of time, followed by a gift to family members. A trust set aside exclusively for charitable purposes can be established to provide an **endowment** (an income interest) for charitable purposes in perpetuity, or it can provide greater benefits for a limited period of time.

A **special needs trust** is a trust created for the benefit of a person with disabilities, in order to provide for the beneficiary without causing the beneficiary to be disqualified from receipt of government assistance, such as Medicaid. The trustee generally has broad discretion to make distributions to the beneficiary during his or her lifetime. If this trust is created for the benefit of the grantor, the balance of the trust must ultimately be payable to the State in order to reimburse it for assistance provided to the grantor during his or her lifetime. If this trust is created by a grantor for the benefit of another person, the balance of the trust does not need to be payable to the State upon the death of the disabled beneficiary.

An irrevocable trust may be created by a grantor in anticipation of his or her eventual entry into a nursing home. In this case, the grantor may reserve the right to receive all income earned by the trust, but the grantor must release all rights to receive any principal of the trust. Under current law, the principal of this type of trust will not be counted as an available resource for the grantor or the grantor’s spouse if the trust is created and funded more than 5 years before the grantor or spouse would otherwise qualify for Medicaid assistance. A home held in trust is always counted, however, and care will need to be taken to avoid this result.

In 2009, New Hampshire started to recognize **self-settled asset protection trusts**. Originally, these trusts were authorized under the Qualified Dispositions in Trusts Act, which allowed an individual to transfer property to an irrevocable trust that provides asset protection but still allowed the individual to benefit from the property transferred to the trust. In 2017, the Qualified Dispositions in Trusts Act was repealed, although existing trusts created under the Act were grandfathered. In place of the Qualified Dispositions in Trusts Act several statutory provisions were added that together provide similar protection for irrevocable self-settled asset protection trusts. Under the new provisions, a trust offers asset protection for a grantor who is a beneficiary of the trust, provided the trust includes a spendthrift clause. A spendthrift clause indicates that the trust assets are not subject to anticipation, assignment, pledge, sale or transfer by the beneficiary.

Creditors generally cannot reach property or assets held in a self-settled asset protection trust. No action will be permitted against an asset protection trust unless the transfer to the trust was fraudulent or if the claim arose after the transfer to the asset protection trust and an action is brought within 4 years after the transfer to the trust.

The creditor protection afforded by this trust is not absolute, however. Exceptions are made for alimony, support or property claims by a spouse or former spouse, and child support. Exceptions are also made for death, personal injury or property damage claims against the grantor for damages, which were caused in whole or in part on or before the date of a transfer to the trust.

ADMINISTRATION OF TRUSTS

The trustee must administer a trust in accordance with its terms and applicable law. As a starting point, the trustee must identify the property which is either owned by the trust or payable to the trust. The trustee must then identify the beneficiaries of the trust and their rights in the trust property.

Property transferred to the trust is called **principal**. **Income** refers to the amount earned from time to time, such as interest and dividends, which is taxable as ordinary income. When a trust owns residential property, the income beneficiary may be entitled to use the property, in lieu of rental income. Capital gains and losses are generally allocated to principal, unless a trust provides otherwise. **Net income** refers to income, after payment of expenses, including trustee fees and similar expenses.

In New Hampshire, the New Hampshire Trust Code provides for the administration of trusts to the extent that a trust does not provide otherwise. Most trusts include a reference to the applicable laws, as well as specific rules for the administration of the particular trust.

As a general rule, a trustee must invest the trust as a reasonably prudent person would invest his or her own funds. This is called the **prudent investor rule**. Unless a trustee has the requisite skills to manage a trust, we recommend that trustees consult with an investment advisor to assure compliance with this rule.

When a trust holds stock in a closely held business, the trustee may be given authority to manage this business interest, even if it would not be considered to be a prudent investment. Similarly, when a trust principally holds illiquid assets or a non-diversified investments, such as an insurance policy or real estate, the trustee may be given express authority to retain these investments.

