Revocable Living Trusts:

Family Values, Vision and Planning

As the use of a revocable living trust for estate planning has increased in popularity over the past two decades, it has been seen primarily as a planning tool to be used only by families with taxable estates. While a revocable living trust can be designed to deal quite effectively with estate tax issues, its real superiority over other methods of estate planning focuses on planning for the myriad of non-tax family issues.

Many think of estate planning as being synonymous with tax planning, but estate planning more fully encompasses issues far beyond the financial size of the estate. As families and estate planners work through this era of tax uncertainty, the revocable living trust transcends the potential for estate tax repeal and provides a mechanism to meet the diverse and complicated issues of both tax and family planning.

For those who do not thoroughly understand trust planning, the assumption has been that trusts are only for large estates. How many times have you heard, **"We don't need a trust; our estate is less than $1million dollars."**?

While tax planning is an important facet of estate planning, and frequently the motivating factor for our clients, all agree that foremost in benefits is the preservation of their family values and family vision, all encompassed within a thorough plan.

On the following pages, explore with us some of the more common issues you may face as you plan for yourselves and future generations.

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"The best proof of love is trust."

Plan for the ones you love!

1. Passing property in trust to a surviving spouse does a better job of making sure that a married couple's plan stays on track.

Most married couples, particularly in a first marriage, share these basic planning goals: the property of the first spouse to die should pass to the survivor who can use, control and enjoy all of the property until the survivor's death; then, at the survivor's death, the remaining property should pass to that couple's children in equal shares.

The revocable living trust is one of the best tools available to make sure that all of the goals of this plan are met.

If a trust is not used and property is transferred outright to the surviving spouse, the couple's goals may be partially or completely defeated, particularly if the surviving spouse remarries.

A typical married couple has wills that leave everything to the other. Often, married couples own some assets jointly. The survivor "inherits" the marital assets by simply being the surviving spouse. Similarly, each spouse will typically name the other spouse as the primary beneficiary on property that passes by beneficiary designations such as life insurance, annuities, IRAs and qualified benefit programs. Consequently, all the marital assets end up in the name of the survivor.

Upon remarriage, property received by a spouse outright may be lost to a new spouse. This can happen either inadvertently or intentionally. If the surviving spouse remarries after the death of the first spouse, the spouses in this new marriage may, without really thinking about it, title some or all of their property in joint tenancy or create marital property interests.

If the original surviving spouse is the first to die in the remarriage, the property titled with a marital interest in the new marriage will pass automatically to the new spouse who then has no obligation to pass that property to the children of the original couple.

Although the children of the original marriage were meant to receive the property, it will likely be passed to the family of the new spouse. The children of the first marriage were "disinherited" simply because the parents did not understand the impact of spousal transfers. In addition to the possibility of outright spousal transfers inadvertently causing problems, the surviving spouse who receives his or her property outright may simply choose to give some or all of the property to the new spouse.

As we can see, transferring property outright leaves the surviving spouse with the ability to transfer the inherited assets, either mistakenly or intentionally, to a new spouse thus preventing the property from ending up in the hands of the children of the original marriage.

This is not what most couples intend. The most effective solution to these problems is for each spouse to leave property to the other in trust, rather than outright.

Property left to the surviving spouse in trust can contain the simple directions that the surviving spouse may control, use and enjoy the property but only for himself or herself and the children. Property in a properly designed trust cannot inadvertently end up as joint tenancy property nor can it be gifted to a new spouse.

When the surviving spouse dies, the trust provides that any of the property not consumed by the surviving spouse or the children will pass, according to the terms of the trust, to the couple's children or other designated beneficiaries. The use of a trust also prevents the surviving spouse from being free to give the property to a new spouse at death.

Thus, with a trust, the first spouse of a couple to die can eliminate the possibility that either through inadvertence or intentionally his or her property will end up in the hands of a new spouse or the new spouse's family, rather than the original couple's family. For most couples, it will be the most effective way to meet the basic estate planning goal.

2. Passing property in trust to a surviving spouse provides protection from that spouse's creditors, including a future spouse and nursing homes.

Married couples have the choice of leaving property outright to each other when the first of them dies. When this is done, either by use of a will, joint tenancy or a direct beneficiary designation, the surviving spouse becomes the new owner of the property left to him or her by the deceased spouse.

