WHAT IS A TRUST?

A person who makes a transfer of wealth, either by a gift during her lifetime or by a bequest at her death, might do so by a direct transfer of cash or other property to the recipient. For example, while Mother is alive she might give Son corporate stock valued at $100,000 as a birthday present; alternatively, she might leave him a $100,000 cash bequest in her will upon her death. In either situation, once the transfer occurs (*i.e.*, when Mother transfers the stock to Son while she is living, or when Son receives the stock upon Mother's death) Son owns the property outright. As a result, he can do with it whatever he wants.

Sometimes a person in Mother's position might want to transfer property so that it benefits Son, but might be concerned about transferring it directly to Son. For example, Mother might be concerned that Son will immediately sell the corporate stock and spend all the proceeds on a weekend gambling spree, or that he might otherwise not be capable of managing the property.

Under such circumstances,[1] Mother might utilize a **trust**. Instead of transferring the corporate stock to Son directly, she might transfer it to Daughter (whom Mother trusts to handle money responsibly), as the trustee of a trust for the benefit of Son. Although Daughter, as the trustee, is the legal owner of the property, she holds it for the benefit of Son and must deal with the property in a fiduciary capacity. In other words, the legal ownership (in Daughter's name as trustee) is separated from the beneficial ownership (*i.e.*, for the benefit of Son).

Mother, in establishing this trust, has significant flexibility in specifying how the property and its income are to be distributed to Son. For example, the trust document might state that the dividend income generated each year from the corporate stock held in trust is to be distributed to Son, while the corporate stock itself is to remain in trust until Son reaches age 40, at which time it is to be distributed outright to Son. In addition, Mother has flexibility to retain various interests in or powers over the trust. For example, Mother might retain the right to revoke the trust and take back the corporate stock for herself. As we will see during the semester, the gift and/or estate tax consequences arising from the transfer to the trust will vary, depending on whether Mother retains various interests in or powers over the trust.

The following general terminology often is used in the trust context:

GRANTOR (Mother) – the person who creates and transfers property to the trust. Sometimes referred to as the "**donor**", the "**settlor**", or the "**trustor**" of the trust.

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[1] Another reason a person might make a gift or bequest by trust is if the intended beneficiaries cannot yet be ascertained with certainty. For example, Grandmother might want to provide money to all of her grandchildren, some of whom might not have been born yet. She could transfer the money to a trust to be held for the benefit of her grandchildren (including those not yet born).

TRUSTEE (Daughter) – the person who holds legal title to the trust property for the benefit of the beneficiary. Often a trusted family member serves as the trustee of a trust. Alternatively, particularly with larger trusts, the trust department of a bank or some other institution might be the trustee. The grantor herself can be the trustee of the trust she establishes, although this might raise additional tax complications (as we'll address during the semester).

BENEFICIARY (Son) – the person for whose benefit the trust property is held. A trust often has more than one beneficiary, and different portions of a trust might have different beneficiaries (*e.g.*, one person might be the beneficiary entitled to the income generated by the trust corpus, while another person might ultimately be entitled to receive the corpus itself at some future date). The trust grantor can also be the trust beneficiary (as well as the trustee). This is often the case in a common estate planning structure known as a "living trust" (which we'll address later in the semester).

CORPUS (the corporate stock) – the main body of property held by the trust, as distinguished from the income generated by that property. Corpus can consist of cash, income-producing property (*e.g.*, corporate stock), or non-income-producing property (*e.g.*, a family residence). Complicated rules (which we won't cover in the class) govern whether particular property constitutes corpus or income of the trust. The corpus is sometimes referred to as the "**principal**" or the "**res**" of the trust.

INTER VIVOS TRUST – a trust established by the grantor during her lifetime. The grantor may retain the right to revoke it during her lifetime, or it may be irrevocable. It often continues in existence after the grantor's death.

TESTAMENTARY TRUST – a trust established upon the death of the grantor pursuant to the terms of her will.

Although trusts generally are creatures of state law (which governs how to create a trust, what fiduciary duties the trustee owes to the beneficiaries, etc.),[2] the Treasury Regulations contain a general definition of "trust" intended to ensure that only arrangements coming within the commonly understood usage of the term (as opposed to business ventures) are considered trusts for Federal tax purposes. Treasury Regulation § 301.7701-4(a) contains the following definition, which is consistent with the general description above:

> In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created either by a will or by an inter vivos declaration [*i.e.*, a declaration while the **grantor** is still alive] whereby **trustees** take title to property [**corpus**] for the purpose of protecting or conserving it for the **beneficiaries** under the ordinary rules applied in chancery or probate courts. Usually, the **beneficiaries** of such a trust do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. However, the **beneficiaries** of such a trust may be the persons who created it [*i.e.*, the **grantors**] and it will be recognized as a trust under the Internal Revenue Code if it was created for the purpose of protecting or conserving the trust property for **beneficiaries** who stand in the same relation to the trust as they would if the trust had been created by others for them. . . [emphasis added].

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[2] In general, the course will not focus on these state law provisions. Instead, we will assume that a trust has been validly created under state law, and we will focus on the Federal estate, gift, and GST tax consequences arising therefrom.