Specialized Trusts

CHAPTER OUTLINE

§ 9.1 Totten Trust
§ 9.2 Special-Purpose Trusts
§ 9.3 Marital Deduction Trusts
§ 9.4 Charitable Trusts
§ 9.5 Life Insurance Trusts

CHAPTER OUTCOMES

• Describe a Totten trust.
• Determine when to use a spendthrift trust and when to use a sprinkling trust.
• Compare assorted marital deduction trusts and the use of each.
• Describe several types of charitable trusts and discuss the use of each.
• Explain the use of a life insurance trust as a way to save taxes.

JOB COMPETENCIES

• Be able to determine whether the money in a Totten trust bank account is probate or nonprobate property when preparing an estate inventory.
• Be able to draft spendthrift and sprinkling provisions when preparing trusts under the supervision of an attorney.
• Be able to draft marital deduction, charitable, and life insurance trusts under the supervision of an attorney.

“Leave the shower curtain on the inside of the tub.”

LAST WORDS OF CONRAD N. HILTON (1887–1979)
Tiffany Casey, a paralegal in the office of Knight & Francis, is called into Attorney Knight’s office where she is introduced to Mr. and Mrs. DeNunzio, a middle-aged couple.

“We’re going to do some estate planning for the DeNunzios, and I’d like you to help them with the estate planning questionnaire,” Attorney Knight explains to Tiffany.

“I’ll be glad to,” Tiffany replies. “The questionnaire is quite complicated.”

“Our lives are quite complicated, too,” Mrs. DeNunzio interrupts. “We just won the state lottery!”

“Congratulations!” Tiffany exclaims.

“We’ve only been married for two years, but we were both married before,” Mrs. DeNunzio volunteers. “I have six children from my first marriage, and Angelo has eight children from his first marriage.”

“That is some family!”

“If I die first, I want Angelo to have enough to live comfortably, but I want my own children to inherit my money. Angelo wants his children to inherit his money, too,” Mrs. DeNunzio continues as Angelo looks on quietly.

“We might consider using a special type of trust that will qualify for the marital deduction and save a considerable amount of taxes for your estate,” Attorney Knight suggests.

“Good,” Mrs. DeNunzio answers. “Right now I have a bank account for each of my children in my name in trust for each child. Will the children get that money if I die?”

“We’ll review your bank accounts when we have all the information together, and develop a plan that will be suitable for both of you,” Attorney Knight answers.

“Good,” Mrs. DeNunzio answers, “Angelo has a daughter who goes through money like water over a dam. If she inherits from Angelo, it won’t last very long.”

“Tiffany,” Attorney Knight suggests, “why don’t you take Mr. and Mrs. DeNunzio into your office and go over the estate-planning questionnaire with them? Then you can set up an appointment for us to meet again when we have the information we need.”

“Fine,” Tiffany replies, ushering Mr. and Mrs. DeNunzio to her office.

Queries:

1. What type of trust might be considered to give the survivor of Mr. and Mrs. DeNunzio a suitable income, while retaining the principal for the children?
2. What is the answer to Mrs. DeNunzio’s question about the bank accounts in her name in trust for each child?
3. What might Attorney Knight consider as a way to handle the problem of Angelo’s daughter, who spends money “like water over a dam”?
§ 9.1 TOTTEN TRUST

Paralegals who work with trusts must be familiar with a variety of trusts and need to know what type of trust is most suitable in a particular situation. Some of the specialized trusts with which paralegals often work include Totten trusts, spendthrift trusts, sprinkling or spray trusts, marital deduction trusts, charitable trusts, and life insurance trusts. As in the case of Mrs. DeNunzio, people may open bank accounts in their own names “in trust” for someone else, without signing any other trust instrument. The trust that is created when this happens is known as a Totten trust (from a 1904 New York case, In re Totten, 71 N.E. 748 (N.Y. 1904)). A Totten trust is a savings bank account in the name of the depositor as trustee for another person. The depositor may withdraw money from the account at any time during the depositor’s lifetime. When the depositor dies, the money in the account belongs to the beneficiary, as shown in the Adams case. If the beneficiary dies before the depositor, however, the trust terminates; the money belongs to the depositor, not the beneficiary’s estate. Totten trusts are not true trusts, because they lack the normal trustee and beneficiary, and the creator has total control over the funds. As trustee in name only, the funds in a Totten trust are subject to claims of creditors of the person who opened the Totten trust.

CASE STUDY  In Re Estate of Adams  587 A.2d 958 (VT)

FACTS: Bertha Mae Adams deposited her own money in her own name in the Troy Savings Bank “as trustee for Evelyn Lindquist,” her daughter. Adams died without making any changes to the bank account.

LEGAL ISSUE: Does a bank account opened by a depositor in trust for another belong to the depositor’s estate when the depositor dies?

COURT DECISION: No.

REASON: A deposit of one’s own money in one’s name as trustee for another is a tentative trust only, revocable at will, until the depositor dies. When the depositor dies before the beneficiary, there is a presumption that an absolute trust was created. This was a valid Totten trust. Evelyn Lindquist was entitled to the balance in the account, not Adams’s estate.