A person's own property is subject to the claims of his or her creditors. Exposure to these creditors can include liability due to professional or business activities, or inadequate homeowner's or automobile coverage. In addition, if the surviving spouse chooses to remarry, his or her new spouse, in the event there is a divorce, also becomes a potential creditor. Plus, the creditors of the new spouse may also have a claim against all the assets of the new marriage.

A trust can be drafted so that property left in trust to a surviving spouse will not be subject to the claims of the surviving spouse's creditors since trust property, unlike property transferred outright, will not be seen as owned by the surviving spouse. This is true even though the trust allows the spouse to use that property to support his or her existing lifestyle.

Property passed to a surviving spouse outright is potentially subject to division in the event of divorce after remarriage. Although divorce law of most states provides some protection for both property brought to the marriage and inherited property, that protection is not ironclad and may be very weak.

In the event the surviving spouse requires nursing home care, the surviving spouse must pay for the care to the extent the spouse has financial resources. If the assets of the deceased spouse are left outright to the surviving spouse, they become the assets of the surviving spouse. As a result, all these assets must be consumed before the surviving spouse will qualify for Medicaid.

On the other hand, assets left for the benefit of the surviving spouse in certain types of trusts are made available for nursing home care only at the discretion of the trustee. Assets in these trusts are not "countable" for purposes of determining Medicaid eligibility.

Therefore, the surviving spouse qualifies for Medicaid even with unspent assets still in the trust. The trustee is then able to provide benefits for the surviving spouse that are not available through Medicaid or other governmental programs.

3. Passing property in trust avoids probate.

At the time of death there are costs associated with passing property from the deceased owner to the designated beneficiaries, even to a spouse. Unless a trust is used to transfer property to the designated beneficiaries, property that is owned in a person's own name will be required to go through the probate process as part of post-death administration.

The cost for using probate can be substantial. Most of this amount is made up of attorney's fees. A fully funded revocable living trust, regardless of the size of the estate, can reduce much of the cost.

Moreover, the transfer process is completely private and is usually completed much more quickly, particularly if no estate tax is involved. Speed and privacy can be of particular importance when passing on the family business or other sensitive assets or if family issues dictate private settlement.

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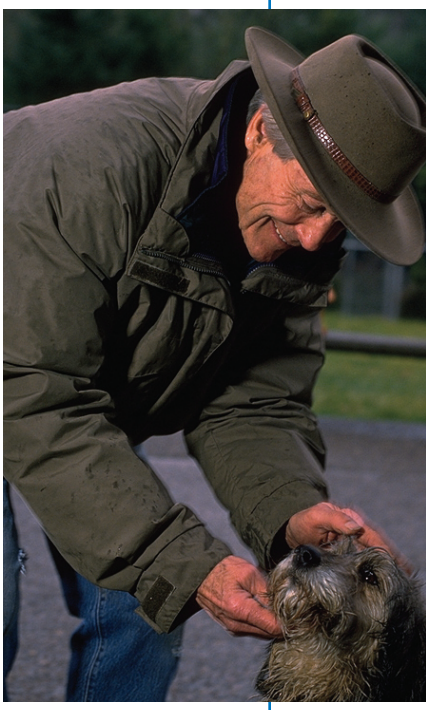
4. The trustmaker names the trustee.

Having the right person in charge of managing property is an essential element of good planning. If a person becomes incapacitated, he or she can leave detailed instructions concerning the desired level of care. Just as importantly, a trustmaker can personally select the trustee who will carry out the instructions. Knowing who will serve as trustee gives the trustmaker the opportunity to discuss how the trustmaker wants the trustee to make decisions in the future.



Through planning with a trust, a trustee can be pre-selected to serve if any of a number of circumstances occur, such as: (i) incapacity of the trustmaker; (ii) death of the trustmaker; (iii) incapacity of the trustmaker's spouse; (iv) death of the trustmaker's spouse; (v) surviving minor children; (vi) surviving immature adult children; (vii) the desire to include creditor protection for the surviving spouse or other beneficiaries; (viii) a surviving heir with special needs; (ix) the need or desire for professional management; or (x) heirs who suffer from addictions or who are susceptible to undesirable influences.

