

## The Revocable Living Trust

When we first meet with a prospective client we discuss their goals and objectives for creating an estate plan. What we heard from nearly everyone is that their primary goal is to avoid probate at death. Every client has their own unique horror story; more often than not, something they have personally experienced when trying to navigate this court-directed process. What we explain to them is that although there are several ways to avoid probate, a revocable living trust is the most effective and safest way to do so, primarily because a properly funded trust eliminates the need for financial Powers of Attorney or a court appointed conservator. Unlike a Will that is effective only at death, a revocable is effective when signed, and:

- Allows the person creating the trust (the “Trustmaker”) to remain in control of both the assets of their trust and the manner in which those assets are administered;
- Distributes the trust assets at the death of the Trustmaker according to their wishes as expressed in their trust;
- Creates a central repository for all the Trustmaker’s property;
- Takes care of the Trustmaker and his or her named beneficiaries if the Trustmaker becomes incapacitated;
- Offers privacy for the Trustmaker and his or her loved ones;
- If drafted by a dedicated attorney, a trust is easy to create and maintain and can be easily changed as long as the Trustmaker is alive and competent;
- Has no adverse lifetime gift or income tax consequences;
- A trust avoids probate to the extent that the Trustmaker’s assets are owned in the name of the trust or are transferred at death of the Trustmaker’s to the trust by way of beneficiary designation;
- Offers continuity in the Trustmaker’s affairs upon incapacity or death;
- Is valid in every state under Article I, Section 10, and Article IV, Section 1, of the U.S. Constitution.; and
- Is difficult for disgruntled heirs to attack due to the inclusion of a “no contest clause.”

### A Brief Description of the Strategy

Who will manage your assets if you become incapacitated, what happens to family relationships if members argue over management of assets or worse if they disagree after death on when and what each beneficiary shall received. A legal contest over these matters can easily cost an estate tens of thousands of dollars in legal fees and court costs. The revocable living trust provides the best foundation for an estate plan; it helps to avoid these potential pitfalls far better than a Will-based plan can.

In a nutshell, here is how a revocable living trust works: Every trust has a cast of characters, three main characters, to be exact. The first, the Trustmaker, is the character who establishes a revocable living trust. A revocable living trust can be created by a single Trustmaker or it can be for a Trustmaker and his/her spouse. A revocable living trust for a husband and wife is called a joint revocable living trust. The second character is the trustee; the initial trustee is almost always the Trustmaker and his/her spouse. The trust itself has provisions for

successor trustees in the event one or more of the trustees cannot serve for any reason. A revocable living trust contains instructions as to how the Trustmaker's property will be administered during the Trustmaker's life, when the Trustmaker is incapacitated, and after the Trustmaker has died. The Trustmaker generally funds his or her trust with virtually all assets, which simply means that legal title is transferred to the trust. There are some notable exceptions to this rule. For example: with life insurance policies and individual retirement plans, we change the beneficiary designation to the name of trust, rather than change ownership because that would trigger a taxable event. The third character in this trust is the most important: the beneficiary. It is for the beneficiary after all, that the trust was created in the first place. Those assets, held in the name of the trust, are for their benefit. By now, you may have caught on to the fact that upon creation, all three characters; the Trustmaker, the trustee, and the beneficiary, are, in fact, you. It is only at your death that your trust becomes a separate entity; during the lifetime of the Trustmaker, a trust serves as his alter ego, with no need to file a separate tax return. The dispositive provisions of a revocable living trust, which can be changed at any time by the Trustmaker, include extensive language as to how the trustee may manage the assets as well as to whom those assets are to be distributed to upon death of the Trustmaker. For a revocable living trust to work as intended it needs to contain provisions which assure that the Trustmaker's estate tax exemption (\$1 million in 2011) is properly utilized. Provisions for the creation of trusts for children, charitable foundations, and other sophisticated planning strategies can also be drafted into revocable living trusts. Assets in the trust avoid both living probate (a court appointed conservator), and probate at death. An estate plan utilizing a revocable living trust should always incorporate a pour-over will which acts as a safety net in case any assets are inadvertently (or intentionally) left outside of the revocable trust. Assets passing under the pour-over will are subject to probate but will ultimately be controlled by the terms of the revocable trust.

## The Specifics of This Strategy

As the foundation of your estate plan, the revocable living trust is an extensive document that encompasses a number of estate planning strategies. It is a document that offers total flexibility; its terms can be changed at any time that circumstances or feelings change, as long as the Trustmaker is alive and competent.