§ 9.2 SPECIAL-PURPOSE TRUSTS

There are many types of trusts that are used for special purposes. Among them are spendthrift trusts and sprinkling or spray trusts.
Spendthrift Trusts

A spendthrift is a person who spends money profusely and improvidently. A spendthrift trust is a trust containing a provision that protects the assets of the trust from creditors and from the beneficiary’s reckless spending. With such a provision in a trust, the principal and interest of the trust cannot be reached by creditors until they are received by the beneficiary, and the beneficiary cannot assign the principal and interest before receiving them. Without such a provision, a beneficiary for whom money is being held in trust could take the trust instrument to a bank, borrow on it, and assign the rights to the money to the bank as collateral for the loan.

The restrictions imposed by the spendthrift trust are described in the following provision.

Example

<table>
<thead>
<tr>
<th>Spendthrift Trust Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>16B AMJUR LF SP T § 237:17</td>
</tr>
</tbody>
</table>

Every beneficiary of this trust is restrained from anticipating, assigning, transferring, selling, or otherwise disposing of his or her interest in the trust estate, and every beneficiary is without power to anticipate, assign, transfer, sell, or otherwise dispose of his or her interest in the trust estate. No such anticipation, assignment, transfer, sale, or other disposition shall be recognized by the trustee, nor shall any attempted anticipation, assignment, transfer, sale, or other disposition by a beneficiary of an interest in the trust estate pass any right, title, or interest to the trust estate. No interest of the beneficiaries under the trust shall be subject to the claims of creditors or other persons, nor to any bankruptcy proceeding, nor to any other liabilities or obligations of any beneficiary.

Sprinkling Trusts

A sprinkling trust, which is also known as a spray trust, gives the trustee the power to determine how the trust’s income or principal or both are to be allocated among a group or class of beneficiaries. This type of trust is also called a discretionary trust, because trustees are allowed to use their own discretion in distributing principal and income to the beneficiaries. Trustees have the power to “sprinkle” or “spray” the trust income and principal among the people who are most needy or in a way that will save taxes.

An advantage of this type of trust is that when the trust is established, the settlor does not have to decide specifically who will receive the income and principal. The trustee makes that decision at a later time when the circumstances of potential beneficiaries are better known. Funds can be distributed according to need. The trustee can also take advantage of the tax brackets of the different
beneficiaries when distributing income, and thereby save income taxes. In addition, estate taxes can often be reduced. Another important advantage of a sprinkling trust is that the spendthrift provision is built in: the trustee can control allotments to a beneficiary who spends money profusely and improvidently.

A disadvantage of a sprinkling trust is that the trustee has ultimate control. Before choosing to use a sprinkling trust, a settlor should trust and respect the prospective trustee greatly: the trustee, not the settlor, will decide exactly who will benefit from the trust within the general group or class of people that the settlor chooses. These types of trusts lend themselves to actions against the trustee for favoritism. The use of a provision like the following in a trust instrument creates a sprinkling trust.

**Example**

**Sprinkling Trust Provision**

17B AMJUR LF TR § 251:264

Trustee shall hold, manage, invest, and reinvest the trust estate, and shall apply and distribute the income and principal of the trust as follows:

(a) Distribution of income. Trustee shall pay to or apply for the benefit of my children, herein referred to as income beneficiaries, at least annually, and in such proportions as trustee in its absolute discretion may from time to time determine, all of the net income of the trust estate.

(b) Invasion of principal. At any time and from time to time and notwithstanding any other provision of this agreement, trustee may, in its absolute discretion, in addition to any other payments provided for in this agreement, pay to or apply for the benefit of income beneficiaries such amounts as trustee may, in its absolute discretion, elect from the principal of the trust estate.

(c) Further disposition of trust estate. Income beneficiaries’ interests in the trust estate, as provided in subparagraphs (a) and (b) hereof, shall terminate when the youngest beneficiary reaches the age of 30 years. The trust estate shall thereupon be paid and distributed as follows: In equal shares to my issue then living by right of representation.

(d) Shares of income beneficiaries. Payments made to each of income beneficiaries pursuant to this section need not be equal.

§ 9.3 **MARITAL DEDUCTION TRUSTS**

Under federal estate tax laws, property passing from a decedent to a surviving spouse is not taxable. Instead, it is deductible from the decedent’s taxable estate and is known as the marital deduction. A trust that is designed to make optimal use of the marital deduction is called a marital deduction trust. A marital deduction trust may distribute property to a surviving spouse in various ways, including: (1) an outright gift, (2) a life estate with a general power of appointment, (3) a credit-shelter trust, and (4) a qualified terminable interest property (QTIP) trust.
Distribution Outright

Sometimes settlors wish to give the entire trust corpus outright to a surviving spouse when they die. This can be done through a simple clause in the trust, such as “Upon the settlor’s death, the trustee shall distribute all principal and income, outright and free of trusts, to the settlor’s surviving spouse.”

The surviving spouse thereby receives full access to and control of the trust property and qualifies for the full estate tax marital deduction. However, choosing this option makes the entire trust property part of the surviving spouse’s estate, which may be subject to probate when the surviving spouse dies and become taxable at that time. In addition, the surviving spouse, not the settlor, will have the power to decide who will be the ultimate beneficiaries of the trust property.

