

Dispelling the Myths About

REVOCABLE LIVING TRUSTS

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GAINING MAXIMUM BENEFITS FROM A LIVING REVOCABLE TRUST

The living revocable trust is a unique and relatively new technique for owning property during life and transferring it to our intended beneficiaries at the time of death. Essentially, it is an estate planning tool that can also be a very effective lifetime financial planning tool.

The living revocable trust that has been carefully and skillfully planned can provide rich rewards for both the person who sets up the trust (the Grantor) and the persons who will receive the property of the Grantor at his or her death (the beneficiaries).

WHAT IS A LIVING REVOCABLE TRUST?

The very name— “living revocable trust” pretty much explains the basic nature of this arrangement. It is a trust that is set up during life and can be changed or revoked by the Grantor at any time.

Every living revocable trust is the actual owner of all the property transferred to the trust. Like other trusts, the living revocable trust has a *Grantor*. That’s the person who creates the trust and transfers property to the trust. There is always a *trustee*— the person or institution responsible for managing and investing the trust properties. There are always one or more *beneficiaries*--- the persons who are designated to receive income, principal, or other benefits from the trust. And, there is always a *written document* that defines the rights and responsibilities of the Grantor, the trustee, and the beneficiaries.

In most cases, the Grantor will also be the trustee and the sole beneficiary of trust income during his or her life.

The living revocable trust, as the name implies, can be changed, modified, or canceled by the Grantor at any time and for any reason. However, like a will, it does become irrevocable and unchangeable when the Grantor dies.

Finally, the word “living” makes it clear that the living revocable trust is always created during the life of the Grantor even though it may be primarily an arrangement for the disposition of property after his or her death.

Expressed more simply, the living revocable trust is created and funded during your life--- subject to change, modification, or cancellation during your life for the primary purpose of directing the disposition of property at your death.

VARIATIONS IN FUNDING A LIVING REVOCABLE TRUST

It is important to note that there is no such thing as a standard living revocable trust. Your living revocable trust should be planned and drafted to meet your individual needs and accomplish your personal objectives.

One major variation lies in the extent and manner in which the living revocable trust is funded.

When you create a living revocable trust, you have many funding options. You can:

- (1) immediately transfer the ownership of certain properties to the trust;
- (2) arrange to transfer properties to the trust at a later time typically when there seems to be a high risk of death or disability;
- (3) name the trust as the death beneficiary of your bank accounts, securities accounts, annuities, life insurance and/or your IRA and other retirement death benefits; or
- (4) in your will, name the trust as the beneficiary of certain properties or even of your entire probate estate.

A person creating a living revocable trust can transfer the ownership of practically all his or her assets to the trust or, at the opposite extreme, he or she can leave the trust almost completely unfunded. In your own planning, keep in mind that you can transfer assets to and from the trust at any time during your life.

If your primary objective is to avoid the costs and delays inherent in passing the property by will, you will want to transfer most, if not all, of your assets to the trust prior to your death. These assets will be used or disposed of exactly as you have directed in the trust agreement with no need for court supervision or approval. They will not be subject to any of the costs and delays normally involved in settling an estate.

In addition to transferring property to the trust during life, you can also arrange for the financial assets (bank or securities accounts, stocks, bonds etc.), proceeds of your life insurance policies and/or your retirement death benefits to be paid to the trust at your death. (The trustee will receive these proceeds and manage and dispose of them as directed in the trust agreement.)

Finally, you can transfer your personally owned property to the trust. If you allow this property to pass through your will, these transfers will take effect at your death, and they will be subject to the costs, the delays, and the possible complexities of probate. The trustee will hold and dispose of these properties as directed in your trust agreement.

The best funding arrangement will, of course, depend on the nature of your property interests, your age and health, whether you want to retain or be rid of investment responsibilities, and exactly how you want to dispose of your estate.

VARIATIONS IN MANAGING A LIVING REVOCABLE TRUST

Most living revocable trust arrangements name the Grantor as trustee. This arrangement, of course, gives the Grantor complete and immediate control over the management and investment of all assets transferred to the trust.

If you decide to act as your own trustee, you will want to name a successor trustee to assume this office at your death. And it is generally advisable to provide that the successor trustee will also

assume the office of trustee if you become incapable of managing the trust properties.

Some people may want to use a living revocable trust to free themselves from day-to-day investment and management responsibilities. They simply name a family member, bank, trust institution, or other person as trustee. Because they can reserve the right to change trustees— or even to cancel the trust they continue to have effective control over the assets transferred to the trust.

VARIATIONS IN DISPOSING OF PROPERTY AFTER DEATH

A Living revocable trust agreement can direct the trustee to distribute the trust properties to designated beneficiaries immediately after the death of the Grantor. Or the agreement can direct that the trust be continued for a spouse, family members, or other designated beneficiaries.

