

Iowa Trusts (Part 1)

ESTATE PLANNING NEWSLETTER

Basics of Trust Creation and Settlement.

What is a Trust?

A Trust is a legally enforceable arrangement whereby a grantor of property creates a relationship in which one or more persons hold the individual's property subject to certain duties to use and protect it for the benefit of others, creating a split in title between a Trustee and a Beneficiary. In Iowa, all trusts must be reduced to writing in order to be legally enforceable in a court of law.

Why create a Trust?

- To dispose of property (both real estate and personal) as a substitute for a Last Will. (It allows an individual to dispose of property in such a way as to avoid costly and time-consuming probate procedures which generally are required after an individual's death).
- To provide for the benefit of another person. (Trusts have been used for providing financial support to spouse and children, to fund future education, to protect property from a financially unfit or reckless family member, and to make tax-free gifts).
- To provide for a charitable organization. (Trusts can be used to provide property, money, or both for the greater public good; charitable trusts can be either generic or specifically targeting, narrow or broad, to meet an individual's goals and purposes).
- To protect property from outside creditors and debts. (Trusts have been used to protect property from legal attachments and liens, and can be used for the grantor's or another person's benefit; although, there are some restrictions in Iowa).

TERMINOLOGY OF TRUSTS

A Trust is formed by various parties, each playing a role in the Trust:

Settlor—generally is the person granting property rights to another. The Settlor determines the purposes and terms of the Trust agreement.

Trustee—is the person to whom “legal” title is granted and who performs various duties with respect of the trust property for the benefit of another person.

Beneficiary—is the person to whom the actual gift is made. Beneficiaries hold “equitable” title to property, meaning that they actually receive the economic benefit from it.

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SPECIAL POINTS OF INTEREST

- Before seeking the aid of an attorney, an individual should review the basic structure and form of trusts, as contained in this newsletter.
- It is also advisable that a person seeking to create a Trust decide upon the basic terms and purposes before drafting a Trust.



TYPES OF TRUSTS

Trusts come in a variety of types, depending upon how it is created.

- **Living Trusts**—are trusts created while a Settlor is still alive. (Living trusts can be either irrevocable or fully revocable prior to the Settlor's death).
- **Testamentary Trusts**—are those trusts which are provided for in a Last Will. (They usually become effective only after the Settlor dies, and are irrevocable).
- **Revocable Trusts**—are trusts which can be modified or terminated at the free will of a Settlor.
- **Irrevocable Trusts**—are those trusts which after creation can never be modified or changed, unless a court orders otherwise.
- **Personal Trusts**—include trusts created for the sole benefit of a Settlor.
- **Beneficiary Trust**—are created to benefit other persons.
- **Charitable Trusts**—for the benefit of charitable organizations.
- **Specific Purpose Trusts**—created for any number of reasons and purposes. (Examples include: Spendthrift Trusts, Totten Trusts, and others)

Trusts can be fully tailored to meet an individual's unique needs, goals, and purposes.

WARNING

A Settlor can serve as the only Trustee **or** as the only Beneficiary but not both.

In order to create a valid Trust there must be a "split" in title to the property.

A Trustee must hold the legal title with rights to possess the property and to distribute it to the beneficiary.

A Beneficiary will always hold the equitable title which allows the holder to enjoy the economic benefit of the property and the right to its disbursement.

If a Settlor ever becomes the only Trustee and only Beneficiary, there would occur a "merging" of the split in title and the Settlor would once again be an ordinary property owner without protection of the Trust. In effect, the Trust would come to an immediate end.