Life Estate with Power of Appointment

Another way to qualify for the marital deduction is to leave property in trust to the surviving spouse for life and, upon the spouse’s death, to whomever the surviving spouse appoints in a will. This can be done with either a living trust or a testamentary trust.
Example

Testamentary Trust Provision for Spouse

17B AMJUR LF TR § 251:351

With Limited Power of Appointment

PARAGRAPH _______

DIVISION OF RESIDUE

I give the residue of my estate to the trustee, in trust, to be administered, paid or applied as follows:

A. The net income of the trust shall be paid to my [husband or wife] for [his or her] life. If my [husband or wife] does not survive me, the property shall be distributed to my then living children or the issue of any deceased child, per stirpes, but if none survive me then to [name].

B. Following the death of my [husband or wife], trustee shall pay and divide the principal and income of the trust estate among my children and the issue of any deceased child, per stirpes, in such shares as my [husband or wife] shall by will appoint and subject to such provisions as are set forth in [his or her] will. In default of such appointment, and so far as any appointment extends to persons other than my children living at my death and the issue of any deceased child of mine, the principal and income of the trust shall be paid, in equal shares, to my children. The issue of any deceased child of mine shall take per stirpes such share as such child of mine would have taken if then living.

In the preceding trust provision the will leaves the residue of the estate in trust for the surviving spouse to receive the income from the trust for life. Upon death, the trust ends, and the principal of the trust is distributed among the children in whatever fractions are set forth in the surviving spouse’s will. To qualify for the marital deduction, the trust, however, must meet specific requirements found in the Internal Revenue Code.

Credit-Shelter Trust

In a credit-shelter trust, also known as an A-B trust, a bypass trust, or an exemption equivalent trust, a deceased spouse’s estate passes to a trust rather than to the surviving spouse. This strategy reduces the possibility of the surviving spouse’s estate being taxable (a drawback noted earlier in the discussion of an outright distribution).

Assume, for example, that a married couple’s total assets are several million dollars. The husband dies, leaving everything to his wife. There will be no federal estate tax because of the 100 percent marital deduction. However, when the wife subsequently dies, the amount in her estate that exceeds that year’s estate tax exemption will be subject to the estate tax. The tax may be avoided by using a credit-shelter trust.
Under a credit-shelter trust, the will of the first spouse to die leaves the amount that is exempt from the federal estate tax to an irrevocable credit-shelter trust called Trust A. Trust A provides income for the surviving spouse for life; upon that spouse’s death, the corpus of Trust A passes to other named beneficiaries, such as children or grandchildren. In addition, the will of the first spouse to die leaves an equal amount to Trust B for the benefit of the surviving spouse, allowing it to qualify for the marital deduction and, therefore, not be taxable. When the second spouse dies, the amount in Trust A is not part of his or her estate and, therefore, is not subject to the estate tax. The only item that is subject to the estate tax is the money in Trust B, but it also is not taxable because it does not exceed the estate tax exemption.

Example

A-B Trust

In the event that my [husband or wife], [name], survives me, I give to my trustee, [name], to hold and administer as a separate trust, to be designated “Trust A,” the marital trust, an amount equal to [fifty] percent of the value of my adjusted gross estate as that term is defined in the Internal Revenue Code, minus the value of any other assets that qualify for the marital deduction allowable in determining the federal estate tax payable with respect to my estate. I specifically empower my trustee to satisfy the transfer to Trust A in cash or in kind, or partly in cash and partly in kind. For purposes of the transfer, any assets distributed in kind shall be valued at their value as finally determined for federal estate tax purposes. My executor shall, consistent with equitable principles requiring impartiality between legatees, act impartially in allocating assets to the satisfaction of the transfer to Trust A for my [husband or wife] so that any noncash distribution or satisfaction shall be made of assets that are fairly representative of appreciation or depreciation in the value of all property thus available for distribution.

Trust B, the residuary trust, shall be equal to the balance of the residue as reduced by Trust A.

QTIP Trust

A third type of trust that qualifies for the marital deduction is a QTIP trust. This type of trust is used when the settlor wants to pass the entire principal of the trust to someone other than the surviving spouse, but wants the spouse to have the income from the trust for life. A qualified terminable interest property (QTIP) trust gives all trust income to the surviving spouse for life, payable at least annually. During the surviving spouse’s lifetime, no one can appoint the trust property to anyone other than the surviving spouse. This type of trust must also meet specific requirements found in I.R.C. § 2056(b)(7).
Suppose, for example, that a woman has three children by her first husband and no children by her second husband to whom she is still married. She wants her children to inherit her property if she dies before her husband, but also wants her husband to live comfortably for the rest of his life. If the estate is large enough to produce sufficient income, a QTIP trust would be appropriate, because the husband would benefit, but would be restricted to the income from the trust for his life. Upon his death, the principal would pass intact to the three children.

An interesting aspect of a QTIP trust is that the decision to actually use the QTIP provision is made after the death of the decedent, even though the trust is created before death. The decedent’s executor elects to treat the property as qualified terminable interest property on the estate tax return. Otherwise, the property does not qualify as a QTIP. The executor has the option to either elect or not elect to have the QTIP trust qualify for the marital deduction. The estate planner can look at the circumstances that exist at death, rather than at the time the trust is executed, to make the final decision. Such flexibility makes the QTIP trust an advantageous option in postmortem planning.

