

DOES YOUR LIVING TRUST MEASURE UP?

Over the past 10-20 years, Living Trusts have become the estate planning vehicle of choice for many people. Such revocable trusts are frequently recommended by estate planning attorneys, financial advisors and CPAs.

Living Trusts come in all shapes and sizes – there is no “one size fits all” form that can be suitable for everyone. I am often asked by advisors and their clients to review Living Trusts that have been prepared by other lawyers (or sometimes by the clients themselves with the help of software or self-help books.) Here is a checklist of things I look for when reviewing other Living Trusts (and often do not find):

- 1. Are there comprehensive disability provisions?** One of the biggest benefits of having a Living Trust is that it can provide the best method for managing your property in the event of your disability. A good Living Trust will contain broad language authorizing the successor Trustee to make distributions to you or to others for your benefit (such as paying care providers, maintaining your residence and other property you may have.) The trust should clearly define the circumstances under which you are to be considered incapacitated, so that your loved ones will not need to pursue costly and time-consuming guardianship proceedings. You might want your Living Trust to specify that your Trustee should make every effort to enable you to stay in your home, rather than be placed in a nursing home. Without such explicit directions, the beneficiaries who will get your assets upon your death might pressure the successor Trustee to place you in a nursing home if doing so will preserve the trust assets. Depending on your situation, it might be appropriate for the trust to authorize the payment of your spouse’s expenses or the expenses of other people that depend on you – certainly minor children if you have them, and perhaps also for adult children you are still supporting (college kids) or maybe your elderly parents or other relatives. It is usually also advisable for the trust to authorize the Trustee to make gifts to family members, as such gifting is sometimes beneficial for estate tax reasons or for purposes of qualifying for needs-based benefits such as Medicaid.
- 2. Is there a good “chain of command” in place?** A good Living Trust will contain provisions that specify who will be your successor Trustee (the person who will manage your property if you are unable to do so). There should be a “chain of command” set in place, to cover the situation where your first choice is unable or unwilling to act as Trustee. You should select the people who, at the present time, are the best choice, even though you expect (and hope) that a successor Trustee will not be necessary for a long time. Remember, as long as you remain healthy and alive, you can always change any of your trust’s terms, including the trustee succession provisions. It also might be appropriate for you to give your successor Trustee the power to designate his or her successor, even to the point of overriding your second or third choice. For example, suppose your first choice as successor Trustee is Adam, your best and most trustworthy friend

in the world. Your second choice is Bob, another friend or relative, but maybe you had to think long and hard to come up with Bob as a “back-up” selection. Suppose something happens to you and Adam becomes the Trustee. Then, after a few years, due to medical or other unforeseen reasons he is unable to continue to serve as Trustee. Maybe circumstances have changed drastically, and Bob is no longer a suitable Trustee. Since you trust Adam so much for this important role, might it not make sense to empower Adam, after he becomes the Trustee, to make the decision that Bob is not the best person to serve as successor Trustee, and allow him to make a different appointment? Such a provision is not appropriate for every situation, but it often is an option that gives the client more peace of mind.