HOW A TRUST IS CREATED

The essential elements of a trust must be met (otherwise it is not valid):

- * There must be a **Settlor**, who by intention, grants property to another to hold for the benefit of a beneficiary. The Settlor must transfer all trust property to either the trustee or the trust estate account.
- * There must be a **Trustee** to maintain the property, to protect it, and to disburse it according to the trust terms. The failure to nominate or name a trustee, however, will not invalidate a trust as a court of law will appoint one. (Note—a Settlor can serve as a trustee, but see 'Warning' insert at left)
- * There must be at least one **Beneficiary**. (Note—a Settlor can serve as a Beneficiary, but see 'Warning' insert at left)
- * There must be **property** transferred to the Trust. Trust property can be any combination of money, personal property, or real estate. A Settlor should fully own the property, if not, special provisions may be necessary, such as obtaining permission from a mortgage lender. (Trust property can be either tangible, meaning it can be held in hand, or intangible, like stocks and bonds, bank accounts, and other objects which are held by documentation).

Iowa Law's Fifth Element of Trust Creation:

- * In Iowa, in order for a court of law to have power to correct problems with Trusts, all Trust Agreements must be in **writing and signed**. Generally a signature by both the Settlor and the Trustee is good.

Once all the above elements have been met, a valid Trust is created and will go into effect either immediately or upon the Settlor's death, depending on the type of Trust created.



LIVING TRUSTS

Living Trusts are those created while a Settlor is alive. They are intended to go into effect and operation immediately upon creation.

Living Trusts can be either revocable during a Settlor's lifetime or irrevocable.

Deciding whether to create a revocable or irrevocable Trust depends upon the grantor's needs, circumstances, and purposes.

- * A Revocable Trust is freely modifiable and can be changed or terminated at will by a Settlor at any time for any reason. However, because the Settlor retains such power and control, there are some tax and debt consequences. For instance, this trust type will not allow a Settlor to escape from paying income taxes on the trust property's income and creditors might be able to go after the income or principle of trust property. See 'Advisement' insert at right.
- * An Irrevocable Trust can never be amended, changed, or modified except where a court of law orders in response to legal issues litigated against a Trust. Yet, because the Settlor has no more power and control over the trust property, the Settlor will no longer incur tax obligations during his/her lifetime. But see the 'Advisement' insert at right which discusses potential estate tax consequences after death of Settlor.

How Living Trusts are Created.

- ⇒ If the Settlor intends to be a Trustee (and also not a Beneficiary), the Settlor must create a document called a "Declaration of Trust." Under this declaration, the Settlor now as Trustee retains legal title to trust property, and must manage it for the Beneficiary.
- ⇒ If the Settlor intends to be a Beneficiary or intends only to be a grantor of property (neither a Trustee or Beneficiary), the Settlor will create a document called a "Trust Agreement." Under this agreement, the Settlor will transfer all trust property rights to another person, Trustee, who will manage it for the Beneficiary.

Both documents essentially create the same end effect. Under Iowa law, it will be presumed that all Trusts are fully revocable, unless expressly written to the contrary.

ADVISEMENT

Potential Tax Consequences.

Living Trusts pose some concerns for both taxation and debt collection.

If the Living Trust is fully revocable, a Settlor will be held responsible for payment of all income taxes associated with trust property value increases and investments. (However, these consequences can be alleviated by some internal trust terms and directions; also, the Trust can be written to impose income taxation upon the Beneficiary).

Revocable Trusts are also generally included as part of final estate federal and state death taxes, even though upon a Settlor's death, these Trusts automatically morph into irrevocable trusts.

Revocable Trusts also allow a creditor of a Settlor to reach the trust property for payment of debts and other collections.

However, a Revocable Trust is not considered a true gift by the IRS, and thus does not incur federal or state gift taxes upon some Beneficiaries.

ADVANTAGES / DISADVANTAGES OF TESTAMENTARY AND LIVING TRUSTS

Living Trusts are generally preferred to Testamentary Trusts because they allow a Settlor to personally observe and monitor the performance and operation of a Trust while still alive.

If the Living Trust is made fully revocable, the Settlor retains the option of modifying or changing it before death.

Yet, even if the Living Trust is made irrevocable, the Settlor can still monitor it and bring later court action to enforce or change it.

Testamentary Trusts are always irrevocable and made effective only upon a Settlor's death.

