

6 Reasons Why You Should Have a Living Trust

Written by [Michael Pancheri, Esq.](#)
4 June 2009



If you've ever thought about a **living trust**, it's probably because you hate the idea of going through probate. Living trusts have been heavily marketed on that basis over the past several years and, yes, living trusts certainly do avoid probate. But, there's a whole lot more to living trusts than just that. In fact, avoiding probate is not even one of the top three reasons for a living trust. In my opinion, it's #4. To set the record straight, here are the top 6 reasons why you should have a **living trust**.

Reason #1: Protecting Property for Certain Beneficiaries

This is seldom mentioned as a reason for a living trust, but it's probably one of the most important reasons. When most of us think about estate planning, we think about giving our property to our husband or wife, our children, and other loved ones after we die. However, sometimes our intended beneficiaries just aren't able to handle an inheritance. Minor children are the usual suspects here. Many states don't even allow minor children to own property because they're just too young. Instead, the state appoints a guardian to hold the property until they reach majority age (usually age 18). Even then, parents cringe at the thought of an 18-year old getting any amount of money. The first thing they might do is quit school, buy an expensive car, and head to Cancun. But, minor children aren't the only ones who squander money. Most experts agree that no one under the age of 25 should be given an inheritance outright because they need time to finish school and start a career. Of course, there are many people over the age of 25 that shouldn't have money either. Some are spendthrifts at heart, others are in not-so-good marriages, still others are going through bankruptcy. Then there are those who are just too frail and incapacitated to manage property on their own. Giving any amount of property to any of these people is never a good idea.

That's when a trust becomes a vital part of your estate planning. A trust allows you to have your cake and eat it too. Let's take a look at a typical example and see how it works. Let's say that you have a 20-year old son who is a junior in college. If you and your wife both die, you want your son to get all your property, including the equity in your home, your life insurance, retirement plans, etc. If you reduce all your property to cash, it could easily amount to \$500,000 or more. But, having your executor write a check to your son for \$500,000 is probably not a good idea. Instead, it would be far better to create a trust for your son with someone else, say a friend, family relative, attorney, or your local bank, as trustee. The trustee would hold the money and invest it for your son's benefit until he reached a more mature age, say age 25. In the meantime, your trustee would use the money to pay for your son's schooling, his general living expenses, and any other expenses you might specify in the trust instrument - including a down payment on a home or a new business. When your son reaches the specified age, the trust would end and your son would be given a check for the full value of the trust at that time. Revocable living trusts have been used to protect property for hundreds of years, and it is probably one of the most important reasons for a revocable living trust today. If you have any beneficiaries who are in this position, then a revocable living is a necessary component of your overall estate planning.

Reason #2: Reducing or Eliminating Estate Taxes.

Many people say that a revocable living trust doesn't save estate taxes. Technically, they're right. There are no provisions in the federal tax laws that exempt revocable living trusts from estate taxes. However, living trusts are often used by individuals and families to take advantage of certain deductions and credits that are allowed under the tax laws.

That sounds like double talk, but let me explain. For individuals dying this year (2009), up to \$3,500,000 is exempt from federal estate taxes. This exempt amount is made possible by virtue of a so-called "unified credit." In addition to the unified credit, all property passing to a surviving spouse is exempt from federal estate taxes by virtue of a so-called marital deduction. This "marital deduction" is unlimited, so you can transfer any amount of money to your spouse without paying any estate taxes.

Here's what typically happens when a husband and wife have simple wills. Let's assume that you (the "husband") and your wife each have \$3,000,000 estates. Let's also assume that you die first and that all your property is left to your wife. Your estate will not pay any estate taxes because of the unlimited marital deduction. Upon your wife's subsequent death, her estate (then valued at \$6 million) would pay a federal estate tax of roughly \$1,150,000. That's

because her unified credit would shelter only \$3,500,000 from the federal estate tax. The remainder of her property (\$2,500,000) would be taxed at graduated rates reaching 45%.