The living revocable trust can do everything a will can do. It can name contingent beneficiaries; create presumptions as to the simultaneous order of deaths; set up estate-tax-saving trusts and qualify property for a marital deduction.

BENEFITS OF A LIVING REVOCABLE TRUST

Probate Costs and Delays Can Be Avoided

One primary purpose for setting up a living revocable trust is to avoid probate proceedings. Properties transferred to the trust during the life of the Grantor or directed to the trust by beneficiary designation are not subject to probate at the death of the Grantor. Thus, the living revocable trust can avoid all or most of the delays, the confusion, and the costs of settling or probating an estate.

Disposing of property through a will or intestacy always ties up the property — at least to some degree. Typically, the local probate court will appoint an executor or administrator who will collect all the properties of the estate, hold these properties until creditors' claims are satisfied and other formalities are complied with, and then distribute the properties as directed in the decedent's will or by state law. During this time — that can range from six months to a year or more — the properties may be poorly invested and income or principal may not be readily available to the beneficiaries.

Probate costs in North Carolina are four tenths of 1% of the value of the probate estate (up to a maximum of \$6,000.00). Attorney's fees generally range from 1% to as much as 5% of the value of the estate. Although settlement costs will often be based on the difficulties of settling the estate, it can cost about \$2,500 to settle an estate valued at \$100,000, \$10,000 to settle an estate valued at \$400,000, and \$20,000 to settle a million-dollar estate.

A living revocable trust can significantly reduce these costs. And that, of course, means that more of your estate will pass to your intended beneficiaries.

Many assets are not subject to probate. It is important to note that many assets we own will not be subject to probate at our death. These assets will not be tied up in probate and they will

not add significantly to cost of settling the estate.

Life insurance proceeds, in most cases, are paid directly to the beneficiary designated in the policy. The policy is not part of the probate estate and the proceeds do not add directly to the cost of settling the estate.

Retirement death benefits, including individual retirement accounts, are also paid directly to the designated beneficiary and are not subject to the delays and costs of probate.

Property owned jointly with another is generally not subject to probate at the death of one owner. Under most joint ownership arrangements the surviving joint owner automatically becomes the sole owner of the property. The jointly owned property does not pass through probate and is not subject to the delays or the cost of probate.

Bank accounts and securities accounts and stocks can be structured to pass to beneficiaries (including trusts) without probate through the use of payable on death or transfer on death provisions.

Because most assets of a husband and wife will not be subject to probate, on the death of the first to die the ability of a living revocable trust to avoid probate may not be an important factor in their estate planning. But if both die simultaneously, without careful planning, all of the property will be subject to probate in most instances. Clearly, the ability of a living revocable trust to avoid probate costs is most advantageous for persons who will have relatively large probate estates. It is particularly valuable in two scenarios:

1. Where the decedent owns real property in a state outside of North Carolina. In such situations, the cost and hassle of probate in another state far outweighs the cost and time required to draft a revocable living trust and title the property to the trust.
2. In second or successive marriage situations. Where the decedent does not wish to pass his or her property to their spouse outright and yet provide for the spouse during his or her lifetime, then a living trust is the way to proceed.

Note: We need to emphasize that only assets transferred to a living revocable trust during life or directed to the trust by beneficiary designation avoid probate. Assets bequeathed to the trust through the will of the Grantor are subject to probate.

In most cases, the Grantor will transfer most of his or her assets to the trust immediately after the trust agreement is executed. Because the Grantor also acts as trustee, he or she continues to manage and control the properties just as if the trust had not been created. But the properties owned by the trust avoid probate when the Grantor dies.

Some people set up a trust but leave it unfunded until death or disability seems to be probable. At that time the Grantor can transfer the ownership of his or her assets to the trust or, if the Grantor is not competent, the assets can be transferred to the trust under a durable power of attorney.

The Trust Can Continue for Beneficiaries

It may be helpful to point out some of the ways a living revocable trust agreement can direct the disposition of property at the death of the Grantor.

The trust agreement can direct that some or all properties can be distributed to designated beneficiaries immediately upon the death of the Grantor. For example, the trustee can be directed to pay specific sums of money to designated individuals. . . to distribute specified properties to other individuals. . . or to pay certain percentages of the value of the trust to named individuals.

The living revocable trust agreement can also direct that the trust — or part of the trust — be continued for many years after the death of the Grantor. The trustee, for example, can be directed to hold the trust properties and to pay an income to one or more beneficiaries for their lives and distribute the principal to other beneficiaries when all the designated income beneficiaries have died. The use of such trusts can also provide for asset protection for the beneficiaries of the trusts.

