

The Pros and Cons of Revocable Living Trusts

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Introduction

Revocable Living Trusts may be one of the most misunderstood tools in estate planning. Even if you may have received advice that you didn't need one, you should take another look from this perspective:

Recently a client sat in our office during our initial consultation and threw his hands in the air. "I'm completely confused," he said with obvious frustration in his eyes, "Living Trusts sounded like a good idea, but my financial planner told me that *his* attorney says that probate was nothing to worry about, and that I'd be wasting my money using a Living Trust. Was my financial planner wrong?"

The client's question was one that we had heard many times before. Because we are living in an age of mass media information, everyone seems to have an opinion on the value of Revocable Living Trusts. There are attorneys who see little or no value in Living Trusts, attorneys who tout them as the greatest thing since sliced bread, and there are even door-to-door salesmen marketing them. Just as with anything, Living Trusts are *not* for everyone, but understanding who they *are* for is a matter of understanding how they work, and how they are different from wills.

In order to understand how Living Trusts work, it is helpful to have a grasp on what wills are and how they work.

How Wills Work

Your will determines who your heirs are and in what ways your heirs are to receive your assets after you die. Wills have no legal effect until you die. They are sort of the “Darth Vader” of estate planning: They get life from your death.

There is a common misconception among many people that if you have a will, there will be no probate. The opposite is true. A will guarantees probate if you have probatable assets. On the other hand, if you have no will at all, there will still be a probate. This is called an *Intestate* Probate.

Another common misconception is that if you do not have a Will at all, then your assets will go to the State. This is extremely unlikely since there are State laws that determine who gets your assets if you have no Will. Thus, the State has a plan for you, if you haven’t bothered to do any planning.

If you are going to have to go through probate anyway, what is the purpose in doing a will? Intestate probates, the kind you have if you don’t have a will, are more expensive than a standard probate with a will because there is more legal work involved. There are more notices to give and more filings to do. The court is going to want to do more supervision of an intestate probate, and there will be more decisions for a judge to make. Each time the attorney has to visit the judge, the attorney fees go up considerably.

Understanding Probate

Probate is simply the legal process of changing title to your assets to your heirs after you die, with the courts overseeing this process. There needs to be a process in which your designated heirs legally get their name on your assets. Otherwise, there is no way that your heirs would ever be able to sell any of those assets, because no one would buy them from them unless they could be legally sure that it belonged to them. That is the purpose of Probate.

Probates are Arcane

Probates were created in medieval times in England, and really haven't changed much since then. In feudal times, the King actually owned all of the land, which he parceled out to the nobility. When somebody died, the land was usually passed down to the eldest son under the doctrine of *primogeniture*. The transfer was of significant political consequence to the King. The King oversaw all of the land transfers in his own courts. These proceedings were very formal, very complicated, and very costly. Generally speaking, things have not changed much since that time.

When an attorney undertakes a probate, the will is taken before the Judge and the attorney asks the Judge to approve the will as the valid last will of the deceased person. After that there are several filings to do and notices to give to heirs. Also, there needs to be an inventory of all the assets filed with the court and there needs to be a notice to creditors published in a local newspaper so that unknown creditors can have a period of time to make any claims they might have against the estate. After that there are more filings and notices to give out and then finally, at the end, if everything goes smoothly, the attorney requests the court to close the probate.

Probate in Washington State usually takes at least nine months and many times even longer than that. Very often assets are tied up until at least the creditors claim period has run its course. Some of the assets can be tied up much longer than that. Should you have real estate in other states, then you will have to have a probate in those states also. Most states are even worse than Washington. It can be very costly for people who own property in more than one state. If you have your home in Washington, a time-share in Hawaii, a vacation home in Oregon and a piece of the family farm that you inherited in the mid-west, there will be as many as four probates when you die.

Probates Are Public

All documents filed in a probate are open to public scrutiny. Anyone can go down to the courthouse any time and see the probate files, which will disclose to them what your will says, what assets were in your estate, what value they had, and

who the beneficiaries are. That's how we know, for instance, that Natalie Wood's estate was \$6 million dollars in value and included 29 fur coats. A lot of people are somewhat bothered that their entire estate becomes public knowledge on their death, but that is what happens when you use a will as a primary tool for your estate planning.