Thus, Testamentary Trusts do not allow a Settlor the pleasure of seeing first-hand how a Trust will work.

Both types of Trusts can and do come with various tax savings and debt consequences. Your attorney can help you fully explore these considerations.

TESTAMENTARY TRUSTS

Testamentary Trusts are those created in a Last Will. They are intended to go into effect and operation only upon the Settlor's death.

Because Testamentary Trusts are placed in a Last Will, they are by implication irrevocable and cannot be changed or modified, except by court order or by making a new Last Will.

Great care must be taken when deciding upon whether to use this type of trust, simply because the Settlor will no longer be living after its creation, and thus cannot later monitor its performance and operation.

As with Living Trusts, all property placed in a Testamentary Trust avoids the full probate (court) process and can be used to reduce a Settlor's gross final estate for federal and state death taxes and inheritance taxes.

Testamentary Trusts can contain the same provisions allowable for Living Trusts and generally operate exactly the same way, with the same limitations and tax consequences as Living Trusts.

SELECTING A TRUSTEE

If the Settlor does not intend to act as a Trustee, then the Settlor should nominate and appoint one in the trust document.

Selecting an appropriate Trustee is one of the most challenging things for a Settlor to do in creating a good and strong trust agreement.

While the courts will never allow a Trust to fail for lack of a nominated Trustee, a Settlor should nevertheless attempt to appoint one and a successor in order to avoid later litigation and court action.

Note: any time a Trust fails to nominate a Trustee, or any time a Trustee renounces the position, withdrawals from the position, or is removed by a court, the court will appoint a successor Trustee to fill in and finish the work of the Trust. Such Trustees are usually required to post a bond for service, are fully supervised by a court, and are given a court imposed payment for services based on the value of the trust property. This greatly increases the cost and expense of maintaining a Trust.



WHO CAN BE A TRUSTEE

Generally, a Trustee can be any person or corporate entity which possesses good moral character and is capable of entering valid contracts. Persons with mental handicaps, intoxicated persons, and others of unsound mind essentially cannot serve as Trustee.

Examples of Trustees include:

- * **The Settlor.** This is true because only a person of sound mind and legal capacity can create a Trust in the first place.
- * **Any natural person with legal capacity.** This excludes minors and others whom the law presumes to be unfit to enter into contracts, because activities of a trust often involve the making of contracts and changing of property titles.
- * **Any corporate entity.** Such "legal persons" include, but not limited to, financial institutions, banks, credit unions, and any other organization that the law specifically allows for the ability to act as a Trustee. (Note: most but not all banks are authorized to act as Trustee, it is important for a Settlor to ask before assuming anything).

COSTS OF A TRUSTEE

Generally, a Trustee will require payment for the services rendered under a trust agreement. This is natural as rarely will anyone wish to take on the responsibilities and obligations of a Trustee position without some form of compensation.

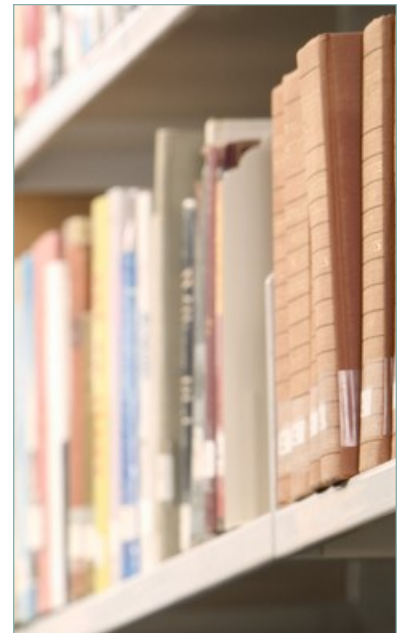
However, Settlers often find close relatives and friends willing to forego payment for services. Corporate Trustees, however, seek to be paid.

At the very minimum, all Trustees are expected by law to be reimbursed for any personal expenses and costs which are directly related to maintaining trust property.

