Here's why you should have confidence in trusts

By Jessica Rao, CNBC.com

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When you think of trusts, the super rich come to mind. You know, those kids who coast through life because of inheritances.

Yet the truth is, you don't have to be Bill Gates or Warren Buffett to leave money to your family in this fashion. There are tools that help even those with modest wealth to reduce tax exposure and protect and transfer assets.

They can also save family members the time and hassle of settling your estate in court. Once upon a time, trusts were used by only the wealthiest.

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"Today, they are very much a middle-class tool," said Dana Fitzsimmons, a partner at McGuire Woods in Richmond, Va. When you retain assets in a trust, they are no longer owned by an individual, and therefore there is a measure of protection. They can, for example, be insulated against the claims of a spouse if your beneficiary were to get divorced. They are also protected against creditors. While distributions from the trust can be reached, the principle cannot.

Lots of folks, when leaving wealth to the next generation, have specific values about how that money should be used. They may want their children to use it for education or to start a business, but they may not want them to live off the money. "If you give an outright gift, you lose the ability to control how the funds are used," said Fitzsimmons.

A way to protect your children

A trust is also useful if you want to provide for a child who is incompetent in some way, said Louis Mezzullo, partner at Luce Forward in Rancho Santa Fe, Calif. and president-elect and fellow of the American College of Trust and Estate Counsel. Likewise, if you have a child who has a drug or alcohol problem and you don't want to leave them assets outright, you could set up a trust only allowing distributions if the child takes a drug test. "You could individualize the trust depending on the circumstance," said Mezzullo.

You could also set up a trust if you were concerned that you would become incompetent. In this case, you would appoint a trustee to handle your financial affairs.

Corporate trustees

Another important benefit that transcends dollar value is the desire for professional management of the assets. Mezzullo suggests using a corporate trustee like US Trust, Bessemer Trust, or some other trust company as opposed to an individual like a financial planner.

In most states, probate, which is the process of admitting your will to record and having your assets administered and supervised by a court or court official, can be expensive and time consuming. If the assets are in, a revocable living trust at the time of your death, your family can avoid this process. The probate fees may not be a big a deal for some, but for a modest estate, probate fees can have a drastic impact on the family, said Fitzsimmons. Probate can be especially tricky if you own property in more than one state.

The downside of a revocable living trust is that assets literally need to be re-titled, said Russell Bishop, chairman of Harvest Advisers in Fort Washington, Pa. This applies to a car, or your checking or investment accounts. Though it is cumbersome, Bishop still recommends it for older people, because it makes it easier for children to take over management of their parents' finances or get them into a facility.

Tax-planning benefits

One of the most important benefits of using a trust is tax planning. Here, the degree to which this applies depends on how much money is in the estate.

At the moment, the estate tax exemption is $5 million. However, this is set to expire at the end of 2012, unless there is Congressional action. Bottom line: if the exemption stays at $5 million, many may not need tax planning. On the other hand, if it comes back down to $1 million or somewhere in-between, then between a house and a 401K it's easier to creep across that threshold.

The basic principle is: if your estate exceeds this mark, whatever it may be, create a family or bypass trust. This will insure that if you die before your spouse, the assets in the trust will not be taxed at your death, nor will they be taxed at your spouse's death. Though an outright gift to your spouse would not be taxed, one would apply when the assets passed to your children. At the moment, there is a variance that came into being with the 2010 tax act, called Portability of Exemption between spouses. This could negate the need for such a trust, but also expires after 2012 unless Congress extends this provision.

The generation-skipping transfer tax is another reason to set up a trust. Currently, any amount over $5 million that you pass to your grandchildren or more-remote descendants would be taxed unless it is in a trust. To prevent your heirs from receiving a much-reduced percentage, a trust is the way to go. Trusts also reduce tax exposure when you are leaving money to a charity.

No matter how much money you make in your life or what you want done with it when you die, you want to make sure your will is carried out. You can trust trusts to do this.

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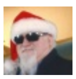

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And this is why all the talk about estate taxes doesn't matter. People think that if they change the laws about estate taxes that when rich people die more of their money will get taxed. It just doesn't happen. Rich people have always had these trusts so that when they die their assets pass to their kids tax free.

The Kennedy's are a great example of this. Ted Kennedy loved to go on about how estate taxes needed to be reformed but his family has always had hundreds of millions in trusts that was passed on to the members of the Kennedy clan tax free over many, many generations of wealth accumulation.

If the government stands to gain by your death then you had better watch out.

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