In the event the pre-selected trustee is unable to serve when the time arises, a trustmaker can name any number of alternate or successor trustees. Since a trustee has the fiduciary responsibility to follow the instructions left in the trust, the trustmaker can be assured that the designated plan will be followed.

5. A trust is the best way to manage property during a period of incapacity.

An often overlooked value of trust planning is the management of property during periods of incapacity. The trustmaker not only has the ability to name who will serve as the disability trustee, but with proper design the trust will establish the guidelines and instructions for the care of the trustmaker and other beneficiaries.

For example, these instructions may express various preferences during a period of incapacity, such as:

(a) home care should be provided to the disabled trustmaker rather than care outside the home;

(b) trust assets may be used to provide assistance to children, grandchildren, parents, or other relatives who incur an emergency situation; or

(c) instructions for care of a spouse may be included in the plan.

If there is no trust, the two most common methods to manage a person's property, if he or she becomes incapacitated with a stroke, Alzheimer's, or other illness or injury, is a guardianship or a durable power of attorney. Neither is as effective as a trust.

Those who do not engage in any planning will usually need a family member to petition the court to have a guardian named. Court proceedings are expensive and time consuming, and they impose limits that may not always serve a family's needs. Continuous annual reporting to the court results in further cost and court intervention.

"The only thing you take with you when you're gone is what you leave behind."

The durable financial power of attorney might be used to avoid the need for guardianship, but this technique also has limitations.

A power of attorney names a person who will be in charge of the incapacitated person's property, but most durable powers of attorney do not effectively leave detailed instructions for the management of property.

As a result, the person holding the power of attorney effectively has a "blank check" access to the assets of the incapacitated party with little or no oversight.

Placing instructions in the power of attorney like those placed in a trust is seldom done and is typically not effective. For guiding instructions to work the best, they should be part of a revocable living trust.

In addition, trusts seldom suffer from the reliability problems that plague durable powers of attorney when there is an actual need for use.[1]

6. Families with minor children should use trust planning.

Parents routinely name minor children as primary or contingent beneficiaries on life insurance policies or retirement benefits without realizing the potential planning nightmare. Minor children, by law, are not permitted to inherit property or receive property by beneficiary designation.

Therefore, if upon the death of a parent, a minor child will receive a distribution, the court imposes a court directed trust over the proceeds, which also continues only until the child's eighteenth birthday.

This can result in a number of undesirable consequences. While the spouse may be the guardian of the children, the court may exercise its discretion to appoint a third party as the custodian of the children's assets. Is it desirable that the surviving parent be dependent upon another party to dole out money for the care of the family?

When a court sets up a trust for a minor beneficiary, it supervises the administration of the trust through an annual accounting. Consequently, even when a spouse is named as the trustee for the children, the spouse must account to the court as to how the money was spent. This reduces family flexibility and adds to the cost of administration.

The court's jurisdiction over a minor ends upon the child becoming an adult at age eighteen. Few eighteen-year-olds are sufficiently mature to receive an inheritance which can result in the "Red Ferrari Syndrome." The money that has been carefully saved for college gets invested in a shiny new sports car.

Rather than involving a court, a parent can create a trust for the benefit of the children and select the trustee. The trust will not end until the time the parent designates and the college savings will be used as planned.

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7. Equal is not always equitable.

Without planning, property will be distributed equally to the children when both spouses are gone. Is that the correct plan for the family? Should the cardiologist get the same distribution as his "special needs" brother?

What if the children are four years apart in age? If distribution to the children occurs when one is age 18 and the other is 22, it is likely that the older child received help with post-high school education while the younger child received none. If they inherit the same amount, the younger child will spend the inheritance on college expenses, while the older child, whose college was paid by the parents, is left with a windfall.

A trust allows parents to create the plan that is right for their family and equitable to all beneficiaries.

8. Possible translation of having no plan is "Mom and Dad didn't care."

With no plan in place, the message that is sent to the family is that Mom and Dad did not care sufficiently about the family to create a plan. The children are left to untangle the legal web and are reminded at each step that their parents did not think they were worth the time to plan.

9. Passing property in trust to children and other beneficiaries provides them with creditor and failed marriage protection.