The Cost of Probate is Unpredictable at Best

Fees for probates vary widely depending upon the state, but most researchers agree that the average is about 5% of the total estate. In California, for instance, attorney's fees are set by a schedule. With a \$100,000 estate, the fees will be at least \$6,500. In New York, that \$100,000 estate will cost \$10,000 in attorney's fees, and it increases proportionately from there. In other states, probate fees may be even higher.

The State of Washington has a more contemporary probate system. Consequently, attorney fees are potentially lower than in other states. There is no schedule of fees for attorneys in Washington. However, probate fees vary widely between lawyers and are unpredictable. Even so, most attorneys agree that a good rule of thumb is somewhere between one and three percent of the gross assets as a good estimate of the attorney's fees in a typical probate where there are no problems such as conflict among the beneficiaries.

In addition to attorney fees, executors may also charge a fee for services rendered.

How Living Trusts Work

Trusts, metaphorically, are the estate planner's golf clubs. Just as golfers use different clubs depending upon what they want to accomplish with the golf ball, there are a significant number of techniques that use trusts to implement the plan, and they can be an important component to a quality estate plan.

Many people think that Living Trusts are a new fad. In actuality, Living trusts are older than wills, dating back to around 1000 A.D. They were invented in order to

avoid the enormous burden of the King's courts in feudal England. Their popularity has been revitalized in recent years due to the economic burden that probate places on people's estates, beneficiaries and executors.

There are many different kinds of trusts, but they essentially fall into four different types. There are testamentary trusts, which are trusts that take effect only when you die. There are *intervivos* or living trusts, which take effect as soon as you sign them. And with both testamentary and living trusts, you can have irrevocable trusts, which can't be changed once they are created, and revocable trusts, which can be easily amended.

Every trust has at least three people involved: A Trustor, a Trustee, and the beneficiary. The Trustor, or what we like to call the *trustmaker*, is the one who creates the Trust; the Trustee is the one who manages the Trust; and the Beneficiary is the one who benefits from the Trust. When you create a revocable Living Trust, you are all three of these people. Thus, you have full control over the Trust, and you do not lose any flexibility or control.

A Living Trust is an alternative to Wills and Probate because (if it is fully funded) it completely avoids probate. The reason it avoids probate is that it is a legal entity that continues even if you die. It is sort of like a corporation, without all the maintenance requirements. It does not care if you die. If you die, you have already designated someone ahead of time to be your successor trustee and that successor trustee follows the instructions you have left in the Trust. The successor trustee has full legal authority to follow your instructions with their own signature, which means that they do not need attorneys or the court to follow your distribution instructions. There is no probate at all and your successor trustee (unlike the executor of a Will) does not have to spend a lot of needless time and hassle dealing with attorneys and the court system.

I like to think of a revocable living trust as a chest of drawers. You create the trust and put all of your assets in the chest of drawers. Anything that is in the chest of drawers passes to your heirs without probate.

There are several major benefits that a Living Trust has over wills, but the two most important are this: With a Living Trust, you will avoid the hassle and cost of probate for any assets in the Trust, and secondly, the Living Trust provides for

management of the estate if you become incapacitated. Living Trusts have distribution provisions just like wills.

Creating a fully-funded, revocable living trust requires two major components. First, you and the attorney have to plan how the trust is to be structured, and on that basis, the attorney drafts a trust instrument. The trust instrument is much like a set of “baby sitter” instructions to the trustee about how to care for your assets.

With a trust, you are leaving instructions to the trustees. In most living trusts, there are four sets of instructions. The first says (slightly paraphrased), “While I (the trustmaker) am alive and have capacity, I’m the trustee, and I can do anything I want with my assets.”

The second set of instructions says (if you are married), “When the first of us dies, the other will be the sole trustee, and the tax planning provisions take effect.”