Payment usually comes from the trust property itself, either as a proportion of the income it generates or directly from the principle underlying amount of the trust property.

Remember, in the event a court must appoint a Trustee or later successor, the court will order some form of payment for services to be rendered, and may also require a bond.

A Settlor should consider all options before determining how to pay a Trustee.



Failure to nominate a Trustee will not invalidate a Trust. However, a court will appoint one and will order that a Trustee be compensated.

REMOVAL OF A TRUSTEE

Whenever a Settlor nominates and appoints a Trustee, there may be occasions when Trustees may be removed.

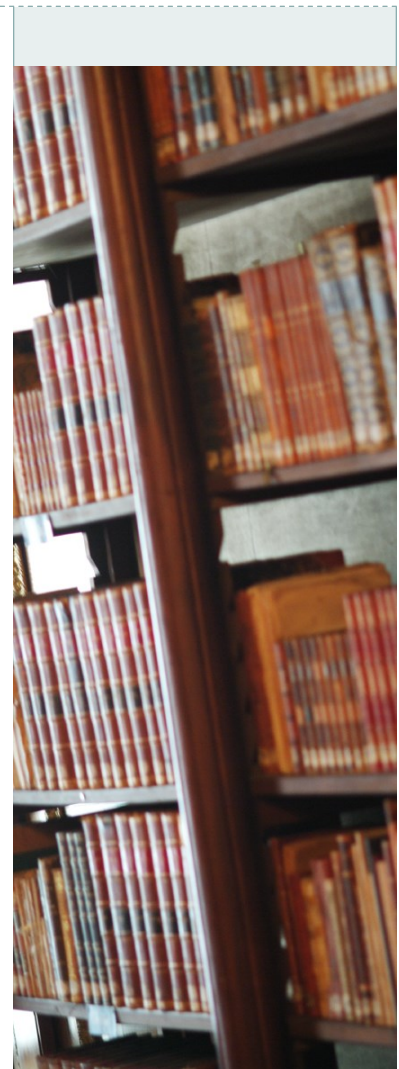
1. The named Trustee does not accept appointment. A court will then appoint a successor.
2. A Trustee accepts but later resigns. A court will appoint a new one.
3. The Trustee dies.
4. A Trustee is found to be incompetent by a court of law.
5. Lack of legal capacity to enter contracts.
6. Serious breach of trust agreement.
7. Refusal to give bond when one is required.
8. Refusal to account for expenditures, investments, and the like.
9. Commission of a serious crime involving dishonesty.
10. Long absence from the State where the trust is to be administered.
11. Showing of unjust favoritism to particular Beneficiaries.
12. Other unjust actions.

As part of any Trust, a Trustee must act in a fiduciary manner, meaning that the Trustee must act appropriately at all times.

Whenever a Trustee fails to act properly, the Settlor (if alive) and the Beneficiary have a right to bring legal action in a court of law.

The fiduciary duties of any Trustee include:

1. Duty to perform with due care. The level of care required will vary depending on the education and skills of the Trustee. (Note: financial institutions are held to a higher standard)
2. Trustee must act with loyalty. There can be no self-dealings or other acts which directly conflict with interests of the Trust or to Beneficiaries.
3. Duty to possess, care for, and preserve trust property.
4. Trustee must attempt to make trust property profitable, through investments or otherwise.
5. Duty to keep trust property separate from a Trustee's personal property.
6. Duty to abide by the Trust's terms and requirements.



CHARITABLE TRUSTS

Here are some key notes regarding the administration of charitable trusts in Iowa.

1. Charitable Trusts do not include a mandatory automatic expiration date, unlike most private trusts.
2. A recognizable charitable purpose must be expressly stated.
3. Cy-pres Doctrine applies in Iowa. This law says that anytime a charitable trust can no longer serve a class of beneficiaries, the court will order that a similar charity be allowed to substitute itself. (For example, if a charitable trusts for persons of a specific disability is made and a cure is later found, then the trust would no longer be necessary, but the court will provide that any charitable purpose should not fail and thus will appoint a successor charity of similar import).

