ESTATE PLANNING: THE LIVING TRUST

By William H. Coleman

In a prior article, we discussed the "will" as one estate planning document. In this issue we will discuss an alternative to the will as a basic estate planning instrument.

What Estate Planning Is

Before discussing the living trust, it is important to review the purpose of estate planning. One of the primary purposes of estate planning is to put in place a mechanism to pass one's property to intended beneficiaries. A will is one method of doing so. As discussed in the last issue a decedent's property passing by will is subject to a court supervised administration called probate.

What Probate Is

Through a probate a decedent's property is inventoried, debts and taxes of a decedent are paid and ultimately the decedent's estate is distributed to the intended beneficiaries. There are various fees which must be paid in a probate, such as court fees, executor's and attorney's fees.

Many clients desire to avoid the costs and administrative headaches of probate by creating an "inter vivos", or "living trust." Although a will would be signed along with a living trust, the living trust would be the primary estate planning document. Assets held within a living trust at the time of a person's death are not subject to probate.

As a preface to our discussion of the living trust you should know that there are certain assets which pass outside of probate, even if no living trust exists. Examples of such "nonprobate" assets include: property held in joint tenancy which passes on the death of a joint as a matter of law to the surviving joint tenant(s); life insurance proceeds which will be paid by the issuing insurance company to the decedent's designated beneficiary; and IRA and pension plan benefits which will pass to the decedent's designated beneficiaries. Probate will be required for most other assets unless a living trust is in place at death.

What a Trust Is

A trust is a document created by a "Settlor." The settlor appoints a "Trustee" and gives the trustee with the power and duty to hold, administer and distribute all property held within the trust (in accordance with the terms of the trust document) for the benefit of "beneficiaries" named in the trust.

In transferring property to a trust, the settlor "splits" the legal and beneficial ownership of property. The trustee becomes the legal owner while the beneficiaries become the beneficial owners.

The trustee, as the legal owner of property, has the power and authority to control and manage it for the benefit of the beneficiaries. The beneficiaries are entitled to all of beneficial interest in the property. For example, if you individually own real property, you hold both the beneficial and legal interests in that property. If, however, you transfer that same property to a trust the trustee of the trust will own the legal interest in the property with the obligation to hold, administer and distribute that property solely for the benefit of the beneficiaries.

Because the trustee of the trust holds legal title to the property, the property is not subject to probate upon the death of the settlor. Instead, the trustee continues to hold legal title to the property with the continuing obligation to continue to hold, administer and distribute the property in accordance with the terms of the trust instrument. If a trustee resigns, dies or is otherwise disqualified from serving the successor named in the trust instrument steps into his or her shoes as trustee. The trust, if properly prepared, gives continuity to the process of administering the trust. Similarly, if no successor trustee is available, the Probate Code sets forth a procedure to name a successor trustee.

The trust instrument will contain the same provisions as would be included in one’s will as to whom and how property within the trust is to be distributed on one’s death. The trust thus becomes the main "dispository document" in one’s estate plan instead of the will.

Benefits of a Living Trusts

In most situations where an individual or married couple create a living trust as settlors, they also name themselves as trustees. The trust will be revocable and can be amended by the person(s) creating the trust during their lives. The trust will be solely for the benefit of the settlors during their lives.

As is discussed above, one of the prime benefits of a living trust is that, generally, probate and many of the fees and costs associated with a probate court proceeding, can be avoided (or at least minimized).

There are other, more practical benefits to a living trust. In the case of a living trust created by a married couple, it is possible to provide that on the death of the first spouse, his/her interest in the trust will be transferred to one (or more) other trusts which will become irrevocable on the first spouse’s death. Typically such irrevocable trusts name the surviving spouse as the successor trustee, provide that all net income to be paid to the surviving spouse, and provide the trustee with the power to use the trust’s assets for the surviving spouse’s health, support and maintenance.

The reason for trust provisions directing that some part or all of the deceased spouse’s properties be allocated to one or more separate trusts is generally for one and/or two reasons. First, property in an amount equivalent to an "estate tax exemption" amount in the year of death can be protected from estate tax both on the first spouse’s death *and* the surviving spouses’ death. The estate tax exemption for persons dying in 1998 is $625,000. In 1999, the exemption goes to $675,000 and will increase annually up to $1,000,000 by the year 2006.

Second, you can insure that the first spouse’s property will be available to the surviving spouse during his or her lifetime, but on the survivor’s death, the property would pass to beneficiaries named by the first spouse. For example, A and B are married. A Dies. B, the

surviving spouse, would not be able to redirect the disposition of the A’s property upon the B’s death to beneficiaries other than those intended by A (and B) prior to A’s death.

In addition to avoiding probate, living trusts also provide an easy mechanism for a successor trustee to step into the shoes of a mentally or physically incapacitated trustee/beneficiary and thereby continue to manage the affairs of the incapacitated trustee/beneficiary.

To assure that all assets are ultimately transferred into the trust, even if they are not transferred prior to the death of one of the beneficiaries, a "pour over will" should always be prepared. A pour over will typically provides that any property of the decedent subject to probate (that is property which for some reason was not transferred into the living trust prior to death by the settlor) will be distributed to the living trust. Upon such distribution, the property would be held, administered and distributed in accordance with the terms of the living trust.

Administration of a Living Trust

Generally, the post death administration of a living trust is easier and less cumbersome than a probate. In both cases, many of the same events occur: The decedent’s debts, expenses and taxes (both income and estate) are paid and the balance is distributed to the decedents named beneficiaries. The main distinction is that if the decedent has properly transferred his/her assets into the trust, there is no probate action required. Probate court and related fees, which are based on the dollar value of the decedent’s assets, are saved. Thus, the larger your estate, the greater the probate fees (for the court and probate referee) and statutory attorneys fees.

Misconceptions

There are a few common misconceptions about living trusts. The first is that through the use of a living trust estate taxes can be minimized or avoided in a manner which could not be done through the use of a will. That simply is not true. The estate tax planning that can be accomplished through a will and a living trust is the same. You can, however, with appropriate planning, take steps to reduce the size of your estate prior to your death or to plan for the payment of the anticipated taxes and post-death administrative expenses through life insurance.

Another misconception is that with the use of a living trust, attorneys’ and accountants’ fees are avoided. That also is not true. In most cases it will be necessary (or at least advisable) to retain an attorney and an accountant to assist in the post-death trust administration. The attorney and accounting fees may, however, be less than they otherwise would have been if there had been a probate such fees will be incurred. Probate court fees and fees for a probate referee will, generally, be avoided if a living trust was prepared.

A third misconception is that one must have an estate large enough for the federal estate tax to be due upon death -- that is larger than the estate tax exemption amount -- for a living trust to be of value. That is not true. The benefits of a living trust, probate avoidance

and a mechanism for management in the event of incompetence, apply whether or not an estate is large or small if it otherwise would be subject to probate.

As can be seen, there are many benefits of considering a living trust a part of your estate plan. We, of course, recommend that you consult with an attorney experienced with all aspects of estate planning. Above all, do not do nothing. Otherwise, state law determines who is entitled to your estate upon your death; you will be left out of the decision. Since a will or living trust is often the last word you will have with your loved ones, it is important to take adequate steps to make sure *your* wishes are carried out.

If you have any questions about this article, or would like to meet with an attorney at Coleman & Horowitt, LLP please call us at (559) 248-4820.

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