We have already seen that trusts can provide remarriage and creditor protection for the surviving spouse. There are also significant benefits to passing property in trust to children and other beneficiaries rather than distributing the property outright.

Property left to a child or other beneficiary in a correctly designated trust will be seen as owned by the trust rather than the individual beneficiary.

The beneficiary may be a co-trustee of the trust, have the use of the trust assets and income to maintain lifestyle, and control the investment of the trust property, but the property will still be protected from the beneficiary's creditors, including those from a failed marriage, or the creditors of your beneficiary's spouse.

10. Property transferred in trust can protect a beneficiary from investment mistakes or the schemes of predators.

When property is left outright to children or other beneficiaries, all in a single lump sum, that property may or may not be invested wisely, depending on the choices the beneficiary makes. If the beneficiary is free to make decisions with respect to the entire amount left to the beneficiary, then one mistake could cost that beneficiary his or her entire inheritance.

One way to avoid this difficulty is to leave property in trust, at least for a period of time, and then allow payouts to be made on an installment basis. That way only the portion of the property that is distributed free of trust would be lost because of a poor investment choice or because the beneficiary was scammed by an unscrupulous person. The property which remains in trust, if it is properly designed, will have a co-trustee to prevent this sort of tragedy from occurring.

11. Maintenance of family values through multi-generational planning is possible.

Particularly in larger estates, the assets available for distribution to children may exceed the amount needed for maintenance of their lifestyle. Rather than leaving all of the property to children, lifetime trusts for the benefit of children can be created, with the unused assets remaining available for the use of all future generations. As each generation passes, the trust fund continues to benefit grandchildren, great grandchildren, and beyond. Incentives can be designed in the trust plan so that the trustmaker's family values can be woven into the distribution requirements and beneficiaries will not be eligible to receive distributions unless certain standards of conduct are maintained. The trust can pay for the professional help necessary to return a beneficiary with drug, alcohol or emotional problems to a meaningful role in society. These trusts can also be designed so that there is no estate tax as the trust assets pass for the use of each subsequent generation.

12. The need for tax planning continues because the federal estate tax is still in effect today.

Good planning is always based on the situation that exists today with an eye to tomorrow. The reality is that if your estate is taxable today, and you or your spouse die today, you will have lost the significant tax avoidance opportunity to which your family is entitled.

Congress is constantly tinkering with the exemption amount and what the law is today may, and probably will, change tomorrow. A good estate plan will be solid enough to avoid the taxes that would be imposed if we died today while still remaining flexible enough to be amended to keep up with changes in the law. Estate planning should not be viewed as a one-time affair.

Instead, a good estate plan should be periodically reviewed to keep it current with changes in the family as well as changes in the law.

Speculation that the estate tax will be eliminated is not a valid reason to forgo implementing your estate plan. Speculation concerning the future should never be a substitute for planning that is needed today. Furthermore, even if the federal estate tax was fully revoked, history teaches us that Congress could, and probably will, reenact it in a few years.

The estate tax, like the phoenix, continues to be resurrected. In fact, the twentieth century saw the estate tax imposed and repealed several times.

Planning your estate is important regardless of the tax consequences. Probate avoidance, asset protection, disabilities planning, and a host of other benefits already mentioned are not tax related but can still provide great benefits to you and your family.

1. Many institutions will refuse to honor powers of attorney because they are not in the preferred form of the institution, while other powers of attorney are frequently ignored because the date of signing has become stale.

CONCLUSION

Whether the estate tax is repealed appears to be very much a political question. Since a 60% vote of both the House and Senate is required to make the estate tax repeal permanent, it is questionable as to whether either party can muster the votes required. In the meantime, estate tax planning inside a revocable trust in the form of a creditor shelter trust will still be necessary for married couples to avoid unnecessary tax.

In addition, whether beneficiaries are singled or married, and whether the estate tax is in place or not, trusts offer terrific protection for beneficiaries who, although they may control and use the property, are not regarded as its owners for creditor protection purposes.

Finally, trusts are emerging as a superior way to plan for the management of property during a period of incapacity and have proven themselves to be a less expensive, quicker and more private way to transfer property at death when compared to the probate court system.

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