§ 9.4 CHARITABLE TRUSTS

A charitable trust, sometimes called a public trust, is a trust in which the property held by the trustee must be used for public charitable purposes. A charitable trust is created for the benefit of a part of the general public rather than for an individual or designated group of individual persons. In a charitable trust, the actual beneficiaries are indefinite and unascertainable. Such trusts are established for religious, charitable, scientific, or educational purposes, or the like. Because no particular individual can benefit from a charitable trust, no one person can bring suit to enforce the trust. For this reason, charitable trusts are enforced by the attorney general of the state where they are established. Gifts to charities, in general, are exempt from the federal estate tax; however, to be exempt, the recipient of the gift must qualify as a charity under the rules found in I.R.C. §§ 2055 and 2106(a)(2).

Cy Pres Doctrine

When money or property is left in trust to a charity, and the charity ceases to exist, does the trust also end? Under the doctrine of cy pres, which means “as near as possible,” if the court finds that the settlor had a general charitable intent, the trust fund will be turned over to another closely related charity. If instead the court finds that the settlor had a specific intent to benefit one charity exclusively, and that charity ends, the trust will also be discontinued, and the trust property will revert to the settlor’s heirs. In the Crawshaw case, the use of cy pres was considered appropriate, and the court allowed a substitution.
In the *Incurables of Baltimore* case, the court followed the doctrine of *cy pres* in making its decision to award Dr. Coggins’ bequest to the Keswick Multi-Care Center. The court said in that case:

The *cy pres* statute directs a Maryland court to salvage a bequest for charity and administer the bequest as nearly as possible in accordance with the testator’s intent if, at the time it becomes effective, the bequest “is illegal, or impossible or impracticable of enforcement,” as long as “the settlor or testator manifested a general intention to devote the property to charity. ...”

As previously pointed out, the purpose of the *cy pres* statute was to save some charitable bequests that would have failed under prior law. ... Furthermore, where the gift over is also to a charity, it would seem that the testator’s general charitable intent is confirmed.

### CASE STUDY  Matter of Estate of Crawshaw

806 P.2d 1014 (KS)

**FACTS:** After making specific bequests totaling $350 to family members, Chester D. Crawshaw’s will left 15 percent of the residue of his estate to the Salvation Army and 85 percent in trust to Marymount College in Salina, Kansas, for school loans to nursing students and other students. If for some reason Marymount College could not accept and administer the trust, the will provided that the bequest go in trust to “the official Board or Association of said college having the legal capacity to accept and administer the herein created trust.” One month after Crawshaw died, Marymount College terminated its existence. The Marymount Memorial Educational Trust Fund was established by the college and the Roman Catholic Bishop to administer this and other scholarship funds.

**LEGAL ISSUE:** Does the doctrine of *cy pres* apply when a testator leaves the bulk of his estate to a named college to provide loans to nursing and other students and the college ceases operation?

**COURT DECISION:** Yes.

**REASON:** Under Kansas law, the doctrine of *cy pres* permits a court to implement a testator’s intent and save a testamentary charitable gift by substituting beneficiaries only when these conditions are met: First, the gift must be to a charitable organization for a charitable purpose. Second, it must be impossible, impractical, or illegal to carry out the donor’s stated charitable purpose. Finally, it must appear that the donor had a general charitable intent. All three requisites are met in this case, and the use of *cy pres* is appropriate.
Rule Against Perpetuities

One feature of a charitable trust is that the rule against perpetuities does not apply: this means that charitable trusts can exist indefinitely, unlike private trusts. Under the common-law rule against perpetuities, every interest in property is void unless it must vest, if at all, not later than 21 years plus the period of gestation after some life in being at the time of creation of the interest. For example, if a settlor left money in trust for the settlor’s children and then for the lives of the settlor’s grandchildren, the rule would be violated, because the grandchildren could include children of an as-yet-unborn child of the settlor, and this might occur more than 21 years after the death of all currently living beneficiaries. Thus, the trust would be void.

The rule against perpetuities has been subject to much criticism and has been changed by statute in many states. Some states have revised the rule to provide that property interests must vest either no later than 21 years after the death of an individual who is alive at the time the interest is created or within

A Benevolent Businessman

Conrad N. Hilton was not only an astute businessman who built a worldwide hotel empire; this gentle-looking man was also a compassionate philanthropist, as shown by this excerpt from his will, which was addressed to the directors of the Hilton Foundation. Hilton began the Foundation in 1944 as a trust, then later transferred its assets to a nonprofit corporation. When Hilton died in 1979, the foundation received much of his wealth (over $180 million) to support his philanthropic ideals: “to alleviate human suffering,” particularly among disadvantaged children, and to promote the human services activities of the Catholic Sisters worldwide.
90 years of such creation. Under the revised rule, in the preceding example, the trust would not be void if the money would vest in the settlor’s grandchildren within 90 years of the trust’s creation. In any event, if the settlor left money in trust to a charitable institution, there would be no time limit and the trust could continue for many generations.

Charitable Remainder Trusts (CRATS and CRUTS)

A charitable remainder trust is a trust in which the settlor, or a beneficiary, retains the income from the trust for a period of time (usually for life), after which the trust principal is given to a charity. Settlors can use part of such gifts as deductions on their federal income tax returns, thereby increasing their total earning power. In addition, the gift to charity may be deducted from the settlor’s federal estate tax. Charitable remainder trusts may be in the form of an annuity trust or a unitrust (see Exhibit 9–1).