After an irrevocable trust agreement is executed, the trustee is required to give notice to the qualified beneficiaries of a trust, unless the trust provides otherwise. A **trust notice** includes the name, address and telephone number of the trustee, as well as the names of the grantor and the date of the trust. A copy of the trust must either be provided or be available upon request by a beneficiary. This notice must be given within 60 days after the creation of an irrevocable trust, or within 60 days after a revocable trust becomes irrevocable, unless the trust expressly provides otherwise. A similar notice is required when a new trustee is appointed to administer an irrevocable trust.

A testamentary trust account must be filed with the Probate Division of the Circuit Court each year, with notice to all interested parties, including beneficiaries and creditors of the trust, unless the accounting requirements have been waived. This **Trustee's Accounting** must be filed on the forms directed by Court rules.

For all trusts, the trustee must account annually to the beneficiaries of the trust about the administration of the trust, unless the trust provides otherwise. There is no specific form for this **trust account**. The account may be in the form of a formal account (similar to the Trustee's Accounting filed for testamentary trusts), or it may be informal, including copies of account statements or a letter which explains the activity of the trust during the year. An account is not generally required for a revocable trust, unless the grantor is not a trustee of the trust or the grantor is incompetent.

If trust income is not directly reported on the social security number of the grantor, the trustee must file a federal income tax return, form 1041, for the trust for each year in which it earns any income. This return is due to be filed on or before the 15th day of the 4th month following the end of the taxable year (April 15th for a calendar year trust).

On the form 1041, the trustee must identify the trust as either a simple trust or a complex trust. A **simple trust** is a trust that requires all income to be distributed currently, does not provide for amounts to be paid or set aside for payment to charity, and does not distribute principal. All other trusts are **complex trusts**.

Generally, ordinary income is taxable to the trust in any year in which it is accumulated within the trust, but it is taxable to the beneficiary of the trust in any year in which it is distributed to the beneficiary, or it is required to have been distributed to the beneficiary under the terms if the trust. In the first 65 days of a year, the trustee may elect to treat a permissive income distribution to have been made during the prior taxable year of the trust. The beneficiary who is taxable on trust income will receive a Schedule K-1 to reflect the income which is taxable to that beneficiary for the prior year. Capital gains are taxable to the trust, except in the final year of a trust.

For trust years ending before December 31, 2013, a New Hampshire interest and dividends tax return may also be required if trust income exceeds $2,400 in any year, if any beneficiary and any trustee of the trust is a resident of New Hampshire.

For trust years ending on or after December 31, 2013, trust income will be taxable to the New Hampshire beneficiaries who receive the interest and dividends reported to them on the federal income tax return of the trust. Trustees will not need to file a New Hampshire interest and dividends tax return for any year beginning on or after January 1, 2013.

The change in New Hampshire law will allow trusts to avoid payment of interest and dividends on accumulated income in the trust after 2012. Of course, this change will only affect complex trusts which are not required to distribute income annually, and which will pay federal tax on accumulated income at the trust's tax rate. In order to determine whether or not this is advantageous, the rate of federal tax on accumulated trust income will need to be compared to the tax rate applicable for income distributed to the beneficiary under both federal and state law.

Trustees often hire an accountant to prepare the income tax returns for a non-grantor trust. Due to the complexity of the income tax rules, this is generally recommended for complex trusts.

Upon the death of a grantor, the assets of a revocable trust will be included in the grantor's estate for federal estate tax purposes. If probate of the grantor's estate is not required, the trustee of the trust will be treated as the executor of the grantor's estate for the purpose of filing a federal estate tax return, if one is required to be filed.

FUNDING A TRUST

A trust will only govern the assets which are transferred to the trust, either during the lifetime of the grantor, by beneficiary designation upon the death of the grantor, or through the probate of the grantor's Will.

