The Elder Law Information Series

Q&A

Revocable Living Trust

A POWERFUL COMPLEX DOCUMENT

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What is a trust?
A trust is a legal document and arrangement designating a trustee to receive and hold legal title to property and administer the assets in accordance with the instructions in the trust document. The person who creates the trust is known as the "settlor," "grantor" or "trustor." The persons who receive income or other distributions from the trust are called "beneficiaries." In this Q&A when we refer to a "trust" we refer to a revocable living trust.

What is a "living" trust?
A living trust (also called a "grantor trust" or an "inter vivos trust") is created during your lifetime. A trust that is created after you die is a "testamentary" trust.

What is a "revocable" trust?
A revocable trust is one that is capable of being changed, amended, or terminated. This is almost the only trust that the average person will ever see. "Revocable" means the settlor retains control over the trust. A trust that may not be changed is called "irrevocable." Such trusts are frequently used in tax planning.

How is the trust better than a Will or using joint property to avoid probate?

Most people should review what they are really trying to accomplish with their assets and consider what is possible. The cost, although important, is secondary to the goal. The key is that by using the trust we can have our instructions followed. We cannot do this with joint property – the joint tenant is free to do as s/he wishes. If we put instructions or conditions on a gift in a Will, we have created a testamentary trust. With the trust we can give guidance even when we cannot speak and that may be during incapacity or after death.

When is a trust the best alternative?

There are a number of situations where a trust is the best alternative. Some of them are:

- A person who wants to leave property with conditions or "strings attached." For example a grandmother may want to leave $10,000 to a child for college education, but if the child does not go to college, then to the child at age 25. A parent may have a child with a drug or gambling problem. In that case the trustee will administer the money. A Will may not place conditions on gifts and if it does then the probate court must create a testamentary trust.
- Persons with real estate in more than one state who want to avoid multiple state probate.
- Persons with a business such as a landlord with many rental homes. The trust will allow for smooth transition of administration in case of disability or death.
- Single persons who have no spouse or children to take care of them should they become incapacitated. The trust can help the person maintain independence and have their instructions followed. The trust will also direct their gifts after death otherwise the property would go to distant heirs.
- A married person whose spouse has a degenerative disease such as Alzheimer's who is concerned about who will take care of the sick spouse should the "healthy" one predecease. In this case there may be no children or the healthy spouse may judge that the children need guidance and assistance in the care of their parent.
- A parent of an adult disabled child who wants to provide for the child after the parent dies. The trust may be made so that the child does not lose public benefits.
- Persons who want to avoid probate and do not want to use joint property and beneficiary designations to do so.
- Tax motivated persons whose tax avoidance plan requires the use of a trust. Examples include "A-B trusts," Irrevocable Life Insurance Trusts, and QPRTs, to avoid paying estate taxes on the transfer of property at death of the settlor.

How can a trust help in case of incapacity?

One of the great advantages of a trust is that it provides for comprehensive disability planning. If the settlor becomes incapacitated, the trust provides for a successor trustee to take over administration of the trust. The successor follows the instructions in the trust. For example if a nursing home stay is a possibility, the settlor may instruct that all alternatives are considered first. The settlor may set personal standards of care over and above what the law would require. The trust instructions may require the hiring of independent professionals to monitor the quality of care, to provide for regular visitation and for a patient advocate. The trust avoids the necessity of having the probate court name a guardian and conservator to manage the assets and make personal decisions.

Once a living trust is established can it be changed?

Not only can it be changed, it often should be. In most cases the terms of the trust should be changed or at the very least reviewed on a regular basis to account for changes in your family situation (deaths, divorces, etc.). In light of the events of September 11 everyone should review all estate plans to make sure they cover situations they once never considered. Similar to a will the terms of a living trust may be amended as long as you have the capacity to do so.

