

Understanding Trusts: Types, Uses, and Key Considerations

Type of Trust	Description	Primary Function	When/Why Useful	Tax/Other Notes
Revocable Living Trust	A flexible trust where the settlor retains control, often acting as trustee. Assets pass to beneficiaries without probate.	Avoids probate, provides privacy (trusts aren't public like wills), allows incapacity planning (successor trustee takes over if settlor is disabled).	For anyone with assets who wants to skip probate court delays/costs. Ideal for middle-class estates. Useful in SD for seamless asset transfer.	Assets remain in settlor's taxable estate, no tax savings during life. No creditor protection since revocable.
Irrevocable Living Trust	Settlor gives up control; can't revoke. Often used for gifting assets.	Removes assets from estate for tax reduction, asset protection from creditors/lawsuits.	High-net-worth individuals facing estate taxes (federal threshold ~\$13.61M in 2025 but could change). Protects against Medicaid spend-down for long-term care. In SD, strong for perpetual trusts.	Gift tax may apply on transfer; income taxed to trust or beneficiaries. Provides estate tax exclusion.
Testamentary Trust	Activated by will upon death. Often for minors or spendthrifts.	Controls post-death distributions (e.g., staggered payouts).	When settlor wants conditions on inheritance (e.g., beneficiary gets funds at age 25). Useful for blended families.	Goes through probate first; no lifetime benefits. Taxed as part of estate.
Charitable Trusts (e.g., CRT, CLT)	Transfers assets to charity, with income to settlor/beneficiaries. Charitable Remainder Trust (CRT): Settlor gets income, charity gets remainder. Charitable Lead Trust (CLT): Reverse.	Tax deductions, supports philanthropy while providing income.	Philanthropic clients; reduces income/estate taxes. CRTs good for appreciated assets (avoids capital gains).	Significant tax benefits: deductions up to 30-60% of AGI. Irrevocable.
Special Needs Trust (SNT)	Holds assets for disabled beneficiaries without disqualifying them from government benefits (e.g., SSI, Medicaid).	Supplements (not replaces) public aid; pays for extras like education and travel.	For families with disabled children/adults. First-party (self-funded) vs. third-party (family-funded).	Assets not counted for eligibility. Taxed to beneficiary or trust.

Understanding Trusts: Continued

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Asset Protection Trust (APT)	Shields assets from creditors. Domestic APTs (DAPTs) allowed in states like SD.	Protects wealth from lawsuits, divorce, bankruptcy.	Business owners, professionals (e.g., doctors) at litigation risk. SD's DAPT statute allows self-settled trusts with strong protections after 2-year seasoning period.	Irrevocable; must transfer assets in advance. Tax-neutral if grantor-retained.
Dynasty (Perpetual) Trust	Lasts for generations (or forever in some states).	Preserves family wealth across generations, minimizes transfer taxes.	Ultra-high-net-worth families. SD abolished the rule against perpetuities, allowing perpetual trusts — great for your location.	Avoids generation-skipping transfer tax (GSTT) if properly funded (exemption ~\$13.61M in 2025).
Spendthrift Trust	Restricts beneficiary access to principal; protects from their creditors.	Prevents irresponsible spending or creditor claims.	For beneficiaries with addiction, poor financial habits, or legal troubles.	Creditors can't attach unless for necessities. Taxed to beneficiary on distributions.
Bypass (Credit Shelter) Trust	For married couples; maximizes estate tax exemptions.	Shelters assets up to exemption amount for heirs, provides income to spouse.	Couples with estates near federal tax threshold. Less common post-2017 tax changes but still useful.	Uses deceased spouse's exemption; portable now, but trusts add control.
Irrevocable Life Insurance Trust (ILIT)	Holds life insurance policies outside estate.	Excludes proceeds from estate taxes; provides liquidity for heirs.	High-net-worth with large policies. Fund premiums via gifts.	Removes policy from taxable estate if settlor survives 3 years post-transfer.
Qualified Personal Residence Trust (QPRT)	Transfers home to trust while settlor retains living rights for a term.	Reduces gift/estate tax on home value.	For valuable residences; discounts future value.	Irrevocable; gift tax on discounted value.
Grantor Retained Annuity Trust (GRAT)	Settlor retains annuity payments; remainder to heirs.	Transfers appreciating assets with minimal gift tax.	For assets expected to grow (e.g., stock); "zeroed-out" GRATs minimize tax.	Success depends on IRS rates; great in low-interest environments.
Pet Trust	Provides for pets after owner's death.	Funds care for animals.	Pet owners without heirs to rely on. Legal in most states, including SD.	Taxed as part of estate; remainder to charity/heirs.