When our clients create a trust for probate avoidance, we recommend that they transfer all assets to the trust, or name the trust (or individuals) as the beneficiaries of these assets. These clients also generally sign a **pour-over Will** (a Will which names the trust as the beneficiary of the probate Estate.) Assets which are in a person's name alone at the time of his or her death, without a beneficiary designation, will be subject to probate. By funding the trust during the grantor's lifetime, assets will be immediately available to the beneficiaries of the trust, eliminating the considerable expense, as well as the delay, that is part of the probate process.

Funding a trust is not difficult, but it does entail some work. The grantor funds a trust by changing the title to assets from the grantor's individual name to the name of the trustee of the trust, identifying the trust by its name and date of execution. The grantor's social security number will be used for the transfer of assets that require a taxpayer identification number to a revocable trust or an irrevocable grantor trust. A new taxpayer identification number will be needed for assets transferred to non-grantor, irrevocable trusts. The trustee's address will be used as the address of the trust. For example, a savings account formerly titled in the name of "Dana Smith" would become a savings account titled in the name of "Dana Smith, Trustee of The Dana Smith Revocable Trust, dated December 30, 2014." Because this trust is revocable, this account would continue to use Dana's social security number as the taxpayer identification number of the account and Dana's address as the address of the trust.

Listed below are some of the most commonly held assets and the usual procedure for transferring them into a trust:

<u>Real Estate</u>

Real estate must be transferred by deed, recorded in the Registry of Deeds for the county in which the real estate is located. For New Hampshire real estate, notice of the transfer must be given to the New Hampshire Department of Revenue Administration. In addition to the cost of the deed, recording fees, and the LCHIP fee will also need to be paid for the transfer of real estate to a revocable trust. There is no real estate transfer tax due on transfers to a revocable trust for estate planning purposes provided the owners interests before and after the transfer are the same. Additionally, there is not real estate transfer tax on the transfer of real property to an irrevocable trust in New Hampshire. As a non-contractual transfer, it represents a completed gift to the beneficiaries of the trust.

If property is subject to a mortgage or home equity loan, please note that most mortgages permit the lender to demand the immediate payment of a loan when property is transferred without the consent of the mortgage holder. Fortunately, an exception is made under federal law when the grantor's residence is transferred into a revocable trust for estate planning purposes. This exception does not apply to commercial real estate. Accordingly, we recommend that clients either contact their mortgage companies to request consent to the transfer (for commercial or residential real estate), or decide to proceed without the consent of the mortgage holder (for residential real estate.)

After the transfer to a trust, the trustee will need to contact the homeowner's insurance carrier to reflect the trust as the new owner of the property. Please note, however, that the grantor of a revocable trust will remain as an insured on this policy, with the trust as an additional insured party. If the grantor has title insurance on the real estate, he or she must also contact the insurance company and arrange for an endorsement of that policy to the trust. For title policies issued before 2006, some title companies may charge a nominal fee ($100-$200) for the endorsement.

Ansell & Anderson can prepare the deeds and the accompanying documents to accomplish the transfer for New Hampshire and Massachusetts real estate to a trust. For real estate that is located outside of New Hampshire and Massachusetts, however, the grantor will need to consult with legal counsel in the state in which the real estate is located to ensure that the transfer complies with local law.

Bank Accounts and Brokerage Accounts

Banks and brokerage houses deal with transfers into trusts on a regular basis. To change the title on each account from an individual name to the name of the trustee of the trust, the grantor or trustee would normally provide the bank or brokerage house with a copy of the trust or a Certification of Trust. If the institution requires an attested copy of the trust, Ansell & Anderson can provide one.

As an alternative to the transfer of a bank or brokerage account to a revocable trust, the trust may be designated as the beneficiary of an account which remains in the name of the grantor. In this case, the grantor will need to complete paperwork with the bank or brokerage firm to designate the trust as the beneficiary of the **ITF** (in trust for), **POD** (payable on death) or **TOD** (transfer on death) account.

