

REVOCABLE LIVING TRUST

You may have seen the advertisements for this type of trust - save thousands of dollars in probate costs, estate taxes - the panacea for all ills associated with the legal system and the government upon your death.

Sign up, order the package and you, too, can be saved from the hassles. Truth or fiction?

Like many highly touted "legal packages," there are two sides to this story. Revocable Living Trusts can be very useful vehicles to accomplish a number of purposes, but not necessarily the ones advertised.

Should you have one? Not a black and white decision. To use or not to use - a decision I will let you make since even attorneys don't agree on the answer.

We'll begin by looking at what it is. We can then look at it from the perspective of its advertised benefits and then from its multitude of purposes and functions.

The Revocable Living Trust is a trust which is created to hold and manage your property during your lifetime and to provide for the manner in which your property is to be distributed upon your death. The trust provides that you are the Grantor (creator), Trustee and Beneficiary of the trust. The trust can be changed or canceled at any time. You can put property in the trust and take it out as you desire. The trust holds legal title to your property but is ignored for tax purposes. For example, let's assume you transfer your home, your brokerage account and your bank account to the trust. The title to

your home would be in the name of the trust. e.g. Lee Jones would transfer her house to the "Jones Revocable Living Trust dated September 1, 1996, Lee

Funded vs Unfunded...When you create the trust, you may choose not to transfer all of your property to the trust at that time.

Jones, Trustee." Your brokerage account would also be changed to the name of the trust. The tax identification number for the trust is your social security number. Legal title would be in the trust, but you do not file

a separate tax return for the trust. All of the income in the trust is reported on your tax return as if the trust did not exist.

So what does the trust do? If you transfer all of your property to the trust, and if you become disabled, the person you name to act as successor Trustee to yourself would step in and manage the assets held in the trust until such time as you were able to do so. Also, if you transfer all of your property to the trust, you avoid probate. Probate is the process used to authorize someone to transfer your property from your name to the persons you named in your Will. If your property is all held in the trust, then probate is not necessary since the trust provides how the Trustee is to distribute your property

upon your death. However, you may not want to transfer your assets to the trust now, but you do want the trust to be available to manage your property in the event of your disability. You may also want the trust to be available should you later decide to use the trust to avoid probate. The trust then is a "standby" trust which is available should you choose

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to use it at a later time. If you never transfer your property to the trust, your Will is filed for probate to transfer your property to the trust upon your death. Whenever you have a Revocable Living Trust, you will also have a Will which states that you direct that all of your property be distributed to the trust. This type of Will is called a "pour over" Will since it provides that your property is "poured over" to the trust. Even if you decide to transfer all of your property to the trust, to "fully fund" it, you will still have a "pour over" Will. Frequently, even with a fully funded trust, one item is left out, for example your car, or an item is later discovered, e.g. non-producing mineral interests which begin producing. If a single item is omitted, your Will must be filed for probate.

Now let's look at the two biggest advertised benefits - avoiding probate and saving taxes.

Does the Revocable Living Trust avoid probate, saving you thousands of dollars, preventing your estate from being tied up

in this time consuming and costly process? Yes, you avoid probate and if probate is time consuming and costly, and since a revocable living trust avoids probate, it would save you the time and cost. - So is probate time consuming and costly? Not in Texas, not if you name an Independent Executor.

But before we look at probate in Texas, let's look at probate in California, the state in which the Living Trust was born. Probate in California is expensive. California probate fees (the fee paid to an attorney to probate your Will - that's what a good legal lobby will get you) are fixed by statute and are based on the value of the property passing through probate. As an illustration, the probate fee of a \$200,000 estate is \$10,300, a \$500,000 estate is \$22,300 and a \$1 million estate is \$42,300. Hmmm, now that is a cost to be avoided. Generally, the fee to be paid to the Executor is similar to the fee to be paid to the attorney, so you can double those amounts. And time consuming? Time consuming in the sense that all actions taken by the Executor must be authorized by the court - translation: an application must be filed, a hearing held and an order entered.

Now what is probate like in Texas. Texas has the simplest probate procedure in the United States.

In Texas, if you have an individual you trust to handle your estate, you can name

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that person your "Independent Executor". An Independent Executor acts

independently of the probate court, in other words the Independent Executor does not need the court's authorization to act. Your Will is filed for probate and about two weeks after filing the Will, a hearing is held at which your Executor or some member of your family states under oath facts concerning your death, your residence, your family situation and that

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the document filed is your Will and has not been revoked and that the Executor is qualified to serve. Your Independent Executor signs an Oath stating that he/she will perform his/her duties properly. Your Independent Executor never goes to court again. No more hearings are ever required. The only other action required is that your Independent Executor must file an Inventory of your assets which are subject to probate. Assets such as retirement plans and life insurance policies with a beneficiary designated pass directly to the beneficiary and are not part of your probate assets.

So does that cost a lot of money and is it time consuming? The cost for probate is about \$1,500.