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Iowa's Trust Code can be found by reviewing:
Title XV, Chapter 633A
(on Iowa's Legislative Website)

BENEFICIARIES

Most trust types create two kinds of Beneficiaries, an income beneficiary and a remainder beneficiary. The same named beneficiaries can act as both or either.

- * Income Beneficiaries are those persons or organizations whom benefit from net income generated by the trust property's principle value (the underlying amount contributed to the trust).
- * Remainder Beneficiaries are those whom enjoy the right to receive any remaining trust property, both principle and net income, upon the termination of the Trust.

Note: a Beneficiary can receive both principle and net income during the lifetime of the Trust. Such persons are generally referred to as Income Beneficiaries, even though some of the principle trust property is also distributed along with net incomes.

Usually, but not always, a Settlor will elect to be the Remainder Beneficiary. Such Settlers direct that any remaining trust property reverts to the Settlor's ownership upon termination of the Trust. However, if the Settlor retains a right to recapture trust property, this right will become part of a Settlor's final gross estate upon death, and will be subjected to the estate's death taxes.

Of course, a Settlor can direct any other person, including the Beneficiary, to receive any remaining property, thereby avoiding tax obligations on the Settlor's final estate.

WHO CAN BE A BENEFICIARY?

Valid Trusts require a Settlor to "name" at least one Beneficiary.

Generally a Beneficiary can be any person or organization.

- Natural persons and organizations need not be related or even associated with a Settlor. However, the Settlor must fully identify the Beneficiary with exacting certainty.
- Indefinite Beneficiaries, those most often associated with charitable organizations, need not be fully identified. However, a class of persons to be benefited must be mentioned. Such classes can be either for the public at large or for a small group of persons (provided that the Settlor is "unaware of the specific number of persons to be benefited and does not personally know these persons"). See also the insert at left on 'Charitable Trusts'.
- Trusts for Pets are allowed in Iowa. These trusts generally do not expire automatically under the law, so long as the trust provides for such.
- Honorary Trusts are also allowed in Iowa. They include trusts made for non-charitable purpose which benefit Indefinite and Unknown Beneficiaries.

Coming up in the Next Issue:

1. Further detailed discussion on Iowa Trusts
2. Lawful Purposes of a Trust, and examples
3. How a Trust can be Terminated
4. Best Practices and Advice

Iowa Trusts (Part 2)

ESTATE PLANNING NEWSLETTER

Detailed Discussion of Trusts.

Review of Last Issue

Trusts are arrangements between a Settlor and a Trustee for the benefit of a third party, known as a Beneficiary. Trusts can cover a wide range of legal purposes and individual goals. There are two basic forms, Living Trusts and Testamentary Trusts.

Living Trusts

- Are created during a Settlor's lifetime, usually for the purposes of avoiding probate.
- They can be either Irrevocable or fully Revocable. Each has its advantages and disadvantages.
- They allow a Settlor an opportunity to personally observe the operation of the Trust and to make changes as needed, either personally or through court litigation.

Testamentary Trusts

- Are created in a Settlor's Last Will.
- They can only be Irrevocable and take operation only upon the death of the Settlor.
- They are partially probated, but are not included in a Settlor's final gross estate for death-tax purposes.

IN THIS ISSUE

In this Issue, detailed discussion will dive deeper into the workings of Trusts, including:

1. What are the lawful purposes of a Trust?
2. How a Trust can be Terminated.
3. Types of Specific Purpose Trusts, and examples.
4. Tips on working with an Attorney in Creating a Trust.
5. Best Practices and Advice.

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SPECIAL POINTS OF INTEREST

- Before seeking the aid of an attorney, an individual should review the basic structure and form of trusts, as contained in this newsletter.
- It is also advisable that a person seeking to create a Trust decide upon the basic terms and purposes before drafting a Trust.



LAWFUL PURPOSES OF TRUSTS

Iowa law generally allows a Settlor to create a Trust for any purpose or goal, so long as it meets certain lawful provisions.