## Incapacity

One of the most important and effective uses of a revocable living trust is for incapacity planning. Insurance company statistics show that we now have a 6 times greater chance of becoming incapacitated before we die than at any other time in our history. Because of this telling statistic and the fact that Americans are living longer, incapacity is something that should be addressed in a proper estate plan. Often, incapacity planning is accomplished with a general power of attorney, granting another person or persons the power to deal with our assets if we are incapacitated. The disadvantage of this method is that it offers no instruction, making it effectively a 'blank' check for the Attorney-in-Fact which provides no insights into how the incapacitated individual would have wished his agent to handle his affairs. In addition, durable powers of attorney might be completely ineffective as they are not readily accepted by many third parties such as banks and financial institutions. If an incapacitated person failed to create a durable power of attorney, then that individual must be hauled into court by those he loves in order for the court to declare him incompetent, a process that is both degrading and expensive. It puts the power over assets in the hands of a court-appointed conservator, who may or may not be a family member. Some 'docs in a box' forms have powers of attorney end if the maker is declared incompetent. This means that all too often these cheap documents become the most expensive estate planning tool ever, allowing the unhappy heirs to go to court to attempt to wrest control of assets from the power of attorney holder. A revocable living trust allows the trustees to continue to administer the property of

the incapacitated Trustmaker. The trust itself defines incapacity and contains instructions as to how the trust property is to be managed during the maker's incapacity. Requesting the Court's intervene in petty disputes is highly unlikely. While a durable power of attorney is useful even in a trust-based estate plan, its purpose is limited as to what the agent controls; usually a personal bank account for bill paying purposes and the power to transfer unfunded assets to the trust. However, given the exceptions we have already noted that are not usually transferred to the living trust, we recommend that clients execute a general durable power of attorney in order to allow the agent (usually the same persons who are trustees under the living trust) to manage tax qualified assets such as IRA accounts, 401K accounts and pension or profit sharing accounts as well as life insurance policies. This power of attorney may also authorize the continuation of the client's lifelong gifting program.

## Funding

A revocable living trust is typically funded with almost all assets. Funding simply means that the title of the assets will be held in the name of the trustees rather than in the individual name of the Trustmaker. Generally, funding is not necessarily a difficult process, but to the uninitiated it is time consuming and serious mistakes can be made. For this reason our firm funds all trusts we help our clients create, an important responsibility we willingly undertake for our clients and one that very few law firms offer. As mentioned, some assets are not held in a revocable living trust, most notable of which are IRAs, 401(k) accounts, pension and profit sharing accounts. A transfer of such assets to a revocable trust will cause the immediate income taxation of the monies in the accounts. In order to plan for these assets without accelerating the income taxation, the beneficiary designation is typically made to be the revocable trust, either as primary beneficiary or contingent beneficiary, depending on the circumstances. Normally, life insurance policy are treated in the same way as these plans (unless additional tax planning is required) with the beneficiary designations changed so that the trust becomes the beneficiary at death. Stock options are another example of an asset class that may not be able to be transferred into a trust; shares in a business are another prime example. If these are assets that you hold, you must discuss the appropriateness of transferring them prior to doing so. Severely adverse income tax consequences as well as other penalties may incur if the transfer is not made correctly.

## The Creation of Subtrusts

A revocable living trust agreement also typically creates a number of trusts within it to serve one or more purposes. These sub trusts come into existence upon certain events such as the first Trustmaker's death or at the death of the surviving Trustmaker. Each of these subtrusts has a specific function. For example, a Marital Trust maximizes the federal estate tax unlimited marital deduction. A Family Trust (also known as a Bypass Trust, a B Trust, or a Credit Shelter Trust) makes certain that any remaining portion of the Trustmaker's \$1.0 million exemption equivalent (in year 2011) is fully used. The living trust may also contain subtrusts to provide for the management of assets for children in ways which assure that those assets are fully protected from divorce and creditor claims. These subtrusts can also be designed to allows a beneficiary's inheritance to pass estate tax free to his or her descendants when the beneficiary dies thereby skipping the estate tax on an entire generation of asset growth.

## Selecting Who Can or Should Be Trustees

With the exception of a few states, notably New York, the Trustmaker can be his or her own trustee. For married couples, both spouses serve as co-trustees of their joint trust and, if separate trusts are created for husband and wife then both can serve as the co-trustee of the other's trust as long as that serves their planning

objectives. As a trustee, you can retain control of your trust assets during your lifetime. The trust's terms allows you to use the assets in any manner you would if you owned them outright. Great consideration should be given to naming trustees upon your incapacity or death. Individual trustees can be named, including family members or professional advisors. Corporate fiduciaries such as banks or trust companies can also be named. For most clients, family member serve as successor trustee. Carefully consider how this might adversely impact the family dynamic and if it might be wiser for more than one child to serve. After all, if a number of trustees are serving, each of their individual strengths can be used effectively. One trustee's weakness can be compensated by another's strengths. Trustees have, as their primary duty, the responsibility the carrying out of the terms of the trust. The trust instrument itself is the source of a trustee's direction. A well-drafted trust document is critical to fully explain the wishes of the Trustmaker. A clear trust document enables the trustees to make decisions that reflect the unambiguous intentions of the Trustmaker and cannot be questioned by the beneficiaries.

## Planning Risks and Detriments

A revocable living trust is relatively risk-free. It can be changed, amended, or canceled by the Trustmaker at any time. There are no adverse income or gift taxes associated with its creation. A revocable trust that reflects the goals and objectives of the maker is the foundation on which a sophisticated estate plan is based. By coordinating the revocable living trust with the remainder of the planning, a flexible estate plan can be created that saves the maximum amount of administrative costs and taxes.