Annuity Trusts

A charitable remainder annuity trust (CRAT) is a trust in which a fixed amount of income is given to a beneficiary at least annually, and the entire remainder is given to charity. Under Internal Revenue Service (IRS) regulations, the beneficiary must receive annually at least five percent of the amount that was initially given to the trust. The amount can never change, regardless of the needs of the beneficiary or economic inflation. If the income of the trust is insufficient to meet the required annual payment, the difference must be paid from the principal of the trust. If the income of the trust is more than the required payment, the difference remains in the trust. When IRS requirements are met, the settlor receives an income tax deduction for the contributions made to the trust, based on an IRS formula.

Example

Charitable Remainder Annuity Trust Payment Clause

4B AMJUR LF CHAR § 55:9

PAYMENT OF ANNUITY AMOUNT
The Trustee shall pay to [a living individual] (referred to as “the Recipient”) in each taxable year of the Trust during the Recipient’s life an annuity amount equal to % [at least five] of the net fair market value of the assets of the Trust as of this date. The annuity amount shall be paid in equal quarterly amounts from income and, to the extent income is not sufficient, from principal. Any income of the Trust for a taxable year in excess of the annuity amount shall be added to principal. If the net fair market value of the Trust assets is incorrectly determined, then within a reasonable period after the value is finally determined for federal tax purposes, the Trustee shall pay to the
How You can Receive an Income for Life and Support The Salvation Army:  
The Charitable Gift Annuity

A Salvation Army Gift Annuity gives our donors an income for life while making an important investment in the physical, spiritual, and emotional well-being of people who need a helping hand.

- Frequently a donor names him/herself as the income beneficiary. However, he or she can arrange for someone else - a spouse, another family member or a friend - to benefit from this program.

- The donor transfers a gift of cash or appreciated securities to The Salvation Army for a Charitable Gift Annuity and receives payments on a monthly, quarterly or semi-annual basis.

- The donor/income beneficiary receives regular payments for life. When the last income beneficiary is deceased, The Salvation Army uses the remaining principal to help others.

- There are tax benefits. A portion of the amount a donor transfers is deductible as a charitable gift. Part of each payment a donor and/or beneficiary receives is tax-free.

- The size of each payment depends on a combination of factors including the amount of cash and/or appreciated securities which funds the annuity and the age of the donor/beneficiary(s) when the annuity is created. Single-life annuity rates range from 6.3% for a 50 year old donor to 12% for a 90 year old donor.

- Payments are always guaranteed and they will always be exactly the same amount for the rest of the beneficiary's life.

ILLUSTRATION

Mrs. Jones, who is 75 years old, transfers $10,000 to a Salvation Army Gift Annuity:

- she receives an 8.2% rate of return or $820.00 per year,

- of that amount, $451.82 is considered tax free income for the course of her life expectancy,

- her charitable contribution deduction is $4,400.90 in the year the gift was made,

- her payments continue, guaranteed, for the rest of her life.

EXHIBIT 9–1  Sample Gift Annuity Features

Courtesy of the Salvation Army

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Recipient (in the case of an undervaluation) or receive from the Recipient (in the case of an overvaluation) an amount equal to the difference between the annuity amount(s) properly payable and the annuity amount(s) actually paid.

## Unitrusts

A **charitable remainder unitrust (CRUT)** is similar to an annuity trust, but does not require the payment of a fixed amount each year to an income beneficiary. Instead, the income beneficiary must receive a fixed percentage—not less than five percent—of the value of the trust property, which is determined annually (see Exhibit 9–2). A unitrust is in effect a type of variable annuity: it offers protection against inflation because the beneficiary’s income increases as the value of the trust property increases.

### Example

**Charitable Remainder Unitrust Payment Clause**

*PAYMENT OF UNITRUST AMOUNT*

In each taxable year of the trust, the Trustee shall pay to [relation, such as: my wife], [name of life income beneficiary] (the “Recipient”), during [his or her] lifetime, the Unitrust Amount, which shall be equal to % of the net fair market value of the trust assets as of the first day of each taxable year of the trust (the “Valuation Date”).

These types of trusts are referred to as “split interest trusts.” They provide the benefits of the charitable deduction while providing for other beneficiaries.

## § 9.5 LIFE INSURANCE TRUSTS

If carefully prepared, a life insurance trust may be used to pass money to heirs tax free. First, an irrevocable trust is established; then the trustee purchases a life insurance policy on the settlor’s life. The settlor contributes a certain amount of money each year to the trust, which is used by the trustee to pay the premiums on the policy. When the settlor dies, the proceeds of the insurance policy are paid to the trust. If the trust contains Crummey powers (described later), the settlor’s spouse may receive the income from the trust for life; upon the spouse’s death, the principal passes tax free to the settlor’s heirs.

**Crummey powers** (named from the case of *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968)), give one or more of the trust beneficiaries the right to withdraw each year the money that is contributed to the trust. The withdrawal
amount is usually the amount of the contribution to the trust or the amount of the annual gift tax exclusion ($11,000 per donee, adjusted annually for inflation), whichever is less. Because the contribution may be withdrawn, it is considered a present interest and qualifies for the gift tax annual exclusion. Without these special Crummey powers of withdrawal, the payment of insurance premiums to a trust would normally be considered a taxable gift, not a gift of present interest, and not eligible for the annual gift tax exclusion.