That cost is the probate cost and does not include any cost related to the

And time consuming?

administration of an estate, transferring title, funding the trust or preparation of tax returns. But the fee mentioned above for California does not include any of those costs either. And these costs are also incurred when you have a Revocable Living Trust. So the cost that is saved is the probate cost.

And time consuming? Assuming there is no Will contest, which is a separate issue

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and will be discussed later, the time delay is about two weeks after filing the Will for probate.

Let me say that I took this efficiency for granted. This short time delay is the delay required by the statute. I have always been able to have a hearing in the first week that the statute allowed a hearing in Dallas County. A few years ago I filed a Will for probate in Tarrant County and the first date available for a hearing was five weeks away, a delay I have never

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experienced in twenty years in Dallas County. Time consuming? No. Time delay? minimal - two to five weeks. With a Revocable Living Trust, the successor Trustee can begin to act immediately, a time factor which might be important if the estate owns time sensitive, highly traded stocks for example.

A caveat in terms of appointment of an Independent Executor -

The good thing about the appointment of an Independent Executor is that your Executor does not need the court's authorization for all actions, is not supervised by the court and does not need to file an accounting for all of his/her actions. The bad thing about the appointment of an Independent

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Executor? - you're right, the same things. If you name a person who is not completely honest, completely trustworthy, well organized and/or who does not keep the beneficiaries of your estate informed, there is no one to check on him/her. It is an important decision, not to be taken lightly - and for the Executor, a significant responsibility, not to be accepted casually. But an extended discussion is not appropriate here - just noted.

What about the big tax savings?

The tax savings obtained in a Revocable Living Trust are not unique to the Revocable Living Trust; they are simply the basic estate planning techniques used in any tax planned Will. What are these techniques?

First, a tax planned Will includes the creation of a trust for the surviving spouse in order to preserve the use of each of the spouse's exemption amount (\$1 million in 2003, \$1.5 million in 2004, \$2 million in 2006, \$3.5 million in 2009 but see the

Transfer Tax overview for the changes in the exemption thereafter). This trust has a multitude of names including a Bypass Trust, an Exemption Equivalent Trust, a Credit Shelter Trust, a Family Trust, or B Trust, just to name a few. A tax planned Will also uses the marital deduction available for gifts to the survivor to eliminate all tax on the death of the first spouse to die. The trust may include other tax planning, but none of the tax planning contained in the trust is tax planning which cannot be included in a Will.

Well ... are there any reasons to use a Revocable Living Trust?

Yes, let's look at a few –

- ▶ Avoid probate in other states.

The costs of probate in California is typical of most states and should be avoided. If you own property in other states, the use of a Revocable Living Trust which is funded with only or, at a minimum, the assets in other states, is worthwhile from a cost, time and hassle standpoint.

- ▶ Minimize the likelihood of a Will Contest.

If you anticipate a Will contest is a possibility, consider the use of a fully funded Revocable Living Trust. If a Will contest is filed when the property passes through probate, the Will is not admitted to probate and the Independent Executor is not appointed. The estate is frozen.

Minimize the likelihood of a Will Contest.

The court appoints an administrator to handle the estate while the Will contest is pending -- and, the cost is similar to probate in California -- or even worse. It is more difficult to contest a Revocable Living Trust. First, no Will is filed which the contestant can challenge. The "leverage" of the Will contest filing is lost. The contestant must assert that the property in the trust is properly an asset of the estate. The only person who has the right to make this claim is the Executor of the Will, generally a person who is not the contestant. The whole process becomes much more complex.

- ▶ Avoid the possible hassles associated with a power of attorney in the event of disability.

Everyone should plan for the management of their property in the event of their disability. If no plans are made and you become disabled, your family will generally have to have a guardian appointed through the courts. The cost is similar to probate in California. The

Avoid the hassles associated with a power of attorney in the event of a disability.

process is emotionally draining at a time when emotions are already drained. You can use a power of attorney to provide for the management of your property in the event of your disability, but there can be problems associated with the use of a power of attorney. Unfortunately, some third parties, e.g. banks, may be reticent to accept the power of attorney.

- ▶ Provide additional protection and safeguards in the management of your property in the event of your disability.

The protection provided is designed by you. When an individual manages your property using a power of attorney, he reports to no one. The person who is given the power must use your property solely for your benefit according to the terms of the power, so a use of the funds for any other purpose would be a violation of the power. However, when a person is not reporting to anyone, the temptation to abuse the power increases. Not only does the use of a power of attorney increase the possibility of abuse, but even more frequently it dramatically increases the perception or suspicion of abuse. If one child holds a power of attorney and is handling all matters for Mom and tells his siblings that he is handling everything - not to worry, they begin to do just that - worry - about Mom's welfare and about the welfare of their inheritance. Generally, the imaginations of the siblings as to the possibility of abuse far exceed reality. Splits are created in families that are hard to repair.