How does a trust work?
Most often the settlor is the trustee with full power over trust assets. The settlor transfers assets to the trust and the trust is considered the owner. The trust document is given to account holders to make the transfer. Upon incapacity or death the trust provides for a successor trustee. Upon death the trust contains instructions for the distribution of assets, just as a Will would. The primary difference between a trust and a Will is that assets held in trust do not have to go through probate.. This is because the trust is considered the owner of the assets. The assets are then distributed according to the instructions in the trust. The Will may not address incapacity

If I create a trust , do I still need a Will, power of attorney and a" living will?"
Yes. A will, called a "pour over" Will, is also drafted in conjunction with the trust. If all assets are not transferred into the trust, the Will picks up those assets at the time of death and transfers them into the trust for central distribution A general durable power of attorney is needed for legal matters that cannot be handled by the trust such as assets not transferred to the trust or items than cannot be transferred such as pension benefits or rights under health insurance policies. A living will or more broadly and properly, a healthcare power of attorney is needed to handle substitute medical decision making during lifetime and at death.

Does my tax status change when I create a revocable living trust?
No. As long as the settlor is the trustee any income generated by assets owned in the trust are taxed as if they were still held in the settlor's name. Taxes are still reported on the IRS 1040 form. No special taxpayer treatment is needed.

Does the living trust reduce income taxes or estate taxes?
In a word, no. During the owner's lifetime the revocable living trust has no effect on the owner's income tax. The owner will continue to be taxed on the income from the assets held in the trust. Similarly property taxes will not increase for property placed into a trust of the Settlor. After the owner's death the assets in the trust will be subjected to the estate tax, if at all, in the same manner as a probate estate. However, a different kind of trust may be used as part of a *tax avoidance plan* and as such reduces taxes. That type of trust effects limitations on control of the trust assets in ways the typical trust does not. Often times, proper estate planning will involve the use of both types of trusts.

Does a trust cost more than a Will?
Yes. The cost for a competently drafted trust usually runs somewhere between $1000 and $2000. More complex disability or death planning, or complex asset portfolios result in more time and costs to complete the trust. However, even the simplest trust is more complex than a Will since it does much more than a Will. The only purpose of the Will is to distribute assets at death. The trust has its

own administrative structure, the Will uses the probate court administrative structure. The trust, typically, addresses incapacity, the Will can only address death.

Are there any disadvantages to using a living trust?
Not *per se.* But there are considerations that everyone should be aware of. There is expense in establishing and funding a competently drafted trust. The expense may reflect the complexity of the goals of the settlor. The expense will be limited if the settlor has clear goals and is willing to do much of the "leg work" in the funding of the trust. Also, keeping the trust current in both assets held, applicable law and trustee instruction, is an ongoing process and the failure to keep current can cause more problems than not having a trust in the first place. . In addition, conditions may change that makes planning for naught. Finally, a poorly drafted trust can cause great expense of time and money down the road when the terms cause require court involvement.

Is probate so bad as to make establishing a living trust really worth the effort?
This answer is not an easy one. Many people have been scared to death by the stories of very expensive and slow probate. An average cost may be somewhere between 1% and 5% of your estate if you hire a lawyer. It is less if a family member handles the process without fee. In that case probate may cost less than a thousand dollars. It may take your personal representative six months to a year to finish probate, but he or she may distribute assets without delay as long as creditors are paid and there are no conflicts or tax problems.

Is a trust always faster and cheaper than probate?
In most cases, yes. In the case of probate on death, this answer does not consider the loss of investment return on the money used to create the trust. That depends on the cost and how long before death the trust was created. For example, how much would $1,000 be worth if it were invested for 25 years? Where there are trusts contests in probate court or tax clearances are needed there may be very little difference in time or expense. In the instance of avoiding conservatorship or "living probate" the trust is almost invariably faster and cheaper.

Will a Trust protect my estate if I have to go to a nursing home?
No. Many people think that putting their assets into a trust would help them qualify for Medicaid, because the assets would no longer be titled in their name. The trust is revocable and under the settlor's complete control. Nothing is "given away". The trust can cause problems since Medicaid considers a home in a trust to be a "countable" asset that must be sold or transferred out of the trust to the applicant or spouse. It is no longer an "exempt asset." That could require the trust to be "reformed"in court. See below.

Can a Trust cause more court involvement?
Yes. A poorly drafted trust may cause problems. Consider a trust that becomes irrevocable upon a settlor's incapacity. Assets may not be removed. If the family wants to sell the home that is in the trust, they will have to go to probate court to get the trust "reformed." Consider a couple that has a joint trust and a spouse must go in the nursing home. Medicaid will consider any asset in the trust available to pay the nursing home regardless of the needs of the community spouse. The trust will either need to be amended or else reformed in court.