You can eliminate this \$1,150,000 estate tax very easily with a revocable living trust. Let's assume, for example, that you give your wife only \$500,000 upon your death and you put the rest of your property (\$2,500,000) in a revocable living trust. In that case, no federal estate taxes will be paid upon your death because (a) the property given to your wife (\$500,000) is exempt from federal estate taxes under the marital deduction and (b) the property held in your revocable living trust (\$2,500,000) is exempt from federal estate taxes under your unified credit. By doing that, your wife's estate will be worth only \$3,500,000 after your death (i.e., her original \$3,000,000 plus the \$500,000 you give her). Upon her subsequent death, her estate will pay no federal estate taxes because the entire \$3,500,000 is exempt from such taxes by virtue of her unified credit. The \$2,500,000 in your revocable living trust will not be taxed in your wife's estate because she doesn't own it, even though she is the preferred beneficiary and could receive distributions if needed. After all is said and done, your children will receive \$2,500,000 from your living trust and \$3,500,000 from your wife's estate, for a total of \$6,000,000.

This very simple but highly effective technique - made possible by the use of a revocable living trust - would eliminate roughly \$1,150,000 in federal estate taxes in the above example. For this reason, any married couple with a combined estate in excess of the unified credit (currently \$3,500,000) should consider a revocable living trust to take advantage of this tax-saving technique.

Reason #3: Managing Property upon Incapacity.

One of the major concerns that many of us have today is not about dying - it's about living too long! We see it all around us - we worry about our parents living in their own home. We worry about their bills being paid and whether someone will walk off with their money. In many cases, we are powerless to help them because all of their property is in their own name. Unfortunately, without doing some prior planning, the only option we have is to file an application with the probate court to have a guardian appointed for them. That's a gut wrenching experience because all their personal and financial affairs will have to be paraded before total strangers, and they will be forced to suffer the indignity and humiliation of being declared incompetent.

It doesn't have to be that way. Many people try to avoid that result by putting certain properties (particularly checking and savings accounts) in joint name with a son or daughter. That enables the son or daughter to pay their bills, but it doesn't provide a lot of help with other financial matters. It also creates more problems when the parent dies because those accounts pass automatically to the son or daughter and leaves the other children out in the cold. A better solution is a durable power of attorney. A durable power of attorney allows you to designate the people you want to help you with your financial affairs. However, as good as a durable power of attorney is - and I'm a firm believer that everyone over the age of 50 ought to have one - it does have some shortcomings. First, your attorney-in-fact may find some financial institutions difficult to work with. Second, it may not give your attorney-in-fact all the powers needed to manage your affairs. For instance, if you were making gifts to family members on a regular basis, your attorney-in-fact would not be able to continue making those gifts unless that was specifically stated in the document.

A much better solution is a revocable living trust. A revocable living trust allows your successor trustee to take over whenever you resign or become incapacitated. There is generally no interruption in the management of your property, and there is no court supervision. Revocable living trusts also enjoy a greater level of acceptance throughout the legal and financial community, and almost all states provide a broad range of statutory powers regarding the management of trust property. While it is true that a living trust isn't effective unless your property is in the trust, a durable power of attorney will enable your attorney-in-fact to transfer property into your trust if you can't do it on your own.

Reason #4: Avoiding Probate.

It is true that property in your revocable living trust will not go through probate when you die. That's because the trust instrument spells out who gets the property. It's a lot like life insurance, annuities, 401(k) plans, IRAs, and company retirement plans - those properties do not go through probate because they each have a designated beneficiary. Jointly-owned property, with rights of survivorship, doesn't go through probate, either. It passes automatically to the surviving joint owner.

