Revocable Living Trusts

SECTION OF REAL PROPERTY | TRUST & ESTATE LAW

AMERICAN BAR ASSOCIATION
Defending Liberty
Pursuing Justice

Revocable Living Trusts

Much has been written recently regarding the use of *living trusts* (also known as a *revocable trust* or *inter vivos trust*) as a solution for a wide variety of problems associated with estate planning through wills. Some attorneys regularly recommend the use of such trusts, while others believe that their value has been somewhat overstated. Neither one is necessarily correct, and the choice of a living trust should be made after consideration of a number of factors. This brief brochure is intended to provide a framework of basic knowledge regarding living trusts in general, so that you might determine whether you should pursue a discussion of this technique further with your attorney licensed to practice in the state where your estate would be administered.

The term *living trust* is generally used to describe a trust (a) that you can create during your lifetime and (b) that you can revoke or amend whenever you wish to do so.

The term *living trust* is generally used to describe a trust (a) that you create during your lifetime and (b) that you can revoke or amend whenever you wish to do so. In fact, you can also create an *irrevocable* living trust, but that is permanent and unchangeable and is almost exclusively done to produce certain tax results beyond the scope of this brochure.

A *living trust* is legally in existence during your life, has a trustee who is currently serving, and owns property that (generally) you have transferred to it during your life (or at your death via your *pour-over will*, discussed below). While you are living, the trustee (who may be you) is generally responsible for managing the property as you direct for your benefit. Upon your death, the trustee is generally directed either to distribute the trust property to your beneficiaries or to continue to hold it in trust and manage it for the benefit of your beneficiaries. Like a will, then, a living trust can provide for the distribution of property upon your death. Unlike a will, it can also (a) provide you with a vehicle for managing your property during your life and (b) authorize the trustee to manage the property and use it for your benefit (and your family's) if you should become incapacitated, thereby avoiding the appointment of a guardian for that purpose.

Avoiding Probate

The living trust is most often praised as a vehicle that allows you to avoid probate upon your death. Probate is the court-supervised process of transferring property at death pursuant to the terms of a will. Many types of property pass outside of the probate process anyway, such as life insurance or retirement plan proceeds passing to a named beneficiary or real estate or financial accounts held in joint names with right of survivorship.

While it is true that the property passing under the terms of a living trust upon the settlor's death will avoid probate, it should be noted that there may or may not be actual value in that result. Probate laws are different in every state, and the red tape and expense usually associated with the probate process differ from state to state. In some states there are statutorily mandated court or attorney fees while in others those fees may be minimal. Many states have expedited or simplified court proceedings that are efficient and inexpensive for small or simple estates. A properly drafted will in many states can eliminate some of the steps otherwise required in the probate proceedings. Much of the delay and red tape customarily associated with probate is a result of the tax laws and tax filing requirements, which cannot be eliminated through a living trust.

A living trust can almost never totally avoid probate and a simple will is needed to "pour over" to the trust any property that has not been transferred to the trust during life.

A living trust can almost never totally avoid probate and a simple will, or *pour-over will*, is needed to transfer or pour over to the trust any probate property that has not been transferred to the trust during life.

Property that passes at death through a living trust must be administered by a trustee and then transferred out of the trust to (or in further trust for) the beneficiary. The costs of this administration (including trustee fees) and the costs associated with tax filings that are unaffected by the living trust format are often ignored. There may be other costs as well depending upon the jurisdiction, such as real estate transfer taxes, that must be considered. The comparison of administration, costs of probate and a living trust should be made on a case-by-case basis.

Maintaining Privacy

Maintaining privacy may be an important consideration for some people. For example, they may not want to expose family relationships, including disinherited

family members or the existence of a marital agreement, to public scrutiny. The living trust is frequently recommended as an instrument that is kept private, while your will is technically a matter of public record. While that is mostly true, it may or may not be a consideration. For instance, it is uncommon for a will to contain information that would disclose the value of the estate or the assets comprising the estate. The will generally refers only to groups of assets, such as your "personal effects," your "home," and "all the rest and residue" of estate. Most people's wills are not particularly newsworthy.

On the other hand, in most states a living trust instrument is not required to be filed with any court in order to be effective, so even the general disposition of the assets is not disclosed on the record. Note, however, that if the trust is to be a vehicle for distributing real estate or if the trust is party to any legal proceedings in any court, it will probably be necessary to record a copy of the trust instrument in the public records. And in many states the state death tax returns are public record anyway.

