Types of Trusts and Their Tax Treatments

Type of Trust	Income Tax	Estate Tax	Gift Tax
Testamentary trust: Created in the grantor's will and takes effect only at his 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 grantor is still living but can be revoked or amended during her lifetime. Assets in the trust will avoid probate expenses, delay and publicity.	No income tax savings while grantor 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 grantor is still living and cannot be revoked by the grantor. 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 is taxable to the grantor.	Usually excluded unless gift of policy was within three years prior to insured's death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $15,000 annual gift tax exclusion.[2]
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 transfer was within three years prior to death.	There may be a gift tax liability, but gifts to the trust can usually be made to qualify for the $15,000 annual gift tax exlusion.[2]

Note: For 2018-2025, if a child subject to the "Kiddie Tax" has unearned income in excess of certain limits ($2,000 for 2018), the excess is taxed according to the brackets applicable to trusts and estates. The remainder of a child's taxable income is taxed at the child's rates. 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 ($15,000 in 2018) 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.