DOES A REVOCABLE LIVING TRUST FIT INTO YOUR ESTATE PLAN?

Many people are using revocable living trusts as substitutes for wills in estate planning. This article will explain what living trusts are, some of their advantages, and ways to decide if a living trust is right for you.

What is a Revocable Living Trust and How Does it Work?

A living trust gets its name because it is a trust that comes into existence during the lifetime of the person (variously called the trustor, settler or grantor) who creates it. It is revocable because the grantor can amend or revoke it at any time. The grantor signs a trust agreement, which creates a separate entity, the trust, to own the grantor's assets.

A husband and wife can create a joint living trust by signing a trust agreement in which both are grantors. The characteristics of living trusts described in this explanation apply to both joint revocable living trusts and individual trusts.

Usually the trust agreement provides that the trust will hold and manage its assets solely for the benefit of the grantor during the grantor's life. The grantor can change or revoke the trust at any time. When the grantor dies, the trust becomes irrevocable, and the trustee distributes the trust assets according to the trust agreement's instructions. In this respect, the trust is much like a will, and can have the same terms for distribution of assets as a will.

A trustee, who is typically the grantor, manages the trust. The grantor will name a trusted individual or a bank trust department to be the successor trustee if the grantor loses capacity or dies.

For the trust to work properly the grantor must transfer his or her assets into the trust. However, despite these transfers, a grantor who is the trustee can write checks and carry on other activities the same as before. Others need not be aware of the trust's existence. In a sense, the trust will be "invisible."

Advantages of a Living Trust

A living trust has two main advantages over a will as the primary document in an estate plan:

1. Trusts avoid the need for conservatorships if age or illness robs the grantor of the capacity to manage his or her own assets.

2. Trusts avoid the need for probate on the death of the grantor.

Living trusts achieve these advantages because the grantor transfers his or her assets into the trust, leaving no assets to be put into a conservatorship or a probate estate. Of course if the grantor does not transfer assets to the trust, then these advantages are lost.

Avoiding Conservatorships

A conservatorship is a court proceeding to protect the assets of a person who has lost the capacity to manage his or her financial affairs. The court must decide the person needs protection, and appoint a conservator to manage the protected person's assets for his or her benefit.

The expense and emotional drain of a conservatorship can be avoided if the person establishes a living trust and transfers his or her assets to it before incapacity. Typically, the grantor is the initial trustee of the trust. If the grantor becomes incapacitated, the successor trustee named by the grantor will take over management, without court intervention.

A living trust is not the only method available to avoid a conservatorship. Powers of attorney can be used to give another person, an agent, the right to manage assets for you. However, a power of attorney is difficult to use for some types of assets, and cannot contain the detailed instructions on asset management typically found in trusts and depends on the availability of the specific person given the power.

Avoiding Probate

Probate is a court proceeding to supervise the disposition of assets following the death of the asset's owner. Probate is necessary any time an individual dies owning significant assets in his or her own name, whether or not the individual had a will.

Many people would like to avoid probate, because probate may delay getting assets distributed to loved ones and probate causes additional expense. Probate also requires public disclosure of personal information regarding assets and how they will be distributed. Joint ownership of assets, beneficiary designations, and the use of pay on death designations are all methods used to avoid probate. All these methods, however, have drawbacks. They are not adequate to describe an entire estate plan. They can create problems for the owner if a joint owner becomes bankrupt, or is otherwise subject to the claims of creditors. A joint owner may refuse to cooperate in the sale of property.

In comparison, a trust is an effective way to avoid probate. The grantor never gives up control over his or her assets. The creditors of others have no claim against trust assets. Unlike a simple bank form or a deed, a trust can contain a well-ordered estate plan, including provisions for disability or the premature death of a child.

Does a Living Trust Save Taxes?

A living trust does not reduce income taxes. All trust income is ordinarily taxable to the grantor during his or her lifetime as though the grantor had retained ownership of the assets.

A living trust also does not, by itself, reduce estate taxes. Although a living trust may be part of a coordinated plan to reduce estate taxes, we can reach the same estate tax result using wills. For married couples, a trust may achieve estate tax savings with less complexity than with wills.

Cost Versus Benefit

Estate planning with a living trust makes sense only if the costs of a trust are less than its benefits. For many people, particularly those who buy and sell assets frequently, the difficulty in keeping all the assets in the trust outweighs the trust's advantages. Those who are young or in good health may find that planning to avoid probate or a conservatorship is not cost effective.

There are costs to establish the trust and to transfer ownership of assets to the trust. There may also be some lifetime administrative costs and expenses. For example, if the trustee is someone other than the person who set up the trust, the trustee must file annual income tax returns, and may be entitled to compensation.

Even with a living trust, your estate will not avoid some costs commonly associated with probate. For instance, on your death the trustee, like the personal representative of a probate estate, will still have to inventory, appraise and transfer ownership of the assets. The trustee will also have to pay creditors, file income and possibly estate tax returns, and resolve disputes.

Only you can decide if a living trust is right for you. If avoiding conservatorships and probate are major concerns, then a trust is likely to be the clear choice. In addition, a trust can be the simplest estate planning vehicle for couples with potential taxable estates. However, a trust will be less suitable for those unable to transfer their assets into the trust, or who anticipate that they will be buying and selling assets frequently.

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