- **Restrictions based on Contrary to Public Policy**—Iowa requires that Trusts not unduly burden Trustees or Beneficiaries. (Examples are provided in the next section below).
- **Restrictions against Illegal Activities**—Trusts must not be created in order to conduct illegal or criminal offenses or to aid in the commission of a crime.
- **Restrictions against Personal Impropriety**—Trusts cannot be used to insulate a Settlor from creditors as a sole purpose of hiding assets from debts or collections.
- **Restrictions based on Perpetuities**—Iowa will not allow a Settlor to encumber title to full property rights for an indefinite time period. As a result, most private trusts must “vest” full title to a person within a set time period.
- **Restrictions against Improper Gifting**—under Iowa’s Medicaid Estate Recovery law, the State is allowed to pierce some trusts in order to recapture some of the benefits paid to certain individuals.
- **Restrictions against Avoiding Certain Necessary Debts**—Iowa allows creditors who provide certain medical, food, and other necessities to reach all trust property for reimbursement.

Trusts can be fully tailored to meet an individual’s unique needs, goals, and purposes.

OTHER RESTRICTIONS

Iowa law provides for a variety of other restrictions under its Trust Code and statutes.

A Settlor should fully consult an attorney before drafting and executing a Trust.

While the Iowa Trust Code does provide that any term or provision in a trust will take priority and be enforced over provisions in statutory law, the court is also empowered to apply the “Common Law of Trusts” whenever a trust purports to contradict statutory law.

The Common Law of Trusts varies greatly from the statutory Trust Code and generally provides for more restrictive applications than the statutory law does. In short, the statutory law is more friendly than its common law counterpart when dealing with restrictions.

CONTRARY TO PUBLIC POLICY RESTRICTIONS

Whenever a Trust provision or article attempts to unduly burden a Trustee, a Beneficiary, or both, Iowa law will step in to prohibit the offending act. There are many aspects in findings of contrary to public policy. But the most common examples include:

- * Requiring a Beneficiary to totally forego marriage or to encourage a divorce.
- * Inducing a Beneficiary to live with a Settlor in adultery.
- * Attempting to defraud creditors and others.
- * Inducing criminal acts by a Trustee or Beneficiary, like perjury or paying the legal costs and fines for another person’s criminal acts.
- * Requiring a change of a Beneficiary’s religion or faith.
- * Restrictions on communicating or socializing with certain family members.

Conditions that might be allowed (if not unduly burdensome):

- * Restriction against a Beneficiary’s remarriage.
- * Restricting marriage before Beneficiary reaches age 18.
- * Restricting marriage to a particular person. This requires some caution.
- * Restricting marriage to a person of a particular religious faith or a faith different from the Beneficiary.

The above listings are samples only. The range of invalid restrictions or allowable conditions is far greater than those discussed above. Therefore, a Settlor must fully discuss with an attorney any potential attempts which could be contrary to public policy prior to drafting and executing any Trust.



HOW A TRUST IS TERMINATED

Most Private Trusts cannot live forever. Iowa law prohibits a Settlor from encumbering title for an indefinite time period. As a result, most private trusts must “vest” full title to a person within a set time period. There are also other ways for a Trust to end.

- * **Rule Against Perpetuities.** Under Iowa law, full title to trust property must “vest” or come to end within 21 years and 9 months following the death of a known person who must be living at the time the Trust is created.
- * **By Terms of the Trust.** The Trust itself may provide for a definite time to end, which can occur before the time set under perpetuities.
- * **By Completion of the Trust’s Purposes.** Whenever a specified purpose no longer exists or can no longer be performed, the Trust will end. This will also occur when no Beneficiaries remain alive or “vest-able.” There is an exception for charitable trusts.
- * **By Revocation.** If a Settlor creates a Revocable Trust and exercises the power to terminate the trust, it will end.
- * **By Merger.** Whenever the “split” in title no longer exists, the Trust will end. This occurs whenever a single Trustee becomes a single Beneficiary.
- * **On Request.** Whenever all Beneficiaries unanimously (along with any living Settlor) request a trust’s termination, it will end. This must occur in a court of law.
- * **By Order of Court.** A court can declare a trust terminated or invalid for any number of reasons. Careful drafting can help avoid this however.