The living trust is frequently recommended as an instrument that is kept private, while your will is technically a matter of public record.

Tax Savings

The decision to use a living trust as opposed to a will should not be made on the basis of tax considerations. Living trusts are often incorrectly characterized as being entitled to uniquely attractive tax treatment. As a general rule, the living trust is ignored for income tax purposes, and you will be treated as the owner of all the trust's property, because you have retained the unrestricted power to revoke the trust and take the property back whenever you wish. Therefore, the living trust will provide no favorable income tax benefits that you cannot otherwise obtain for yourself. Similarly, for gift and estate tax purposes, your retained power over the trust assets will cause them to be treated as part of your estate for determining any gift or estate tax due, just as if you owned the trust property personally. While it is true that we can draft a living trust to take the optimum advantage of the deductions and credits available in minimizing estate tax costs, those same benefits are available through a properly drafted will. In fact, although they are not generally of great value or always applicable, there are some tax benefits available to your estate that cannot be duplicated in the living trust. Therefore, while effective tax planning may be important in accomplishing your overall objectives, there is no unique benefit to a living trust in accomplishing that goal.

Some factors that may indicate a living trust approach:

- Probate costs and procedures in the state where you live are high and can be avoided.
- A legal challenge to your will is likely.
- Your estate will be subject to the claims of creditors.
- Incapacity is a concern.
- You own property in several states or move often from state to state
- Privacy is important.

Reducing Legal Fees and Administration Costs

Whether a living trust will effectively reduce the costs of settling your estate is a question to be addressed in each individual case. To the extent that administration costs are determined as a percentage of the probate estate, the living trust can reduce costs. For example, a designated executor may charge the fee provided by law, which may be lessened by instead designating a trustee under a living trust.

On the other hand, the trustee of the living trust is also entitled to compensation, so it is important to consider whether there will be any actual net savings between the estate and the trust. The costs involved in assembling the necessary tax information and preparing the estate tax return will be unaffected by the living trust because, as noted above, the trust assets are fully included in the estate for these tax purposes.

As you can see, there is no automatically right or wrong answer to the question of a will versus a revocable trust.

In Case of Incapacity

Statistics tell us that many of us will suffer some period of incapacity due to advancing age, illness, or injury before we die. During that time, your will is of no effect because it is a testamentary instrument (effective only at your death). However, during your lifetime, you may become temporarily or permanently legally incapable of managing your own property and making rational financial and business decisions. While some of these problems may be addressed by a properly executed power of attorney, as a practical matter it has become increasingly unreliable to provide for the management of property through that vehicle. In the absence of another solution, it will frequently be necessary to ask a court to appoint a legal guardian or conservator for the management of your property. That procedure (a) is cumbersome and expensive, (b) usually requires your guardian or conservator periodically to file complete reports of your assets, liabilities, receipts, and disbursements with the court, (c) often requires that a bond be purchased from an insurance company, and (d) usually prevents the guardian or conservator from doing any but the most routine tasks without petitioning the court for approval.

The costs and burden of a guardianship or conservatorship may be much greater than those you have otherwise attempted to minimize in your estate planning. With a living trust, however, a trustee can simply be authorized to continue the management of your property in case of disability, and to use it as needed to provide for your support and maintenance. This can all be accomplished without court involvement and without the costs associated with a guardianship. This protection is one of the truly unique advantages of the living trust and should be considered carefully.

As you can see, there is no automatically right or wrong answer to the question of a will versus a revocable trust. You should seek legal advice from a competent attorney licensed to practice in your state. It is your attorney's job to help you determine, given your goals, objectives, family structure and assets, the most appropriate and cost effective structure for you. Beware of national marketing organizations that promote the living trust technique without consideration of the alternatives, or offer documents prepared by an attorney who never meets with you personally. ■

Providing a Management Vehicle

Because the living trust is a separate entity, it can provide a separate vehicle for the management of assets. That management vehicle might be particularly attractive if:

- you are considering using a professional trustee and want to see how they perform while you're still here to judge for yourself, or
- you want to maintain the assets separate from your other property because you intend to pass them to some specific beneficiary at your death, separate and apart from the rest of your estate, or
- you need to keep the assets readily identifiable as your own separate property under a premarital agreement or other arrangements so they don't become commingled with the property of your spouse.

ISBN: 978-1-64105-256-6

SECTION OF REAL PROPERTY | TRUST & ESTATE LAW

AMERICAN BAR ASSOCIATION
Defending Liberty
Pursuing Justice