Example

Crummey Withdrawal Provision in Irrevocable Trust

The beneficiary shall have the right during each calendar year, upon making written demand upon the trustee therefore, to receive from the trustee outright and free from this trust all or any part of any property transferred or added to such trust by way of *inter vivos* gift during such calendar year. The trustee shall give the beneficiary notice of any such transfer within 10 days of such transfer. However, in no event shall the trustee honor any such demand that exceeds the sum of $____ per donee in one calendar year. The trustee shall honor any such demand in cash or in kind, in the discretion of the trustee, immediately upon receipt by the trustee of the written demand of the beneficiary. Such payment shall be made from the property transferred to the trust by each donor during that year.
Trust funds must be sufficient to allow for the Crummey withdrawals. Therefore, gifts to an otherwise unfunded trust to pay insurance premiums should be held in trust until the demand period has elapsed. Of course, with this type of trust, the settlor and the beneficiaries would probably want the withdrawal power to lapse each year so that the money could be used to pay the insurance premiums (see Exhibit 9–3).

### REVOCABLE TRUST AGREEMENT

[17A AMJUR LF TR § 251:114]

Trust agreement made on ______ [Date], between ______, of ______ [address], ______ [city], ______ County, ______ [state], referred to as trustor, and ______, of ______ [address], ______ [city], ______ County, ______ [state], referred to as trustee.

In consideration of the mutual covenants and promises set forth in this agreement, trustor and trustee agree:

#### SECTION ONE

**TRUST ESTATE**

Trustor assigns, transfers, and conveys to trustee the property described in the attached Exhibit ______, which is incorporated by reference, and the receipt of which property is hereby acknowledged by trustee. The property shall be held by trustee in trust on the terms and conditions set forth below.

#### SECTION TWO

**REVOCATION AND AMENDMENT**

Trustor reserves the right at any time, by an instrument in writing delivered to trustee ______ [if appropriate, add: and acknowledged in the same manner as a conveyance of real property entitled to be recorded in ______ [state], unless acknowledgment is waived by trustee], to revoke or amend this trust in whole or in part. The duties and liabilities of trustee shall under no circumstances be substantially increased by any amendment of this agreement except with its written consent.

#### SECTION THREE

**ADDITIONS TO TRUST ESTATE**

Trustor reserves the right for ______ [himself or herself] or any other person to increase this trust by delivering property to trustee, by having the proceeds of insurance policies made payable to trustee, or by bequest or devise by will. Trustor will notify trustee in writing of any policies made payable to it or will deliver the policies to trustee as custodian. Trustee's
duties and liabilities under this agreement shall under no circumstances be substantially increased by any such additions, except with its written consent.

SECTION FOUR
DISPOSITION OF INCOME AND PRINCIPAL

After paying the necessary expenses incurred in the management and investment of the trust estate, including compensation of trustee for its own services, trustee shall pay the net income of the trust and distribute the principal of the trust in the following manner: _____ [provide for payment of income and distribution of principal of trust].

SECTION FIVE
INVASION OF PRINCIPAL FOR BENEFIT OF TRUSTOR’S SURVIVING SPOUSE AND DESCENDANTS

After trustor’s death, trustee may apply so much of the principal of the trust for the use of trustor’s _____ [spouse], _____, and trustor’s descendants, or any of them, at such time or times as in trustee’s discretion it may deem advisable for their proper education, care, or support. The provisions of this section are intended primarily as a means of affording financial assistance to trustor’s _____ [spouse] and children in the event of their serious illness, misfortune, or other emergency or unusual condition, and also to assist _____ [his or her] descendants during the period of their education or setting up in business or at the time of their marriage. This enumeration is to serve only as a guide and shall not be construed to restrict the discretionary powers so conferred on trustee. Any amounts so applied to the use of trustor’s _____ [spouse] or any descendant shall be charged against, or deducted from, the principal of any share then, or thereafter, set apart for such _____ [spouse] or descendant.

SECTION SIX
DISTRIBUTIONS TO MINORS

Trustee in its discretion may make payment of income or principal applicable to the use of any minor by paying the same to the parent or guardian of the minor, or to any other person having the care and control of the minor, or by expending it in such other manner as trustee in its discretion believes will benefit the minor, provided, that trustee may also pay as an allowance directly to the minor such sums as trustee may deem advisable. Trustee may accumulate for the benefit of any minor so much of any income applicable to the minor’s use as trustee in its discretion may deem advisable. Any income so accumulated shall be paid to the minor on his or her attaining majority. Trustee in its discretion may make payment of principal vesting in and payable to a minor, to such minor’s parent or guardian, or may defer payment of any part or all of the amount.
until the minor attains majority, meanwhile applying to the minor’s use so much of the principal and income, and at such time or times, as in its discretion it may deem advisable for the minor’s proper education, care, or support. Any payment under this section shall operate as a full discharge to trustee with respect to the payment.

SECTION SEVEN
POWERS OF TRUSTEE

_____ [Set forth trustee’s powers, as desired.]

SECTION EIGHT
TRANSACTIONS WITH THIRD PERSONS

No person or corporation dealing with trustee shall be required to investigate trustee’s authority for entering into any transaction or to administer the application of the proceeds of any transaction.