Remember, a Trust will never terminate or become invalid for want of a Trustee. A court will always appoint someone to act as Trustee.

MORE ON THE RULE AGAINST PERPETUITIES

Title to property must “vest” within a certain period of time, usually 21 years plus any applicable period of gestation (9 months).

The purpose behind this rule is to prevent a property owner from exercising power and control over property long after the owner’s death. Once a person dies, it is presumed that someone new will inherit the accumulated estate.

However, some property owners just can’t seem to “let go” of their property. As a result, in England, long ago, common law equity was created to prevent the hoarding of aristocracy estates for the benefit of a blood-line. The thought was two-fold.

First, whenever a person inherits property they should be free to do whatever they wish with the property.

Second, some property should revert to the public good. By demanding that property remain in a blood-line sometimes required the waiting of many years before a proper person could be found to legally inherit it.

The Rule attempts to compromise between these competing interests. On the one hand, the rule will not allow a property owner to control it forever.

On the other hand, the rule allows a long time for “vesting”, in order to ensure the property “stays within the family.”

Vesting can occur 21 years from the death of a living person. In essence the property could be tied up for as long as 21 years plus the lifetime of a newborn who is named as the “living person.” If the newborn lives to age 90, then vesting would become complete at the end of 111 years.

TIPS FOR WORKING WITH ATTORNEYS ON TRUST CREATION

Before consulting with an attorney for the creation of a trust, a prospective Settlor should first review the two-part series Newsletter on Iowa Trusts, as provided herein.

After mastering the basic terminology and workings of trusts, you will be more capable of presenting your proposals to the attorney for review.

In addition, you can aid your attorney by compiling some information:

1. Records and Location of all property intended for the Trust, be sure to include any secondary lien or mortgage holders.
2. Draft a basic outline of what you wish the trust to do and how it should work.
3. Be sure you can discuss information on all known intended beneficiaries, including location and background.
4. Determine if the Trust should be placed in a Last Will, and if so bring a copy.
5. Make an informed and reasonable preliminary determination of who will serve as Trustee, this includes finding someone willing or researching "pay for" services, such as bank imposed fees.
6. **Perhaps most important,** you should brainstorm what would happen if parts of your trust were to fail. For instance, who should receive the remaining property if your first choice beneficiary dies before the end of the Trust? (Of course, your attorney will also help you run through some scenarios before final creation).

SPECIFIC PURPOSE TRUSTS

Trusts can be created to meet an individual's personal goals, needs, and purposes. Trust terms and provisions can be drafted to fit unique and tailored applications.

This section will take a closer look at three common specific purpose trusts.

- Spendthrift Trusts
- Sprinkling Trusts
- The Bypass Trust

SPENDTHRIFT TRUSTS

Spendthrift trusts are commonly created by parents for the benefit of children they feel may be financially unfit. These trusts generally create a fund which is sparingly handed out by trustees in order to protect financially unfit beneficiaries from over-spending or wasting of income. The following highlights some of these protections:

- * Beneficiaries cannot assign or transfer their interest in the fund to anyone (this includes future income streams).
- * Generally, outside creditors and lien holders cannot reach the principle funds prior to disbursement. However, once funds are given to the beneficiary, creditors can then levy against it. (There are some exceptions for necessities contracts).
- * Beneficiaries cannot pledge future trust income as security or collateral for a loan.

Note: in Iowa, Spendthrift Trusts created solely for the benefit of a Settlor will generally not protect property from creditors.



SPRINKLING TRUSTS

Sprinkling Trusts allow for unequal distributions for multiple beneficiaries. The Trustee is generally empowered to determine need-based distributions based on a Settlor's pre-determined criterion.