That does not mean, however, that your successor trustee is free to distribute the trust property immediately. It's not as simple as that. Just because your property is in trust doesn't mean that your outstanding debts don't have to be paid. Likewise, the federal government still wants to collect its estate taxes; your state government still wants to collect its inheritance taxes; and the probate court still wants some fees even though most of your property may avoid probate. There probably will be trustee's fees and attorney's fees as well. In view of all these expenses, the successor trustee may be able to make some advanced distributions from the trust, but enough money has to be retained in the trust to pay all the debts and expenses.

Still, a reasonably efficient successor trustee will be able to determine fairly quickly just how much the potential debts and expenses will be, and he or she will then be able to make advanced distributions accordingly. In the final analysis, most revocable living trusts are able to distribute property more quickly and with much less cost than is possible through probate.

Does that mean that everyone should avoid probate? I don't think so. Some people suggest a threshold limit of \$100,000, exclusive of real estate, in order to justify the expense of a revocable living trust. I think the cutoff should be much lower than that. Most states have a simplified probate for estates valued at less than \$20,000. If you're in that situation, then a simplified probate is probably right for you. However, if your probate estate is valued at more than \$20,000, then you really need to look closely at a revocable living trust, especially if any of the other reasons for a revocable living trust apply to you. After all, it doesn't take much to make up for the few dollars it takes to establish a revocable living trust.

Reason #5: Avoiding a Will Contest.

It is true that a will is far more likely to be contested than a revocable living trust. That's because a will goes into effect only when a person dies, whereas a revocable living trust goes into effect as soon as the trust instrument is signed and generally lasts for some time after the owner's death. If you're going to contest a will, all you have to do is prove that the testator was either incompetent or under undue influence at the precise moment the will was signed. To contest a revocable living trust, you have to prove that the grantor was incompetent or under undue influence not only when the trust instrument was signed, but also when each property was transferred to the trust, when each investment decision was made, and when each and every distribution was made to the owner or anyone else. That is virtually impossible to do.

Moreover, it costs nothing to contest a will. All a disgruntled family member has to do is object when the will is presented for probate, then hire an attorney on a contingency fee basis, and wait for the final outcome. A disgruntled family member has nothing to lose. On the other hand, contesting a revocable living trust generally involves a substantial commitment of time and money. Whereas a will contest is heard in probate court, a revocable living trust contest is heard in civil court where there are substantial filing fees and formal procedures that have to be followed. Still, some people argue that will contests are seldom successful, so why bother with a revocable living trust? The answer is threefold: First, a will contest puts a screeching halt to the settlement of an estate. Most will contests take a minimum of two or more years to complete and, during that period, no distributions will be made to anyone. Second, defending a will contest involves lots of attorney time that results in large attorneys' fees. Even unsuccessful will contests end up costing \$50,000 or more in attorney's fees. And, those fees come out of the estate, which means that much less for the beneficiaries. Third, many will contests are settled before they ever get to court. In that case, the estate will be further diminished by the amount of the settlement that is eventually reached. In the final analysis, will contests are time consuming and expensive. The best way to avoid them is through a revocable living trust.

Reason #6: Privacy.

Most of us naturally dislike the concept of probate because it is a public process. Theoretically, anyone can go into probate court when a person dies and look at the estate file. You can read the will, you can find out who the relatives and beneficiaries are, you can look at the claims of creditors and the list of assets, and you can find the phone numbers and addresses of estate beneficiaries. Unscrupulous sales people often go through estate files to locate grieving heirs to prey on. Disgruntled heirs, even friends and neighbors, often like to poke their noses into an estate file to see what's there.

Revocable living trusts can prevent all of that. Revocable living trusts are private; they don't get filed with the probate court, and no one gets to look at them unless the grantor or the trustee allows it. Some people put a high value on privacy - some people don't. In my experience, most individuals know whether they will have a problem with a family member or some other person regarding their estate. In those cases, privacy becomes a very important concern and one that should properly be addressed with a revocable living trust.

These, then, are the top 6 reasons why you should have a revocable living trust. If one or more of these reasons apply to you, then you should consult a professional to see whether a revocable living trust makes sense in your overall estate planning.