

Revocable Living Trusts

A revocable living trust is a trust created during a person's lifetime that gives the creator full power to revoke or amend any or all of the terms of the trust.

Revocable Living Trusts

A revocable living trust can play an extremely helpful role in estate planning. Revocable living trusts have the potential to greatly reduce administrative expenses, time, and effort and provide privacy to the family. These trusts are, however, often misunderstood, and sometimes rendered useless by incomplete planning.

This material attempts to answer commonly asked questions about the revocable living trust, to outline the circumstances under which a revocable living trust might be most useful, to illustrate some of the advantages of this arrangement and to describe the means of establishing a revocable living trust. A revocable living trust is a legal arrangement that can have far-reaching effects. Legal counsel should be consulted with regard to trust creation and establishment.

What Is a "Trust"?

A trust is a legal entity, somewhat akin to a corporation. Like a corporation, a trust has an existence separate from that of its creators. For estate planning purposes, a trust may be used as an ownership vehicle for several different reasons. Commonly, revocable trusts are employed to avoid the probate process at death. They are also used to provide a framework for care and financial management in the event of incapacity. Revocable trusts are often structured to minimize estate taxes, but it is possible to obtain the same results by careful planning without the trust structure.

In the typical revocable trust, the trust creator describes the terms of the arrangement in writing, including retention of the right to amend those terms or revoke the entire arrangement at any time. A trustee, the party that interprets those terms and manages the trust, is named. A successor trustee is named, or the means of identifying a successor trustee are described in the event the initial trustee is unable to serve. Beneficiaries, who may belong to several different classes, are designated.

Frequently, the trust creator serves as both trustee and beneficiary of his or her trust.

The trust's terms should detail the actions the trustee is to take on behalf of each beneficiary. The terms should also specify powers vested in the trustee and the circumstances that will bring about the trust's termination.

After trust creation, assets may be transferred to trust ownership. Once assets are transferred to trust ownership, they no longer belong to the transferor – they are trust assets, and are governed by the terms of the trust.

What Is a Living Trust?

A living trust, also known as an “intervivos” trust, is the name given to a trust entered into during its creator's lifetime. It may be effective at the time of its creation, or it may simply wait in a state of dormancy, for some event to trigger its use. A living or intervivos trust is the opposite of a “testamentary” trust, which is a trust described under the terms of a will. A testamentary trust is not effective until the death of the creator and the probate of the will creating it. A testamentary trust will not avoid probate; in fact, such a trust ensures probate, as the will describing the trust has no authority until it has been probated.

What Is a Revocable Living Trust?

A trust created during a person's lifetime, with full power in the creator to revoke the trust or amend any and all of the terms of the trust, is a revocable living trust.

What Are the Components of a Revocable Living Trust?

- A) The Grantor – the person who creates the trust and (usually) places assets into it. Also called settlor or trustor
- B) The Trustee – the party who controls the assets of the trust. The grantor may serve as his or her own trustee
- C) The Beneficiary(ies) – the person(s) receiving the benefit of the assets. The grantor may be the beneficiary
- D) The Successor Trustee – the party designated by the trust's creator who, upon the earlier to occur of the death, incapacity, or resignation of the originally named trustee, steps in to manage the trust according to its terms

What Are Some Common Uses of a Revocable Living Trust?

Revocable living trusts are employed to:

- A) Secure asset management and protection for the trust creator and the family of the trust creator in the event of the trust creator's incapacity
- B) Avoid the probate process at the death of the trust creator
- C) Secure estate and inheritance tax savings
- D) Protect assets for the benefit of family members after the death of the trust creator

Who May Serve as the Trustee?

Under most revocable trust circumstances, the person creating the trust can act as trustee. It is possible to create a revocable trust and name another person to serve as trustee, or name more than one party to serve as co-trustees. Some corporations (banks and trust companies) are licensed to offer professional trustee services. The trust's terms should designate another trustee to serve as backup or successor trustee in the event the named trustee is unable to serve, or provide a mechanism to determine a successor trustee.

What Is “Probate” and Why Should It Be Avoided?

Probate is a formal, court-supervised process established by each state to protect the rights of citizens to transfer property at death. Probate ensures that the creditors of a deceased person have a venue for recovering their claims. Each state has established its own separate probate process. The universal problem with the process is that it is cumbersome, time consuming, expensive, and public. Legal counsel is usually required. Probate proceedings are public domain, and probated wills become a matter of public record. Anyone can read a probated will merely by visiting the courthouse. A listing of the assets of the deceased is added to the probate file. Family assets (and their values) become public knowledge (in some jurisdictions, the inventories of estates are even published in local newspapers). State laws establish mandatory minimum time periods for estate administration, regardless of the size of the estate.

It is the court's responsibility to ascertain the validity of the decedent's will, appoint a party to represent the estate (an executor or personal representative), and to make sure that the decedent's taxes and debts are paid. The court also sees that the decedent's property is distributed according to the terms of the decedent's will or, if there is no will, in accord with a distribution scheme devised by the state legislature of the deceased's state of residence.