Certificates of Deposit

The procedure for changing the title on a CD is similar to that of changing the title to a bank account. Please note, however, that some banks will charge a penalty for any change made to the title of the CD before the maturity date. An exception is made if the change is the result of the death of the owner. If there would be a penalty involved, the grantor should weigh the penalty against the potential consequence of waiting until the maturity date to re-title the CD in the name of the trust. The grantor may designate the trust as the beneficiary of the CD, in lieu of an immediate transfer to the trust.

<u>Stocks and Securities Not Held by a Broker</u>

For individual stock certificates, the grantor will have to complete stock powers transferring the stock from the grantor's individual name to the trust or to the trustee of the trust. Stock dividend stubs usually give the name and address of the transfer agent for each issue of stock. The grantor should contact the transfer agent to determine the transfer policy for each company.

For stock in a closely held corporation, the grantor will have to arrange for the shares to be transferred to the trust or to the trustee of the trust. The corporate records will have to be changed to reflect this transfer. The grantor or trustee should consult with the attorney for the corporation to complete the necessary legal documents. Under New Hampshire law, stock held in a professional association cannot be transferred into a trust.

For government obligations, such as federal, state or municipal bonds, including United States Savings Bonds, the grantor or trustee should contact the issuer to determine the procedure for changing the title to the trust.

<u>Tangible Personal Property</u>

Ansell & Anderson clients generally assign their tangible personal property to their revocable trusts when they sign Schedule A at the end of the trust. Other attorneys have clients sign a **Bill of Sale**, **Assignment** or **Deed of Transfer**. None of these documents will, however, transfer title to vehicles and other items of property that have a Certificate of Title. Automobiles used for family purposes will automatically pass to a spouse under New Hampshire law. Individuals may re-title vehicles in the name of the trust or trustee when the vehicle registration is renewed or a new vehicle is purchased, in order to direct a distribution to someone other than a spouse or to avoid probate for an unmarried owner.

The trustee should contact the insurance carriers when insured property is transferred into a trust, making sure that any individuals who use the property owned by the trust are named as insureds on the policy, with the trust as an additional insured party.

Ansell & Anderson revocable trusts often include a reference to a **tangible personal property memorandum** by which the grantor may request the distribution of jewelry, furniture, family heirlooms and similar items to family members and other beneficiaries following the grantor's death. On this memorandum, items to be distributed and the intended beneficiaries should be described with sufficient clarity to permit the trustee to satisfy the grantor's intentions. The grantor should update the memorandum periodically as circumstances change. This memorandum should either be kept in our vault with the grantor's original trust documents or in a place where the trustee will be able to find it after the grantor's death.

Life Insurance Policies

If the grantor is the owner of insurance policies on his or her life, the grantor can change the beneficiary designation on those contracts to name the trust as the primary beneficiary. If the grantor owns an insurance policy on the life of another person, he or she should change the ownership as well as the beneficiary designation to the trustee or the trust. Insurance agents or insurance companies will provide the necessary forms for these assignments and beneficiary designations.

IRAs and other qualified retirement plans

IRA, SEP, 401(k) or other qualified retirement plans are subject to special rules for income tax purposes. The ownership of the retirement account or plan will not change during the grantor's lifetime. Generally, the primary beneficiary of a qualified retirement plan should be the grantor's spouse, if the grantor is survived by a spouse. We recommend that our clients name their trusts or an adult child or children as the contingent or secondary beneficiaries of the retirement account or plan. When a trust is designated as the beneficiary or contingent beneficiary of a qualified retirement account, the trust may include a provision to extend the payment of the account for a period of time measured by the life expectancy of the oldest beneficiary of the trust. At the time of the grantor's death, the grantor's executor or trustee should seek legal advice regarding the estate and income tax issues that arise from the transfer of these assets to the trust or to other designated beneficiaries.