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ESTATE PLANNING BASICS: REVOCABLE LIVING TRUSTS

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What Is a Revocable Living Trust?

A revocable living trust is a estate planning tool by which an individual shifts ownership of property and assets such as a home, real estate, bank accounts, stocks and bonds from personal ownership into the legal ownership of the trust for later distribution to the trust's beneficiaries. Revocable living trusts are just what the name implies–they are created during an individual's lifetime (living), but can be changed or terminated at any time (revocable). The person whose assets are placed in the trust is called the *trustor* or *grantor*. A trust may be created by more than one person. A couple–*co-grantors*–may set up a trust.

Management of the property and assets in the trust is transferred to the *trustee*, who oversees them according to the directions in the trust agreement. The trustee may be the person(s) creating the trust, a friend or family member, several individuals, a corporate entity such as a bank or trust company, or a combination of these. As the initial trustee, the grantor can maintain full control of the assets and property in the trust until his or her death or incapacity. He or she can sell them, spend them, or give them away. When the grantor relinquishes the trustee role, a *successor trustee* takes over. The successor trustee has the legal responsibility for administering the trust prudently and solely for the well-being of its beneficiaries, and must keep the beneficiaries reasonably informed of decisions affecting the trust.

The *trust agreement* is a document containing instructions to the trustee as to how trust assets are to be invested and managed, who is to receive income from the trust and what happens to the trust if the person creating the trust becomes incompetent or dies. The trustee can do only what the trust agreement specifies. Ultimately, the trust agreement will provide that the trust be terminated and its assets distributed to the beneficiaries.

The *beneficiary* or *beneficiaries* named in the trust agreement may be the individual who created the trust, friends, family members, a college or university, hospital, charity or other organization. Unless the beneficiaries are the trust grantors, they have no control over the trust's assets. The grantor may wish to consider writing safeguards into the

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trust so that beneficiaries cannot transfer their trust interest to a third party, or to protect beneficiaries' trust interests from the claims of their creditors. Assets in a revocable living trust are not protected from creditor claims against the grantor, which includes the costs of long-term care. That is because the grantor has the right to amend the trust, change the beneficiaries, name a different trustee, change the date of termination, revoke the trust and have the property titled back into his or her name, and exercise other acts of control. If nursing home costs are an issue, you may wish to investigate whether a long term care insurance policy would meet your financial goals.

How a Living Trust Works

Trusts are often promoted by the claim that they avoid the time and cost of probate. While that is true, for the purposes of avoiding probate, a living trust does no good until you transfer property from your name to the trust's name. For example, you have to go to the bank and fill out a form to change the name on your checking and savings accounts and to the County Recorder's office to change the title on your home and other real estate from "Thomas A. Reilly" to "Thomas A. Reilly, as trustee for the Thomas A. Reilly Living Trust." The cost to transfer property is usually minimal, but it takes time to organize your papers and make the transfers. Merely setting up a trust agreement does not place any property into the trust–a separate transaction is needed for each asset.

Some types of valuable property, such as jewelry or art works, as well as items like family heirlooms, don't normally have documents of title. In that case, the property is transferred to the living trust simply by listing it in the trust document, and stating that the property is owned by the trust.

Many estate planning lawyers insist on preparing and recording all documents transferring title to trust assets. Perhaps this is because about 49% of all people who have living trusts never complete this step, which pretty much negates the advantages of setting up a trust in the first place. If you acquire new property, you must also take care to place it in the trust's name and not your own.

Considerations in Forming a Living Trust

Taxes

A revocable living trust has no significant income tax advantages. Because the grantor retains the right to exercise control over the assets in the trust, the IRS treats the trust property as it does any other property owned by the grantor. Income generated by the trust assets is income to you, the grantor, and is reported on your personal state and federal income tax returns during your lifetime.