The third instruction says, “If I become incapacitated, I want my successor trustee, (usually a loved one) to take over management of the trust and to take care of me as follows,” and then you set out in numerous pages of instructions how that is to happen. Finally, the fourth set of instructions says “When both of us are gone, we want our estate distributed in the following way” and you put in the provisions for who gets what, just as you would in a will.

With a trust, you have the flexibility to structure the administration of your estate in any way that is legal. We tell people that it is probably your one opportunity to write the law, so what you put in the trust is both very personal and can be very creative.

The second component to the trust is what is called “funding” the trust. A vital aspect of creating a Living Trust is the funding. Funding means transferring title of the assets into the name of the Trust or changing beneficiary designations on insurance and retirement plans. For example, instead of the deed to the house saying John and Mary Jones are the owners, now the deed will say, *John and Mary Jones, Trustees of the John and Mary Jones Trust*. The attorney will prepare a Quit Claim Deed for John and Mary Jones, transferring it to the name of the Trust.

This funding is one reason that doing a Living Trust is initially more expensive than Will planning. The biggest problem with non-attorney companies doing Living Trusts and even with some attorneys is that most of these companies usually don't do the funding, and if the funding is not done, then the Living Trust is pointless. This is because there will still be a probate to put all those assets into the Living Trust when the person dies. Also, since the assets are not in the Trust, if the person should be incapacitated, the Trust cannot serve its function as a vehicle for easy management for the incapacitated person's assets.

After the transfers are completed, the attorney receives confirmation of title changes and puts all documents together in a notebook for you.

It is important for you to understand that you retain the same control over your assets as before. You can buy, sell, rent, gift and manage your assets exactly as you did before they were in the trust. You can amend or revoke the Trust at any time. No additional record keeping or tax returns are required. When you do a Living Trust you do not get a tax ID number for it. Your tax returns are done exactly the same way as before the Trust.

After you die, or should you become incapacitated, your Successor Trustee simply assumes responsibility for the trust, and follows the instructions that you have written in your trust. The Successor Trustee also fulfills the duties normally fulfilled by an executor of a will -- but without attorneys or court filings.

Living Trusts Are Valid In All States

Also, very importantly, Living Trusts are good in every state. Rather than being governed by state law, as wills are, Trusts are governed by Article I, Section 10, and Article IV, Section 1 of the U.S. Constitution, and about a thousand years or so of common law. This means that property you have anywhere in the country can go in one living trust, and if you move elsewhere, you don't have to have your trust re-written. Wills are governed by state law, and as such, need to be updated to comply with each state's unique statutes.

Do You Need a Living Trust?

The big question asked by most of our clients is, “How can you tell if you really need a living trust?” Here are a few reasons that we think are compelling. In our opinion, any one of the following reasons would be sufficient for a person to get a Living Trust.

The Issue of Control

One big reason that people use living trusts is because it fulfills their desire to maintain control over their estate while they are alive, and to allow their heirs to have control over the settlement of their estate after they die. During a probate, control over the estate administration is virtually handed over to attorneys to do the work. Additionally, because of the bureaucratic nature of probates, there is significant hassle and time involved.

When someone dies, is *not* the time that heirs want to be exerting a lot of effort going through legal forms and other probate filings. Also, with a Living Trust you do not have to worry about an attorney taking too long to get the probate done so that the estate can be distributed. The family members settle the estate themselves and can settle it as soon as they like, even within just a few weeks of a death. If you want the family to settle your estate instead of the courts and attorneys, a living trust will provide that.

Protecting Your Estate From Incapacity

Second, and in our opinion, this is the most compelling reason, if you are concerned about protecting yourself during incapacity there is no doubt you should have a living trust. Will planning is not incapacity planning, and the best example of this is the case of Groucho Marx. You might recall seeing the unfolding story on the evening news several years back. Groucho had a live-in friend named Erin Flemming. In 1974, she went to probate court to have Groucho declared mentally incompetent and that she be appointed his guardian. Groucho's family didn't like that idea, and fought back in the courts, as

did Groucho's bank, which had a vested interest in seeing his assets cared for properly. Over three years, Groucho was wheeled into court in his wheelchair while everybody fought over whether Groucho was incompetent and who ought to be his guardian. There was a spectacular and lengthy trial. Groucho lost whatever dignity he had, and we remember watching his agonized face on the nightly news. Five days after the trial, Groucho died. He had spent the last three years of his life in and out of court, and his estate paid the attorneys' bills. Groucho had a will, but it hadn't done him any good. The last three years of his life, Groucho's affairs were controlled by the courts, Erin Flemming and the bank.

