REVOCABLE "LIVING" TRUSTS

Background

One of the more flexible and popular estate planning tools available today is a Revocable Trust (or, as it is more commonly known, a "Living Trust" or an "Inter Vivos Trust"). While Living Trusts are not a new concept, legally, the popularity of the document has experienced a tremendous growth in recent years. Although this is a very useful and beneficial document, it is often misunderstood. Consequently, it is important to understand the basic concepts and advantages of the Living Trust so that any decisions you make regarding a Living Trust will be informed decisions that are based upon a knowledgeable understanding of the document.

Perhaps the single most claimed benefit of a Living Trust is that it avoids probate. However, this is one of the potentially misleading claims that are often stated in Living Trust literature. A more accurate statement would be that ***if funded correctly*** a Living Trust Agreement may allow an individual to avoid probate upon his or her death.

Probate

In order to weigh the benefits of this potential advantage, it is first of all necessary to have a basic understanding of the probate process and the need for probate in order to understand how and why a Living Trust can avoid that procedure.

First of all, contrary to popular belief, probate is not a mandatory process. Upon the death of an individual the executor or administrator of his or her estate makes a voluntary election to open a probate estate. There are a couple of reasons that an executor or administrator would seek to open a probate estate on behalf of a decedent. First of all, one of the advantages of going through probate is that it does provide a cut-off date for creditors' claims. Typically, a creditor's notice is published in the local newspaper shortly after the probate estate is open. That notice informs all

creditors of the decedent's estate that they have six months within which to file any claims they have against the estate. Any claims not filed within that time period will be forever barred. Therefore, the executor or administrator of the estate can be secure in the knowledge that they will have a clean cut-off date and may distribute proceeds to the beneficiaries of the estate after that date without incurring any additional claims from creditors.

However, the primary reason that administrators or executors elect to open a probate estate is to obtain the necessary legal authority to allow them to transfer physical title and possession of certain assets from the decedent's name to the intended beneficiaries.

Specifically, assets that generally require a probate estate to be opened are those assets that are accompanied by some type of paper title or would otherwise require the decedent's signature in order to withdraw or transfer the assets. For instance, if A's Will provides that, upon my death, I give my car, my bank account and my shares of XYZ Corporation stock to B, a probate estate would typically be required in order to effectively transfer those assets to B upon the death of A. If A were alive and wanted to transfer the assets to B, he would have to sign a withdrawal slip or a check to withdraw the funds from his bank account, he would have to sign the back of his car title and hand that to B, and he would have to endorse the back of his XYZ stock certificate and request that a new certificate be issued in B's name. Once A is deceased he can no longer accomplish those tasks.

Therefore, it would be necessary for a probate estate to be opened so that the court can officially appoint and authorize an administrator or executor of A's estate who would then be empowered to transfer the assets on A's behalf. Once appointed by the probate court, the executor of A's estate could withdraw the funds from A's bank account to hand over to B by simply signing A's account as the executor or administrator of A's estate. Similarly, A's executor could endorse the back of A's stock certificate and request that a new certificate be issued in B's name and A's executor could sign the back of A's car title and hand that car title over to B. In each of these instances, the appropriate institution (i.e. the bank, XYZ Corporation and/or the Secretary of State) would recognize the authority of A's executor to sign on A's behalf as a result of the authority vested in A's executor by the probate court.

As a general matter, therefore, probate is required where the assets of a decedent include assets that are titled in the decedent's individual name (i.e. as opposed to joint tenancy) and are accompanied by some type of paper title or written authorization that is required before the assets can be transferred. Certain assets would typically not require the opening of a probate estate. Those assets would include:

① ***Assets Held in Joint Tenancy.***

By law, legal title to assets that are held in joint tenancy automatically pass to the other joint tenant upon the death of the first joint tenant. No signature by the deceased tenant or court approval is required in order for the surviving tenant to obtain sole legal ownership of the asset.

② ***Assets Containing a Beneficiary Designation.***

Assets such as life insurance policies, IRA's, retirement plans and annuities typically designate a beneficiary who is to receive the proceeds of that asset upon the owner's death. No signatures or written authorizations are required. Upon the death of the owner, the proceeds of the asset are paid directly to the designated beneficiary.

③ ***Personal Effects.***

Generally, a probate estate would not be required where the individual's estate consisted of personal assets, such as household furnishings, jewelry and clothing. Since no paper title generally accompanies these types of assets, ownership is basically dictated by possession. In order to transfer ownership of a personal asset to an intended beneficiary all that is required is to hand over that asset to the beneficiary. This is not to say that personal assets are not included in a probate estate or may not require the opening of a probate estate in certain circumstances. However, as a general matter, these types of assets on their own would typically not require the court appointment of an executor or administrator to transfer possession.

Living Trust

With this background in mind, one of the alternatives for avoiding probate is a Living Trust. Essentially, a Living Trust is a trust agreement that is created during your life. The Agreement provides that while you are alive and competent you are the trustee of the trust and have complete control and direction over any of the assets placed in the trust. Upon your incompetency, you appoint a successor trustee who is to use the trust assets for your care and benefit. Upon your death, the trust agreement then describes how your assets are to be distributed, in much the same manner as a Last Will and Testament would provide those instructions.