A situation in which I strongly recommend using a revocable living trust is an elderly person with no spouse, child or other individual who would be appropriate to handle the property matters for that person in the event of disability. The structure of the trust depends on each individual situation. For example, the trust

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may name a team which includes a bank or trust company to manage the property and an individual to supervise the care of the client. Another structure might be to name an individual Trustee to handle all matters with a team of three people serving on a Trust Committee to whom the Trustee reports. The team then provides a safety net with regard to the Trustee's actions. The structures of the trust can be as varied as each client's individual situation. One power I have begun to include is the authority to hire a personal care manager. An understanding of the progress of a decline in capabilities as we age and a knowledge of the resources available to allow us to continue to operate at the highest level is a very important factor to our continuing quality of life.

- ▶ Provide privacy regarding the nature, size and disposition of your estate.

Let's review how the trust works. The trust holds legal title to your property. The trust provides for the disposition of the property during your lifetime and upon your death. If all of your property is held in the trust, no probate is necessary and no public record of your estate is filed.

If you do not have a trust, your Will is filed with the County Clerk (for probate) and a list of all of your "probate assets" are filed in the probate court. Your Will and a list of your assets are all a matter of public

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record which anyone can see. Your Will sets forth the persons who are to receive

your property. The "probate assets" are all assets which are held in your name and are not subject to distribution upon your death according to the terms of some type of contract. For example, the distribution of life insurance proceeds and retirement benefits are controlled by the beneficiary designation and thus are not probate assets. Joint accounts which provide that the survivor receives the property (joint tenants with right of survivorship) are distributed to the survivor upon one of the joint tenant's deaths and thus are not probate assets.

Any property held in a revocable living trust is not considered a probate asset. However, even if you do not transfer all of your property to the trust you still gain a significant amount of privacy. For example, let's assume that you have a large estate and you do not want the size of your estate to be a matter of public record. If you transfer your brokerage accounts, your home and your vacation home to the trust but fail to transfer your cars and some bank accounts to the trust, the only property that will be listed in the probate court will be the cars and bank accounts which are not transferred to the trust.

- ▶ Avoid the hassles of probate.

As I mentioned earlier, the probate procedure is relatively simple and in Dallas County, the Will usually can be probated within a few weeks from the time it is filed. An inventory is filed three months later. This procedure is simple and when I began practice, I did not consider it a hassle. But I am an attorney,

Avoid the hassles of probate.

and to me it is a simple matter, a simple procedure. However, I have come to realize that any action taken upon the death of a loved one can be a hassle - can loom larger than life - and all our energy is all being used to cope emotionally. If there are delays in having the hearing as I had in Tarrant County, this delay can make funds inaccessible and compound the hassles of daily living. So, there is a benefit to avoiding even the simplified probate that we have in Texas. The trust avoids a few additional steps and eliminates the possibility of a delay in probating the Will. Each hassle eliminated at this time can be a blessing.

I find the whole issue interesting. The benefits which frequently are touted in marketing can be misleading and can cause individuals to choose a revocable living trust for the wrong reasons. But there are reasons to use a revocable living trust. The “real reasons” are a little more subtle and more individually determined. An individual may have a reason to use the trust which is just as compelling to that individual as the reasons for which it is marketed, but as you can see - it is your individual situation, and you need to determine whether a revocable living trust is right for you.

- ▶ Flexibility - a “new” benefit.

With the passage of the Tax Act in 2001 which purportedly repealed the estate tax we began operating in very uncertain territory. We have always been subject to possible future changes in the law. However, this Tax Act had radical changes built into the law itself. The law provides for an increasing exemption with \$1 million in 2003, \$1.5 million in 2004,

\$2 million in 2006 and \$3.5 million in 2009. In 2010 there is no estate tax and in 2011 we return to present law with a \$1 million exemption. In 2010 the law also provides for a carry over basis. Our method of planning suddenly shifts from transfer tax reduction to maximizing the basis adjustment in effect when the estate tax is repealed. Planning for this shift is a challenge. This situation results in one type of tax planning to be most effective in 2009 and 2011 and another to be most effective in 2010. As 2010 approaches we will be able to revise the plans of our clients if the law remains in effect as written. However, what if there is a disability and the plan cannot be revised to adjust for the shift in the law in 2010? A Will cannot be modified by anyone other than the person making the Will. A trust can be modified by another person who is given that authority or by a court under limited circumstances to meet the intent of the grantor. To provide some flexibility to adjust to the changing law, a Revocable Living Trust can be used which includes authorization for the court to modify the trust for the purpose of optimizing the tax benefits available under the law in effect at the time of the grantor’s death. The trust must be structured so that a change for this purpose does not change the beneficial interests under the trust.

If the trust is not funded it operates like a Will yet it is available for the other reasons discussed above. Its use as a management vehicle in the event of disability, privacy and immediate access to the funds are not as compelling as the tens of thousands of dollars saved in probate costs in a state like California. However, I have come to appreciate these subtle benefits the longer I practice.

With the passage of the 2001 Tax Act and with the additional flexibility the Revocable Living Trust allows with community property retirement benefits, I have begun to use the Revocable Living Trust much more frequently. In these situations I do not fund the trust unless the client desires some of the other benefits set forth above.