SECTION NINE
DIVIDENDS

Regular or ordinary cash dividends, although they may be wholly or partly in the nature of a payment in partial liquidation or may wholly or partly represent a distribution of assets of the corporation other than surplus earnings, shall nevertheless be treated wholly as income of the trust. All other liquidating dividends shall be principal. All dividends payable in the stock of the corporation or association declaring or authorizing the same shall be treated as principal. All other extraordinary dividends shall be apportioned between principal and income, as determined by trustee in its absolute discretion.

SECTION TEN
COMPENSATION OF TRUSTEE

_____ [Provide for trustee’s compensation or waiver of compensation.]

SECTION ELEVEN
REMOVAL AND RESIGNATION OF TRUSTEE

Trustee may be removed at any time by trustor or after trustor’s death by _____ [designate] by written notice to trustee. Trustee may resign by written notice to trustor during trustor’s lifetime or after trustor’s death to ______. Until the accounts of trustee are settled and trustee is discharged, trustee shall continue to have all the powers and discretions granted to it under this agreement or conferred by law. In the event of the removal or resignation of trustee, trustor or ______ may by written instrument appoint a successor trustee. The successor trustee, on executing a written acceptance of the trusteeship and on the settlement of
SUMMARY

A Totten trust is a savings account in the name of the depositor as trustee for another person. The depositor may withdraw money from the account at any time during the depositor’s lifetime. When the depositor dies, the money in the account belongs to the beneficiary. If the beneficiary dies before the depositor, the trust terminates, and the money belongs to the depositor.

Spendthrift trusts are used to prevent beneficiaries who spend money profusely or unwisely from having access to trust funds until they are due. Sprinkling trusts give the trustee, rather than the settlor, the power to decide who will receive the trust income and principal.

EXHIBIT 9–3d  General Form of a Revocable Trust Agreement

Courtesy of West Group ©2001

SECTION TWELVE
EMPLOYMENT OF AGENTS: EXPENSES OF TRUST

Trustee may employ agents, including counsel, and pay them reasonable compensation. Trustee shall be entitled to reimbursement therefor and for all other reasonable expenses and charges of the trust out of principal or income, as trustee shall determine.

SECTION THIRTEEN
GOVERNING LAW

This trust shall be governed and construed in all respects according to the laws of [state].

SECTION FOURTEEN
BINDING EFFECT

This agreement shall be binding on trustor, trustor’s executor, administrator, successors and assigns, and trustee and trustee’s successors and assigns.

In witness whereof, trustor and trustee have executed this agreement at [designate place of execution] the day and year first above written.

[Signatures]

[Acknowledgments]

[Attach exhibit]
Property passing to a surviving spouse, called marital deduction property, is not taxable under federal estate tax laws. The deduction may be obtained by an outright gift to the surviving spouse; however, when that spouse dies, his or her estate may be large enough to be taxable. Another way to obtain the deduction is by giving a life estate to the surviving spouse and allowing that spouse to determine who will inherit when he or she dies. This is called a power of appointment. A third way to use the marital deduction is to establish a credit-shelter trust, which passes the deceased spouse’s property to a trust for the spouse’s benefit (using the estate tax exemption) and any balance to the spouse outright, qualifying for the marital deduction. A QUITP trust gives the income of the trust to the surviving spouse for life, tax free, payable annually, with the balance left intact for whomever the settlor designates.

Charitable trusts are created to benefit a part of the general public rather than individuals and are free of federal estate taxes. Under the doctrine of cy pres, if a charity comes to an end and the settlor had a general charitable intent, the trust fund will be turned over to a similar charity. Charitable trusts, unlike private trusts, can exist indefinitely, as exceptions to the rule against perpetuities. A charitable remainder annuity trust provides a fixed amount of income annually to a beneficiary, with the corpus going ultimately to a charity. In contrast, a charitable remainder unitrust offers protection against inflation by providing a percentage (not less than five percent) of the value of the trust property each year to a beneficiary, with the corpus going ultimately to a charity.

A life insurance trust may be used to pass money to heirs tax free if the trust contains Crummey powers, that is, powers given to beneficiaries to withdraw the money that is contributed to the trust.

**REVIEW QUESTIONS**

1. In a Totten trust, who is entitled to the money when the depositor dies before the beneficiary? When the beneficiary dies before the depositor?
2. When would a settlor use a spendthrift trust?
3. Why is a discretionary trust also called a sprinkling or spray trust?
4. What is one advantage and one disadvantage of a sprinkling trust?
5. What is an advantage of leaving the entire corpus of a trust outright to a surviving spouse at one’s death? What can be a disadvantage?
6. When a surviving spouse is left property in trust for life with a power of appointment, who receives the trust property when the surviving spouse dies?
7. What type of trust is used when the settlor wants to pass the entire principal of the trust on to someone other than the surviving spouse, but wants the spouse to have the income from the trust for life?
8. What is the rule against perpetuities, and when does it not apply?
9. How does a charitable remainder annuity trust differ from a charitable remainder unitrust?
10. What are Crummey powers, and why are they used?
CASES TO DISCUSS

1. Joseph Berson deposited $73,544.51 with the Metropolitan Savings Bank in an account entitled “Joseph Berson in Trust for New York City Jewish Defense League.” Berson made no further deposits to or withdrawals from the account. When Berson died, the administrator of his estate claimed that the money belonged to the estate. Is the administrator correct? Explain. In re Joseph Berson, Deceased, 170 A.D. 2d 504, 566 N.Y.S.2d 74 (NY).

