CHAPTER 49

Revocable Living Trusts, Pour Over Wills, and Probate Avoidance

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Should I have a Revocable Living Trust? Why? These are the first of many questions new clients ask their estate planning attorney. In order to properly answer these questions, the clients' goals, dreams, hopes, fears, concerns, needs, and plans for themselves, their families, and their loved ones need to be analyzed. Each family has unique planning concerns, and each plan should be customized to accurately reflect those goals and dreams in order to satisfy the three basic principles of estate planning: maintaining control during incapacity; expedient and cost-effective wealth transfer at death; and legacy planning to protect beneficiaries.

So, what is a Revocable Living Trust? A revocable or "living" trust (RLT) is a legal document utilized as a will-substitute. Like a will, the trust names beneficiaries who inherit your property upon your death. The trust document sets the criteria and conditions by which the property is to be held and distributed. Many clients use a RLT to maintain control of assets in the event of incapacity or death, distribute assets in a timely and cost effective transfer at death, and to avoid probate.

To the layperson, trusts can appear complicated. However, they entail use of fairly simple concepts, which include a set of instructions about how you want your "stuff" managed when you are not able to do so yourself, whom you want to manage it, and for whom you want it managed.

The RLT is initiated upon the signing of the trust by the grantor and trustee and funding the trust, which puts the trust legally into place. The trust is designed to continue during the grantor's lifetime and may be designed to continue after his or her death. A RLT is a legal entity established by you, the grantor (the person creating the trust, either individually or jointly, e.g., husband and wife), with a trustee (the person or entity managing the trust property, again, either individually or jointly), and a beneficiary (the person or entity for whose benefit the trust is managed and administered, which is typically the grantor until death).

A grantor may, should, and usually does, name himself or herself as trustee of a living trust during his or her lifetime, and should name a series of successor trustees to act upon the grantor's incapacity or death. At the grantor's death, the successor trustee distributes the assets of the trust in accordance with the trust directions.

The grantor of a revocable living trust can change (amend), or revoke (terminate) the terms of the trust any time after the trust is initiated. This means you can revise, cancel, and/or change trustees and beneficiaries during your lifetime. Using a "revocable" trust, you reserve the right to assert complete control of the assets and change the terms of the trust whenever you like, as long as you have the capacity to do so.

Funding or re-titling property into the name of the trust is a critical step to trust implementation. Unlike a will, assets held in trust do not have to go through probate. Thus, the assets are distributed to beneficiaries without the costs and delays typically associated with probate proceedings. A funded RLT is designed to avoid the procedural requirements of probate, as well as the possible costs and inefficiencies related thereto. Assets funded to the living trust do not have to go through the probate process because, although the trustmaker of the trust has died, the trust, as the owner of the assets, remains. It is important to note, however, that probate is avoided only for the assets titled to the name of the trust while the trustmaker was living.

> **RLT SCENARIO 1:** Mr. X creates a RLT. The terms of the trust state that on his death his assets will go equally to his children. He has a fully funded trust and upon his death, his son, as his successor trustee, divides the trust assets among his siblings and transfers title of those assets to them.
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> **RLT SCENARIO 2:** Mr. & Mrs. X create a joint RLT. The terms of the trust state that upon the death of the first of them, the spouse will continue to be the trustee and continue to use the trust assets, and upon the death of the second of them, the assets will be divided equally among their three children and put into legacy trusts for asset protection.

Many methods and strategies used to reduce estate tax liability involve RLT-based estate plans. A RLT with tax provisions is designed to maximize the use of both spouses' unified credit exemption amount — the "credit" against federal estate taxes. An A-B Trust, referred by some as a "Credit Shelter Trust," "A-B Bypass Trust," "Bypass Trust," or "Federal Credit Trust" can be used to reduce, and, in some cases, eliminate, federal estate taxes, also known as the "death tax," by taking full advantage of the combined value of the marital deduction and the unified credit. Usually, RLT-utilized tax planning is created by married couples whose estate currently exceeds, or will grow during their lifetime to exceed, the federal estate tax exemption.

With a RLT, you maintain complete control of your assets as long as you have capacity, and then the successor trustee of your choosing takes over for you, temporarily upon your incapacity, and then permanently at your death, based on your specifications. Upon incapacity, you can avoid expensive court proceedings for a conservatorship. Upon death, you can transfer "protected" assets to your beneficiaries according to your wishes, with a minimum of cost and delay, and avoid costly lawsuits due to will contests. Note that the RLT does not create adverse income tax or property tax consequences during the lifetime of the grantor. The trust is classified as a grantor trust by the IRS, and all income the trust assets generate is reported on the grantor's individual income tax return.