Estate taxes only become an issue when the value of your estate, or you and your spouse's estate exceeds the following amounts for the given years:

Year	*Amount of Exemption*	*Estate Taxes*
2002	$1 million	50%
2003	$1 million	49%
2004	$1.5 million	48%
2005	$1.5 million	47%
2006	$2 million	46%
2007	$2 million	45%
2008	$2 million	45%
2009	$3.5 million	45%
2010	N/A (taxes repealed)	top individual rate

Management issues

Having a living trust does make managing your financial affairs more complicated. As trustee, you may find it more difficult to deal with stockbrokers, life insurance companies and other financial institutions. When transferring assets into the trust, financial institutions need to know who has what powers under the trust agreement. Some companies have a form on which you provide them the necessary information, some ask for a summary of the trust agreement, and some require a copy of the entire trust agreement.

Many financial institutions will not loan money to a trust. For example, to refinance your home mortgage when your home is owned by the trust, you might have to transfer the house out of the trust, complete the refinancing, and then transfer the house back into the trust. Some insurance companies are unwilling to insure vehicles owned by a trust, maintaining that they can't determine who the authorized drivers are.

Planning for Incapacity

Advanced age, serious illness, or an accident may render a person incapable of managing his or her investments, or even performing everyday financial transactions. A living trust is one tool that can be used to handle your financial affairs if you become incompetent.

In the trust agreement, you may name yourself as trustee, but also a successor trustee who would handle your financial affairs if you are unable to do so. Assets are transferred into the trust while you, the grantor, is competent. The trust agreement would spell out who is to determine you are incompetent and give directions for the management of financial affairs which the successor trustee must follow.

Another tool for planning for financial management in the event of incapacity is the Durable Power of Attorney. This is a written, witnessed, and notarized document giving someone the power to manage your finances in the event that you become incompetent. A Durable Power of Attorney is simpler and less costly than a revocable trust.

Trusts for Special Circumstances

Trusts can be set up for the benefit of one child, or for several children. With a child's trust, your child is the beneficiary and your child's property manager is the trustee. The trust agreement sets out the trustee's responsibilities and the beneficiary's rights, and the age at which the beneficiary is entitled to receive the trust principal outright. With a "family pot trust" two or more beneficiaries share rights to the principal of one trust. You select the adults you want to serve as trustee and successor trustee. With either type of trust, the trustee manages the trust property, under the terms of the trust agreement, until it is turned over to the beneficiary or beneficiaries.

Parents or others who care for someone who has a serious physical or mental disability can create what's called a "special needs" trust A primary concern with a special needs trust is making sure you select a trustee and one or more successor trustees who are attentive to the disabled person's situation and have the know-how to deal with various institutions, from hospitals to banks to government agencies. A special needs trust needs to be drafted carefully so that its existence doesn't render the beneficiary ineligible for help from government programs.

If you want to leave property to an adult who just can't handle money sensibly, perhaps you should consider a "spendthrift" trust. The purpose of this kind of trust is to restrict the beneficiary's ability to spend down the assets in the trust. With a spendthrift trust, the trustee is always a different person than the beneficiary. The trustee is given power to spend trust money for the well-being of the beneficiary but the beneficiary has no ownership rights over the trust property and no right to pledge trust principal or future income expected from the trust, as security for a loan.

A "Pour-Over" Will

A "pour-over" will directs that anything you own at death passes to the trust. This is to take care of assets that may not have been transferred to the trust. In most instances, the pour-over will does not have to be probated if you have transferred your major assets to the trust. Any assets left over would qualify for a quick, administrative procedure for small estates.

Do You Need a Living Trust?

Living trusts cost more to draw up and take more time to set up than a will. Trustee fees must be paid if you cease to be your own trustee. Before establishing a revocable listing trust, think about your financial and estate planning objectives. Discuss ways to meet your objectives with an attorney, certified public account or financial planning professional. There may be several planning alternatives. Know the advantages and disadvantages of each before making a decision.

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