2. Dorothy A. Hewlett left part of the residue of her estate to the New Canaan Inn, Inc. The inn describes itself as a “nonprofit corporation” in its certificate of incorporation. The average age of the inn’s residents is 83. The facility provides recreation, health services, housing, and related facilities suited to the special needs and living requirements of the elderly occupants, three meals a day, bed linen, towels, and maid service. Although residents pay monthly, expenses exceed income by $4,000 per resident per year. The additional expenses are paid for by contributions. The residence agreement states, “Once admitted, no resident who has fulfilled all the other elements of this Agreement shall be asked to leave the Inn for inability to pay beyond his or her control.” Did Hewlett’s gift to the Inn qualify as a gift to charity? Why or why not? Bannon v. Wise, 586 A.2d 639 (CN).

3. Robinson’s will established a trust for the benefit of his wife for life, with the remainder to their daughter. The executor of the estate did not make an election on the estate tax return to treat the trust property as qualified terminable interest (QTIP) property. Does the amount in the trust qualify for the marital deduction on the estate tax return? Why or why not? Robinson v. United States, No. CV489–273, 90–2 U.S.T.C. (S.D. GA).

RESEARCH ON THE WEB

1. On the Internet, go to <http://www.lawcrawler.com>. Under the topic Research, click Summaries of Law. Then, scroll down to Trusts & Estates, and click Estate Planning. Finally, click Living Trust. Write a report on your findings.

2. Learn more about the legal assistant and paralegal field by going to the National Association of Legal Assistants Web site at <http://www.nala.org/whatis.htm>.

SHARPNING YOUR PROFESSIONAL SKILLS

1. In your law library, look up and write a brief of the case that decided the current law on Totten trusts, In re Totten, 71 N.E. 748 (N.Y. 1904). Then shepardize the case to find a recent reference to it in your state, and brief the latest case you find.

2. Describe a factual situation for which you believe an attorney would recommend the use of:
   a. a spendthrift trust
   b. a sprinkling trust
   c. a credit-shelter trust
   d. a QTIP trust
3. What is the purpose of Item IX in the will of Elvis Presley (reproduced in Appendix B)?

4. Explain the reason for including Paragraph FIFTH (B)(2) in the will of Jacqueline K. Onassis (reproduced in Appendix B).

5. How did ARTICLES ONE and TWO of the will of Richard M. Nixon (reproduced in Appendix B) ensure that the legacies contained in those paragraphs would avoid the federal estate tax?

6. Refer to Paragraphs FIVE (C)(1)–(6) of the will of Doris Duke (reproduced in Appendix B), and explain how the charitable remainder annuity trusts established therein will function.

**SHARPENING YOUR LEGAL VOCABULARY**

On a separate sheet of paper, fill in the numbered blank lines in the following anecdote with legal terms from this list:

A-B trust
bypass trust
charitable remainder annuity trust
charitable remainder trust
charitable remainder unitrust
charitable trust
credit-shelter trust
Crummey powers
cy pres doctrine
discretionary trust
exemption equivalent trust
marital deduction
marital deduction trust
public trust
QTIP (qualified terminable interest property) trust
rule against perpetuities
spendthrift
spendthrift trust
split interest trust
spray trust
sprinkling trust
Totten trust
Gino and Dawn considered many types of trusts when they planned their estate. They ruled out a(n) (1), which is also known as a(n) (2) and a(n) (3), because it gives the trustee the power to determine how the trust’s income and principal will be distributed. They considered a(n) (4), which is also called a(n) (5), under which the trust property would be used for public charitable purposes. With this type of trust, the length of time the trust is in existence is not a concern because the (6) does not apply. A(n) (7) would allow Gino and Dawn to retain the income from the trust for their lives, after which the principal of the trust would go to charity. If they used a(n) (8), a fixed amount of income would be given to them annually regardless of inflation, and the remainder would go to charity. In contrast, if they used a(n) (9), they would receive a percentage of the value of the trust property each year, allowing some protection against inflation. They felt that any charitable trust they established should express a general charitable intent so that the (10) would apply, and the trust would not end. Gino and Dawn were concerned about leaving money to their son, Conrad, because he was a(n) (11), that is, he spent money profusely and improvidently. They had a bank account in their names “as trustee for Conrad,” known as a(n) (12), but felt that it did not meet their needs. They decided to create a(n) (13) for Conrad because it contained restrictions on the voluntary and involuntary alienation of the trust corpus. In addition, they decided to set up a(n) (14) because it is designed to make optimal use of the (15), that is, the nontaxable property that passes to the surviving spouse under federal estate tax laws. They decided against a(n) (16) because the surviving spouse would be limited to the income from the trust for life, which they believed would be inadequate. Ultimately, they chose a(n) (17), which is also known as a(n) (18), a(n) (19), or a(n) (20), under which the deceased spouse’s estate would pass to a trust rather than to the surviving spouse, thereby reducing the possibility of the surviving spouse’s estate being taxable. They also felt they might like to have a life-insurance trust with (21), giving the beneficiaries the right to withdraw each year the money that is contributed to the trust.

**KEY TERMS**

charitable remainder annuity trust (CRAT) crummey powers rule against perpetuities
cy pres spendthrift
charitable remainder trust marital deduction spendthrift trust
charitable remainder unitrust marital deduction trust sprinkling trust
(char) charitable trust qualified terminable interest property (QTIP)