This is what some people call a, "Living Probate." They are usually very painful both for family members and the person going through the guardianship proceedings. And, of course, because Groucho died 5 days after the guardianship was specified, an entire probate was required, causing his heirs to go through the mess again in the settlement process.

More and more today, Durable Powers of Attorney are not being accepted by banks and other financial institutions for various reasons. These Institutions are becoming more sensitive about their potential liability for honoring a Durable Power of Attorney. This is because the institutions are being sued more often based on transactions under Durable Power of Attorney. Sometimes a Durable Power of Attorney will not be honored because it is more than five or six years old.

Sometimes a Durable Power of Attorney may not be honored because the bank's legal department does not think it has the language that the lawyers think is appropriate. Sometimes a Durable Power of Attorney will be honored only after you have battled with their legal department for several weeks or months. Therefore, a Durable Power of Attorney is not an effective way to manage an estate of any significant size.

If you are concerned that you might become incapacitated, then a Living Trust is the superior way to manage the estate. Statistics say that very few people simply drop dead. Of course it is possible for anyone to become incapacitated and often couples are worried about what might happen after one has died and the surviving spouse becomes mentally or seriously physically incapacitated. In this case, the successor trustee of the Trust can simply get two doctors to sign

statements that the Trustor is no longer able to handle his/her affairs so that the successor Trustee takes over as Trustee. The successor Trustee will not have any problem dealing with other institutions because other institutions will immediately recognize a Trustee as having full legal power to deal with the estate. An institution will not be concerned about their own liability because it is the Trustee who would be liable for fraud.

Avoiding the Cost and Hassle of Probate

In purely economic terms, it makes sense to do a living trust whenever a probate is costlier than a Trust. My experience tells me that in almost every case a probate will be costlier than a living trust.

The fee for a Living Trust is based upon two components. The first component is for planning the estate and drafting the necessary and the accompanying documents, including Powers of Attorney and any other documents that are necessary. The second component is the funding. The average total cost for a Living Trust in our office for husband and wife with an estate under two million, is pretty difficult to give because the needs of each client are different. Generally speaking, though, the trust is rarely over \$4,500 for both the drafting and funding. For a single person, the total is usually \$600 to \$1,000 less than the fee for a couple. With probate costs being unpredictable, the cost of setting up a living trust is very persuasive.

A living trust is an even better idea whenever there will be two or more probates for an estate. In this situation, there is no question that it makes sense to do a Living Trust. In a situation where a Husband and wife need to split their estate to save estate taxes, a Living Trust definitely makes sense. This is the most common situation in which two or more probates are necessary. For example, a husband and wife might have an estate over \$1,000,000 and need to split their estate on the first death to save the estate taxes. In this kind of situation, almost all clients who come through our office choose to get a Living Trust. If they do not get a Living Trust, then there will be a probate with a cost of multiple thousands of dollars on each death, which would be substantially more expensive than doing one Living Trust.

Another situation in which a Living Trust is best is where a husband and wife do not want to give all assets outright to the surviving spouse for other reasons, such as when they have children from a previous marriage, where they want to protect themselves upon remarriage, or where they want to make a distribution on the first death.

Two or more probates would also be needed if for some reason a husband and wife cannot use a community property agreement on the first death because one of the spouses wants to give assets to someone other than the surviving spouse. Often this situation arises if there are children from a previous marriage, or if the spouse wants to protect the children upon remarriage by the surviving spouse.

If you have real estate, time shares or condominiums in another state, a living trust is a practical necessity. As I stated before, when you die, there will be a probate everywhere that you have real estate. With a living trust, your real estate anywhere in the country placed in that single trust will avoid all probates.