Certainly, all these trust arrangements can be set up in a will just as easily as they can be set up by a living revocable trust. But the living revocable trust does have some distinct advantages.

For example, it is an excellent way to arrange for life insurance proceeds (and, perhaps, retirement benefits) to go into a trust for family members or other beneficiaries of the Grantor.

Example: Fred has named his living revocable trust as the beneficiary of all his life insurance. At his death the insurance proceeds, as well as other trust properties, will be invested by the trust and income will be paid to his widow for her life. His widow will also receive as much of the principal as she may need for her comfortable support. At the death of the widow the remaining principal will be paid to Fred's three children according to their needs at that time.

A living revocable trust makes it possible to accumulate practically all the assets of a decedent in a single fund where it will be managed by a single trustee under a single comprehensive plan set out in the trust agreement.

The Trust Can Minimize Estate Taxes

Another important benefit of a carefully planned living revocable trust is its ability to help avoid or minimize federal estate taxes.

Since the estate tax exclusion is now \$5.43 million per person and can be carried over to the surviving spouse, very few people have tax issues these days. However, the carefully drawn living trust can facilitate the reduction of the size of the estates of wealthy taxpayers and provide additional asset protection for survivors.

The value of all properties that pass outright to the qualified charities are immediately deductible for federal estate tax purposes. Indeed, a deduction is even allowed when the charity will not receive the property until after the death of designated family members, based on how long the

family members continue to enjoy the property.

Note: The living revocable trust does not, in and of itself, avoid or reduce the federal estate tax. Properties owned by the trust are part of the Grantor's gross estate for estate tax purposes in the same way that individually owned properties are part of the gross estate. The living revocable trust does, however, makes it easier to set up arrangements that can minimize estate taxes.

Publicity Is Avoided

When an estate goes through probate, all estate records become public knowledge. Anyone can review the probate file and learn all the assets and liabilities of the decedent, the value of many assets, and exactly who inherited the various assets of the estate.

A living revocable trust, on the other hand, is a private document. The terms of the trust, the nature and value of the trust property, and the beneficiaries of the trust are simply not available to the public.

The privacy of the living revocable trust can be especially important to a business owner who does not want his business plans and finances available to the general public--including business competitors. The privacy of a living revocable trust also lessens the possibility that con artists and unscrupulous investors will be able to prey upon the trust beneficiaries.

Protection In The Event of Illness or Incapacity

Most living revocable trust agreements provide for the appointment of a successor trustee if the Grantor/trustee is unable to handle the trust properties. This can be an important advantage of a living revocable trust because, in the absence of a trust or power of attorney, it is generally necessary to petition a court for the appointment of a guardian or conservator for a person who has become permanently or temporarily incompetent to handle his or her financial affairs.

The living revocable trust has other practical advantages. The bookkeeping discipline that is an essential part of a living revocable trust makes it much easier for a successor to step into the financial shoes of another. And the successor can take over the management of the trust at times when the Grantor/trustee is always on an extended trip or simply wants to be free of investment responsibilities for a time.

Professional Investment Management Can Be Arranged

We pointed out before that the Grantor of a living revocable trust can delegate investment and management responsibilities by appointing a family member, bank, trust company, or an experienced investment manager as trustee. The Grantor, of course, retains control over the trust properties through the reserved power to change any of the terms of the trust or to revoke the trust at any time.

We should note that the Grantor of a living revocable trust can name himself or herself as trustee and, at a later time when he or she no longer wants the day-to-day responsibility for

investments, a professional trustee can be named to take over the management of the trust.

WHAT DO YOU WANT FROM YOUR LIVING REVOCABLE TRUST?

There are other possible advantages of a living revocable trust but in thinking about a living revocable trust you will want to consider how important it is to:

- avoid probate costs and delays in settling your estate;
- continue a trust arrangement for selected beneficiaries after your death;
- minimize estate taxes;
- use your properties to benefit charities as well as family members;
- avoid publicity concerning your estate and your estate plan;
- assure the management of your assets in the event of your incapacity or absence;
- free yourself from day-to-day investment and management responsibilities.
- provide asset protection for the beneficiaries

DISADVANTAGES OF A LIVING REVOCABLE TRUST

The living revocable trust does have certain disadvantages. Planning and drafting a living revocable trust will probably cost more than planning and drafting a will. And transferring the legal ownership of properties to the trust can take time and, perhaps, add to the cost of the arrangement. Managing a living revocable trust is not difficult but it does require a certain structure and discipline. Finally, a living trust can actually reduce creditor protection on certain assets. For example, a home owned by husband and wife as tenants by the entirety is creditor protected against creditors having a claim against only one of the spouses. If the same property is placed in a revocable trust, a creditor having a claim against only one spouse, may be able to reach the property. A revocable trust provides NO protection of assets for Medicaid purposes.