Ownership of real estate in different states creates a probate headache. A separate probate proceeding is required in every state in which a deceased person owned real estate.

What Is the Cost of Probate?

Probate expenses vary from jurisdiction to jurisdiction. Some studies place them as high as 10% of the estate's gross value. Costs will vary depending on complexity of estate plan, assets owned by the decedent and location. The actual court filing fees for estate administration are only a small part of the total cost. Professional fees, such as the cost of legal representation and the executor's fee, usually constitute a major portion of

the total expense and should be included in all projections of probate fees.

Even if a court-supervised probate is avoided, some duties of estate administration may be required.

Death tax returns must be filed by the trustee. Income taxes for the decedent for the year of death must be filed and assets transferred.

Do Trusts Avoid Probate? How?

Assets held in the name of a deceased person must pass through the probate process. Correctly structured, assets held in a revocable living trust are not owned by the decedent; they are owned by his or her trust. The trust does not “die” when its creator does. A successor trustee may have taken over, but the trust itself is still a viable entity. Wills do not avoid probate at all. Testamentary trusts, since they are created under the terms of a will, actually have no effect until they are probated. Assets owned by a revocable trust should not be subject to the jurisdiction of the probate court.

What Happens to My Will If I Create a Revocable Trust?

Your existing will does not cover assets placed into a correctly designed trust. To completely coordinate your estate plan, when a trust is created, a new will (or a codicil amending an existing will) is usually prepared. A will prepared in conjunction with a revocable trust is known as a “pour-over” will. This type of will provides that anything you own outside the trust will pass to the trust when the probate process has been completed, and will thereafter be controlled by the terms of the trust.

How Can a Revocable Living Trust Help in the Event of Incapacity?

The trustee of a revocable living trust may be given detailed authority to manage the assets of the trust, pay medical bills, file insurance claims, and pay day-to-day expenses of the

beneficiary. In the typical revocable living trust situation, the trust creator serves as the initial trustee. If he or she becomes unable to handle business affairs, the successor trustee named in the trust may take over without involvement of the local disability court, and use the trust assets to care for the trust’s creator. The terms of the trust can specify how “care” is to be defined, giving the trust creator indirect control of his or her treatment upon disability.

How Can a Revocable Living Trust Save Federal Estate Taxes?

For married couples, a carefully structured trust can provide that both of their estate tax exemptions will be fully employed. Currently, \$23,400,000 (\$11,700,000 per individual) of the assets of a married couple may pass tax free to their beneficiaries. For single persons with large estates, revocable living trusts can provide estate tax minimization measures that allow the grantor’s annual gift tax exclusion to be fully utilized, even if the grantor becomes incompetent.

Some of the same savings can be realized with wills, but wills do not have the added advantage of avoiding probate.

How Can a Revocable Living Trust Protect My Family?

The privacy enjoyed by a revocable living trust protects survivors. Nosy neighbors, ex-spouses and former in-laws are not able to read the terms of a trust or determine its assets.

Revocable living trusts may provide that after the death of the trust creator, the trust should continue for the benefit of a spouse and/or children, regardless of the ages of the children. Income and principal may be applied for their benefit long after the death of the trust creator. Under certain conditions, a trust of this type cannot be broken, it cannot be invaded if a spouse remarries and the new spouse desires access to trust funds, it cannot be invaded by children’s spouses, creditors of a spouse, or children, or in a divorce action. The trust may even be drafted in a manner that will help your children minimize or avoid estate taxes at their deaths!

How Does the Trust Become Effective?

After you and your attorney prepare and execute a revocable living trust, it must be funded by titling assets in the trust's name. It is not necessary that the names on all assets be changed, but any asset held in your sole name, without a contractually designated beneficiary (such as an IRA or life insurance policy), will require probate at your death.

How Do I Fund My Trust?

A trust is funded by making the name changes referred to above. Your Baird Financial Advisor will help you re-title your securities, regardless of where you acquired them. Your banker will help you re-title your cash accounts, and your attorney will help you re-title real estate.

What Are the Income Tax Consequences of a Revocable Living Trust?

If the trust creator serves as his or her own trustee, the trust simply uses the creator's Social Security number for tax purposes. No special forms are required to be filed.

How Much Does It Cost to Set Up a Revocable Living Trust?

Costs of establishing a revocable living trust depend upon the complexity of your estate plan and the extent of your estate. Fees also vary from attorney to attorney.

In an effort to minimize the costs of creating trusts to our clients, the estate planning specialists at Baird Trust are happy to offer financial advice and general estate planning suggestions to our clients, but we are unable to prepare trusts and wills, or offer legal advice. This must be done by your legal counsel.

Baird Trust

Louisville, Kentucky (headquarters)

500 W. Jefferson Street, Suite 2600
Louisville, KY 40202
502-588-1801 | 888-878-7845

Evansville, Indiana

110 Main Street
Evansville, IN 47708

Cincinnati, Ohio

3805 Edwards Road, Suite 610
Cincinnati, OH 45209

Nashville, Tennessee

1600 West End Avenue, Suite 1100
Nashville, TN 37203

BairdTrust-Info@rwbaird.com

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