Avoiding Will Contests

When there is a good chance that someone might contest your will, a living trust is advisable.

It is relatively easy for a disgruntled heir to make life miserable for the rest of the heirs by contesting a will. In Washington, a will can be contested simply by filing a contest with the probate court. Even if they have no grounds to contest the will, they can add a tremendous amount of time and expense to the probate. With a Living Trust, it is very expensive for anyone to contest the Trust. A lawsuit must be filed, and the requirements for proving the invalidity of a Trust are much more difficult.

Creating Privacy

If you want your affairs to be kept private upon your death, a living trust is the only way to go. Now, it may not bother you for your life and estate to become

public knowledge on your death, but for many people, this is sufficient justification for getting a living trust. There are other advantages to a Living Trust. One is that a Living Trust compels you to get organized.

The process requires you to list all your assets and to gather all the documents regarding those assets. The attorney also makes copies of the asset transfer documents and puts them together in a notebook so that they are easily discoverable. The advantage to this in a Living Trust is really as important as any of the other advantages, because it saves the heirs a lot of time figuring out where everything is when someone dies. In our practice, we have heard numerous stories of children finding stock certificates years after their parents have died that nobody knew existed when the estate was settled

Another advantage is that the process of doing a Living Trust forces the attorney to review how all assets have been titled and who the beneficiaries are on such things as insurance and retirement plans.

Frequently, people don't remember that a particular asset or account is in joint tenancy. Sometimes an asset was inherited from their parents but the title was never changed, and perhaps a probate still needs to be done. All these problems come to light when a Living Trust is done and we see a lot of title problems while going through this process that can be straightened out while it is still easy to straighten them out. Essentially, the Living Trust process forces the client to get all their assets organized and properly integrated into an overall estate plan according to their true desires.

What are the Downsides to Living Trusts?

There are essentially three downsides to using a living trust-based plan. The first is the hassle of setting them up. Wills are convenient because there are no asset transfers involved. With a trust, not only is a much more extensive document created, all of your probatable assets must be retitled in the name of the trust. This means retitling all of your financial accounts, checking, savings, mutual funds, brokerage accounts, and all of your real estate. This entails time and effort. Your estate planning attorney should offer this service as a part of your

planning, but you will still need to provide account statements, deeds, and may need to make a trip to the bank for signature guarantees.

The second downside to a living trust is similar to the first. Once you have a trust, you must remember you have a trust, and if you acquire new assets (financial and real property) they need to be titled in the name of your trust. If they are subject to probate, and are not titled in your trust, this will necessitate a probate after you pass away.

The third downside to a living trust is the cost. The legal fees for setting up a trust are much greater than those with a will. Usually these fees for a married couple will be in the area of \$3,900 to \$5,000. Consequently, you need to do a cost-benefit analysis before you decide which tool is proper for you.

COMPARISON OF WILLS AND REVOCABLE LIVING TRUSTS

Wills	Revocable Living Trusts
Can be used to plan for estate taxes.	Can be used to plan for estate taxes.
Have no adverse lifetime income tax consequences.	Have no adverse lifetime income tax consequences.
Are only effective at death.	Are effective immediately and distribute property after your death.
May not control all property.	Create one receptacle for all your property.
Do not take care of you while alive.	Take care of you.
Are public.	Offer privacy.

Involves complex legal rules.	Are easy to create and maintain.
Have rigid formalities to change.	Are easily changed.
Are not viable interstate.	Are good in every state.
Must go through probate.	Are probate free if they are fully funded.
Should be stored properly.	Are easily stored.
Are easy for disgruntled heirs to attack.	Are difficult to attack.
Cause your affairs to stop at your death.	Offer continuity in your affairs.
Do not allow you to measure trustees while you are alive.	Allow you to measure trustees while you are alive
Are relatively inexpensive to set up.	Can be substantially more expensive than will based plans.
Are relatively simple to set up.	Can be more complex to set up including the process of retitling assets into the trust.