Some advantages of using a revocable living trust-based estate plan:

- RLTs may eliminate issues that can arise when certain financial entities apply 'expiration dates' to Durable Powers of Attorney.
- RLTS may reduce estate and gift taxes.
- RLTs are private and confidential. Survivors do not have to reveal the extent of the trust's assets through a public filing that would occur through the probate process. (A will mandates probate.)
- RLT assets avoid probate. Titling your local and out-of-state real property to your trust avoids probate in every state where the property is located.
- RLTs provide for your incapacity/disability. Your successor trustee steps in without court action or intervention to manage the trust property according to your directions in the event you, the grantor, become mentally or physically incapacitated, until such time that you are physically capable of managing your own affairs again.
- RLTs typically reduce the time required to settle the estate affairs after death, because unlike the probate process, there are no set administration time periods that tie up assets.
- RLTs avoid court intervention. Your estate is handled by the trustee you name in your trust, in accordance with your instructions.
- RLTs protect assets for your spouse, through the family trust (tax planning trust).
- RLTs can utilize special needs planning to protect a dependent's needs-based government assistance, such as SSI benefits. An inheritance given outright (not in trust) to such an individual could be more harmful than helpful as it could disqualify them from receiving their benefits for the statutory penalty period.
- RLTs protect assets for your beneficiaries through legacy planning. Legacy planning provides for children who are not good with money, and protects their inheritance from future divorces, judgments, bankruptcy, creditors, and predators. As long as funds are available, subject to your state's Rule Against Perpetuities, your RLT can continue to operate indefinitely, passing from your children, to their children, and so on, for generations.
- RLTs may include remarriage protection. This type of clause, when included in a RLT, protects trust assets for remainder beneficiaries in the event the surviving spouse remarries, ensuring the inheritance

eventually goes to the beneficiaries whom both spouses, as co-grantors, originally intended.

- RLTs may include business management planning, such as directions for management of your business, in order to facilitate a smooth transition of business management.
- RLTs may include court contest planning, utilizing no-contest provisions to make your estate less susceptible to attack by disgruntled heirs. Only beneficiaries of the trust have standing to sue, but a no-contest clause acts as a deterrent, putting them at risk of being disinherited if they do so.

A pour over will works as a safety net for the RLT, protecting assets left outside of the trust, either because they were not titled to the trust, or because they were made payable to the name of the estate. Upon the death of the last grantor, assets left outside of the trust will go through probate if necessary, and then be "poured over" into the trust, to be distributed according to the terms of the trust. Property passing this way is subject to probate requirements. In many states, if there are no assets outside of the trust, the will does not need to be admitted. If you have minor children, the pour over will also serves to name their guardians and conservators.

> **SCENARIO:** Ms. Y creates a RLT. The terms of the trust state that upon her death, her assets will be divided equally among named charities and her nieces and nephews. She transfers her primary residence into her RLT, but does not transfer some rental real estate, or any other assets, to the trust. At her death, the trust can distribute the primary residence through the trust, avoiding the probate process. However, the rental property and any other asset subject to probate will have to go through the probate process according to the laws of that state. After the probate process has concluded, based on the directions of the pour over will, the assets will be transferred to the trustee, who will then distribute the assets according to the terms of the trust.

Many clients implement a RLT to avoid probate, thereby avoiding delay and expense. Probate is a mandated legal process supervised by Court, in which an executor is nominated; the will is validated; heirs and beneficiaries are identified; all assets are identified; an appraisal is prepared if required by the court; a Judge enforces the will instructions; the Court orders payment of debts and taxes; any will disputes are settled; and, finally, the assets are transferred to the beneficiaries. The probate process was carefully designed to fairly transfer assets to the beneficiaries and creditors of an estate. However, many factors, such as the character of the specific assets, valuation problems, creditor claims, and will contests, can cause difficulties and obscure the true intent of the testator. Understanding the process and the significant distinctions that exist between States can help you determine if probate avoidance is truly your goal. If complications surface, the process can be more time-consuming and expensive. However, it is important to note that many estates are not complicated and the probate process may not be as onerous as initially perceived.

When asking yourself if a RLT is appropriate for your situation, consider the array of estate planning tools available to meet your specific needs, and work with a knowledgeable estate planning attorney who will apply the three basic principles of estate planning to assist you — planning for life, dealing with death, and providing legacy planning for your loved ones.

Wilson Law, PLC specializes in Estate, Legacy Preservation, Asset Protection, and Special Needs Planning. Our goal is to help families plan for life, deal with death, and allocate a legacy.