Happily, a living revocable trust does not create tax-reporting problems. Indeed, in most cases the trust is not required to file any type of report with the IRS. Income, gains, expenses, and losses are reported on the Grantor's tax return just as if there was no trust.

Transferring and Dealing With Trust Properties

Transferring property to and from a living revocable trust can sometimes be cumbersome. Transferring listed securities to the trust may require filing a copy of the trust agreement with the transfer agent.

Buying and selling trust properties may also be cumbersome because the person dealing with the trust may insist upon an assurance that the trustee has the right to buy or sell the property. This may require providing that person's attorney with a copy of the trust agreement.

Your attorney or other advisor can often arrange the trust to avoid some or all of these problems. Property may be transferred to a nominee for the trust rather than directly to the trust.

A deed conveying real property to the trust may be executed but not recorded. In short, your attorney or other advisor can sometimes plan a living revocable trust that will avoid most of the potential problems and disadvantages.

GAINING MAXIMUM BENEFITS FROM THE TRUST

A Funded Trust Is Most Beneficial

Throughout this document we have made it clear that the Grantor of a living revocable trust can transfer most of his or her assets to the trust or he or she can transfer only a few assets or even none at all.

Placing all major assets in the trust will assure that these assets escape probate at the death of the Grantor and, further, that the assets will be managed by a successor trustee if the Grantor becomes ill, incapacitated, or simply is away on extended travel.

We recommend that the Grantor transfer to a living revocable trust basically all property, including, but not limited to, the ownership of business interests, listed securities and brokerage accounts, the residence, certificates of deposit, money market accounts, investment real property and tangible personal property.

Planning for Life Insurance Proceeds

We mentioned earlier in this document that a living revocable trust can be named as the beneficiary of a life insurance policy. This can be an excellent arrangement if the Grantor wants the insurance proceeds held in trust for family members after his or her death.

If life insurance proceeds are to be paid to the living revocable trust, it is generally good idea to authorize the trustee to pay creditors' claims, settlement costs, and estate and inheritance taxes.

A person with a large estate (a value in excess of \$5,430,000) may want to give ownership of his or her insurance to the individual beneficiary or to an irrevocable trust during his or her life. That way, the proceeds will not be subject to the federal estate tax at the death of the insured.

Planning an IRA And Other Retirement Benefits

A living revocable trust can be named as the death beneficiary of an IRA or employee retirement plan. Of course, there is no need to do this unless the Grantor wants the retirement death benefit held in trust after his or her death. This requires careful planning to avoid income tax problems.

The Living Revocable Trust Is Not a Do-It-Yourself Project

You will need the help of an attorney to plan, draft, fund, and administer a living revocable trust... especially if the trust is to continue after your death.

An experienced attorney can point out the potential advantages and disadvantages of various funding, administration, and asset disposition arrangements and — in many cases — the attorney can suggest funding techniques that will be the most efficient and economical.

A LIVING REVOCABLE TRUST CAN SUPPORT CHARITIES

Certainly, you can name a charitable organization as a beneficiary of your living revocable trust. The trust agreement can direct the trustee to pay the charity, at your death, a specified dollar amount, specific property, a percentage of the value of the trust, or the residue of the trust after other beneficiaries have been paid.

Your living revocable trust can also be continued as a qualified charitable remainder trust, a qualified charitable lead trust, or a qualified charitable QTIP trust.

Consider these possible arrangements:

- By converting all or part of your living revocable trust into a charitable remainder trust, designated income will be paid to one or more family members for life or for a specified number of years and, when these interests end, the remaining property will be paid to the charity.
- By converting your living revocable trust into a charitable lead trust at your death, the trustee will pay a designated annuity or variable amount to the charity each year for a specified number of years and distribute the entire trust property to family members after this period.
- By continuing the trust as a charitable QTIP trust, all income will be paid to your surviving spouse for life and your spouse will also receive as much principal as may be needed for his or her comfortable support. At the death of the surviving spouse any property remaining in the trust will be paid to the charity and used for a purpose you have directed in the trust agreement.

Conclusion:

The Revocable living trust can provide definite advantages over a will, jointly owned property, beneficiary designation or other methods of passing property at death. It should be carefully considered weighing the cost of drafting and funding against the potential savings in probate and administrative costs and the avoidance of the emotional costs associated with probate. A living trust gives you and your family the opportunity to make decisions and distributions without interference from the courts and the legal system. In the final analysis, either you make the decisions now, or the decisions will be made for you by the system following your death.