In order for the Living Trust Agreement to be effective, it must have assets to govern. In other words, until assets are actually transferred into the Trust, the Trust Agreement will have nothing to manage and will be essentially meaningless. Therefore, the **funding** of the Living Trust Agreement is the critical second step that is required in order to allow the administration of the decedent's estate to proceed without being subject to the probate process. The Living Trust Agreement, in its written instructions, will provide that whoever is acting as trustee at any given point in time (which is you while you are alive and competent) will have the authority to sell, transfer or deal with any of the assets that are held by the Trust. It is in this manner that the Living Trust can serve as a mechanism to avoid probate.

By placing those assets which would otherwise be required to go through the probate process into the Trust, you will be empowering your successor trustee to transfer those assets to the intended beneficiaries upon your death without the court process otherwise required if the estate must be administered through the Probate Court. The successor trustee, however, may only transfer and deal with those assets which have been titled in the name of the Trust during your lifetime. If you create a Living Trust but do not fund it properly, it will most likely still be necessary to open a probate estate to effectuate the transfer of all or portion of your assets upon your death despite the existence of a Living Trust.

The implementation of a successful Living Trust Agreement, therefore, requires two steps. The first step is to prepare and execute the actual Living Trust Agreement. The second step requires the funding of that Living Trust with all of your assets that are currently titled in your own name, have some type of paper title associated with them, or would typically require your signature in order to transfer or sell all or a

portion of the assets upon your death or disability. Depending upon your specific circumstances and the instructions you leave for the distribution of your assets upon your death, it may also be necessary to make beneficiary designation changes on certain assets.

It is important to realize that the obligation of funding the Living Trust is not a one time effort. The obligation will be continual. Each time a new asset is purchased, you must be cognizant of whether or not that asset should be titled in the name of your Living Trust or in some other manner. Consequently, it may be appropriate to review your assets on a periodic basis in order to make sure that they have been titled properly and funded into the Living Trust.

Other Advantages

Since a Living Trust is revocable, no income tax liability will result from its creation. All taxable income will be taxed to you individually, whether or not distributed to you, and the trust assets will be included in your estate for federal estate tax purposes upon your death. Normally all income will be distributed to you and you will reserve the unrestricted right to withdraw all or any part of the principal and to revoke or amend the trust during your lifetime.

Another advantage of the Living Trust over a Will is the ability of the Trust to more easily withstand an attack brought by a disappointed heir. Although either instrument is subject to attack on the grounds that it was executed as a result of undue influence or that the creator lacked the requisite mental capacity, the Trust will not fail because of lack of formalities of execution such as the failure of a witness to a Will to sign in the presence of the maker.

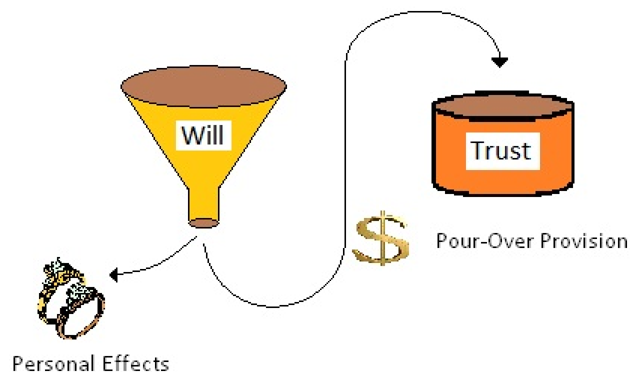
Perhaps the greatest difference between the Trust and the Will, from the standpoint of a contest, is the right of a contestant to a jury trial in a Will contest. No such right exists in a suit to set aside a Trust. Any such action must be tried before a judge alone. Reliance on the sympathy of a jury to rewrite a Will that departs from a jury's ideas frequently gives a contestant in a Will contest an advantage that he would not enjoy were he to attempt to overturn a Living Trust.

In addition to the above differences, by avoiding the probate upon death, a trust administration has the additional "at-death" benefits:

- ✔ Eliminating $5,000 to $20,000 of legal fees typically incurred during the probate process.
- ✔ Eliminating the need to file documents and asset information with the probate court (which would then become available for inspection by the general public).

"Pour Over" Will

Because of the possibility that not all of your assets get transferred to the Trust during your lifetime, a "pour over" Last Will and Testament often accompanies a Living Trust. A "pour over" Will simply states that any assets owned by you individually upon your death are to be transferred to the then acting trustee of your Living Trust to be disposed and administered in accordance with the terms of that Trust. However, because it will be necessary to have a court appointed executor sign off on those assets, a probate estate must be opened to accomplish this transfer. Therefore, although the Pour Over Will serves as a safety net to make sure all assets pass according to the instructions of your Trust, it is advisable to transfer those assets into your Trust during your lifetime rather than relying on the provision of the Pour Over Will.



Asset Protection

One of the misconceptions surrounding Living Trusts is that they also provide protection from creditors. This is NOT true. Because the trust is revocable, it is created by you, you designate yourself as the initial trustee, and you have the right to access the trust whenever you desire, the trust provides no protection from your potential creditors. A Living Trust does not provide protection from Medicaid. If you ever have to apply for Medicaid in the future, any assets that are held (titled) in the name of your Living Trust must be considered "available" assets just as if they were owned in your individual name. Again, the primary benefit of a Living Trust is that it will allow your estate to be administered upon death without the necessity of opening a formal probate estate. It does not provide protection from potential creditors.

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A Living Trust, therefore, can be an outstanding ***tool*** to assist in the administration of a decedent's estate. Like all tools, however, it must be used properly in order to realize the intended benefit. In the case of a Living Trust, this means that the Trust must be funded with your assets in order to realize the benefits afforded by the Living Trust.

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