Because the financial needs of beneficiaries can change dramatically over time, providing for a sprinkling of income or property can result in a tailored approach.

It is usually best to select a Trustee who knows personally the needs of individual beneficiaries, one who is both knowledgeable and capable of determining such goals. (However, it is possible to create a strict criterion for which even a corporate trustee can follow).

BYPASS TRUSTS

The Bypass Trust is an estate planning device which seeks to reduce or eliminate certain federal and state taxations.

This trust is usually established for the benefit of a surviving spouse. As such, it is a testamentary trust established after death as described in the Settlor's Last Will.

Essentially, the Settlor creates a life estate for the surviving spouse who enjoys the benefit of the trust property while alive. Upon the death of the surviving spouse, trust property passes to another person, organization, or charity.

Because the surviving spouse is granted only enjoyment of the trust during lifetime, such property is not included in the final estate after death of the surviving spouse. Thus, the Trust is not taxable as part of a final estate.

Note: in order to use this Trust, a Settlor must also create a Last Will.

FINAL NOTES

Here are some final notes regarding the administration of trusts in Iowa.

1. In Iowa, all trusts must be in writing in order to be enforceable (oral agreements are not allowed).
2. Trust property may change from time to time, due to new additions and from investment activities of the Trustee. Such changes do not void a Trust.
3. A Trust can be created so as to terminate if and when a named Trustee can no longer perform the duties. This would prevent a court-appointed successor.
4. Co-Trustees hold legal title as joint tenants with right to survivorship. When one Trustee dies, the other will take up all duties without the need for court intervention.

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BEST PRACTICES AND PRACTICAL ADVICE

The following discussion is intended for educational purposes only:

1. Revocable Trusts, while generally considered a non-probate asset and not subject to creditor claims, is included in the final estate of a Settlor and subject to death taxes.
2. For a Trust to be valid in Iowa, a Trustee must be granted some powers over the trust property. Asking a Trustee to merely "hold" property without any authority as to its use or disbursement is not sufficient.
3. Trustees, as fiduciary agents, can be held personally liable for mistakes and failure to perform duties. Selecting a Trustee requires great care and thought.
4. Trust Agreements should include provisions on how to allocate additional property received during the course of the trust. Should new property or value increases be added to the principle account or treated as income? Failure to specify will result in statutory law being applied to the Trust's terms on this issue.
5. While a Trust can provide for little or no compensation for Trustees, if for some reason nominated Trustees are removed or resign, a court will impose a fee for services for any appointed Trustees. Can the Trust property support this?
6. Creditors may generally attach a Beneficiary's equitable interest in trust property unless laws or trust provisions exempt such.
7. Whenever a charitable purpose ceases to exist or is no longer possible, Iowa law requires a new court appointed charity to take its place, unless the trust provisions provide otherwise.

Tips and Advice

1. Living Trusts which are revocable are often more desirable prior to setting an irrevocable one. Such trusts can be modified until made perfect, and then can be later included in a Last Will.
2. Generally a Settlor reserves the right to return of trust property upon the trust's termination; however, there is no real avoidance of taxations upon the Settlor's estate.
3. Trusts can be written so that it ends only upon the occurrence or non-occurrence of an event or specific condition.
4. Trust property can be passed from one person or entity to another, at any predetermined rate of time. For example, a spouse can be the first beneficiary to hold for a period of time, then to children for a period of time, and finally to grandchildren (each class to hold exclusively from the others).
5. Generally, a Beneficiary can transfer or gift an interest in the trust to another person or entity, unless the trust provisions provide otherwise.
6. While Charitable Trusts require an indefinite class of beneficiaries unknown to the Settlor, the creation of such trusts can be made limited to even very small groups of potential beneficiaries.
7. Totten Trusts are a great idea for those wishing to pass on money held in bank accounts to another person upon a Settlor's death. Such trusts are created by the bank directly and are often called "pay on death" accounts. (No lawyer is needed).