Types of Trusts and Their Tax Treatment

Type of Trust	Income Tax	Estate Tax	Gift Tax
Testamentary trust: Created in the trustor's will and takes effect only at death. Can be used to avoid tax on a portion of the first spouse's share of the estate, e.g., the bypass trust.	Income which is distributed is taxed to the beneficiary; if income is accumulated, it is taxed to the trust until later distributed to the beneficiary.	Trust assets are included in decedent's estate.	No gift tax.
Revocable living trust: Created while the trustor is still living but can be revoked or amended during his or her lifetime. Assets in the trust will avoid probate expenses, delay and publicity.	No income tax savings while trustor lives. After death, same as testamentary trust for income tax purposes.	Trust assets are included in decedent's gross estate.	No gift tax. Trust is revocable.
Irrevocable life insurance trust: Created while the trustor is still living and cannot be revoked by the trustor. Used to reduce the size of the estate. Works best for removing insurance from the estates of both spouses. Some are "funded," and others are "unfunded" or just own a life insurance policy.[1]	Same as testamentary trust above, except if income from a funded trust is accumulated, it may be taxable to the trustor in certain situations.	Usually excluded unless the gift of a life insurance policy was within the three years before the insured's death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $18,000[2] annual gift tax exclusion.
Sec. 2503(c) minor's trust: A type of irrevocable trust for minors which qualifies for the annual gift tax exclusion even though the gifts to it are "future interest."[3]	Same as testamentary trust above.	Usually excluded unless the gift of a life insurance policy was within the three years before the insured's death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $18,000[2] annual gift tax exclusion.

Note: If a child subject to the "kiddie tax" has unearned income in excess of certain limits, ($2,600 for 2024), the excess is taxed at the parents' tax rate if the parents' tax rate is higher than that of the child. The remainder of a child's taxable income is taxed at the child's tax rate. State or local law may vary.

[1] Cash contributions may be made to the trust, to be used by the trustee to make premium payments on the life insurance policy. Careful drafting of the trust document is required to qualify the cash gifts for the annual gift tax exclusion.

[2] The annual gift tax exclusion ($18,000 in 2024) is indexed for inflation in increments of $1,000.

[3] Under federal law, the minor must become the owner of the assets no later than age 21.

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