- 3. Are there special provisions dealing with tangible personal property?** Some clients have valuable jewelry, artwork, antiques, collectibles or other tangible personal property (what I call “stuff”) that will be passing to their beneficiaries. Surprisingly, it can be these items of property that cause fights among the heirs. A good Living Trust will have a special article or section dealing with these items. Frequently, it is advisable to include language that says that the Trustmaker reserves the right to leave written instructions as to specific items that go to specific people. That way, the Trustmaker can change the list of items without having to amend the trust. Also, I usually recommend a provision to the effect that any tangible personal property not specifically itemized in a writing pass to the beneficiaries “in shares of substantially equal value, as the beneficiaries shall agree.” In case they cannot agree, then the Trustee is given the authority to make the division, or simply sell the property and divide up the cash. Such provisions can alleviate potential disputes over the division of heirlooms and other valuable personal property.
- 4. Does the Living Trust contain provisions that will pass the estate in the most tax-effective manner possible?** One of the biggest challenges facing clients and their advisors is the changing landscape in the laws dealing with estate taxes. Estates that exceed the exemption amount are subject to steep taxes. Over the past 15 years, the federal estate tax exemption has changed *nine times!* As of today, we know what the exemption is for 2011 and 2012 (\$5 million) but we have no idea what the estate tax law will be in 2013 and beyond. While the laws as written on the books state that the exemption will fall back to \$1 million, there is certainly the possibility (perhaps even the likelihood) that the exemption will be higher. We only know that we *do not know* what it will be. Given the uncertainty, all Living Trusts – especially for those people who have total assets in excess of \$1 million – should have provisions *specifically tailored* to achieve estate tax savings. This will usually involve provisions that can establish a “Bypass Trust” or “Credit Shelter Trust.” Many older Living Trusts contain wording that is not flexible enough to allow for the effective use of the estate tax exemption amount. These trusts can be “ticking time bombs” unless they are amended to adjust for changes not only in the federal estate tax laws, but state laws as well. This is especially pertinent to Maryland residents, as Maryland’s

estate tax has been “de-coupled” from the federal law. As a result, I often review trusts that will fall in to what I call the “Maryland Tax Trap” – with the result that an estate tax will be due on a married couple’s estate when the first spouse dies. Such a result can easily be avoided if the trust is properly drafted, since the unlimited marital deduction can at least postpone any estate tax until the death of the surviving spouse.

5. Does the Living Trust provide your beneficiaries with the most protection?

Many people view Living Trusts simply as a vehicle for avoiding probate and simplifying the transfer of their estate. In my opinion, this is a short-sighted approach which ignores the many benefits that can be achieved through thoughtful planning. For example, many Living Trusts provide that upon the client’s death, the trust assets are *distributed* to the client’s children in equal shares. This is certainly not appropriate when the children are not of sufficient age. In such situations the trust should provide that a child’s share of the inheritance is held in trust for such child’s benefit, with a successor Trustee given the power to manage and invest the assets and make payments out of the income and principal of the trust for such child’s health, education and support. But even where the beneficiaries are adults, it almost always would be better if the trust did not provide for outright distributions. A better result is for the trust to provide that the trust continue to be held and managed by a Trustee, but that the adult beneficiary be given the right and power to serve as his or her own Trustee. This is what is commonly referred to as a “Beneficiary-Controlled Trust” because the beneficiary himself controls the trust, and at the same time receives the benefits from having his inheritance protected by the protective “wrapper” of the trust. The trust wrapper protects the beneficiary from his or her spouse in the event of a divorce, from creditors and lawsuits, and it can even protect the trust assets from being hit by estate taxes when the beneficiary dies. Many other planning opportunities are available to be incorporated into your Living Trust, including Special Needs Trust provisions for disabled children, and specially designed provisions for children with addiction or other behavioral problems. In some cases, a client might want to include trusts for aging parents or grandparents, special education trusts, etc. The point is that trusts can be designed and drafted to accomplish many different objectives, and your Living Trust need not (and should not) look just like your next door neighbor’s Living Trust.

6. Does the Living Trust contain provisions to minimize the likelihood of disputes among your heirs?

Trusts can contain provisions that will make it less likely that your heirs will fight over your estate when you die. So-called “Contest Clauses” can provide that an heir who tries to contest your Living Trust will forfeit his or her share. The Trust might contain a clause that requires mediation if a dispute arises, thus avoiding costly court proceedings. Other issues should also be addressed in the document, such as guidelines for how much a Trustee is entitled to be compensated for undertaking the responsibilities of the position, what accountings of trust assets are required, etc.

7. **Does the Living Trust contain a comprehensive enumeration of the powers that a Trustee has?** Keep in mind that third parties – banks, financial institutions, title companies, mortgage companies, etc. – will have to be dealt with. These parties will often need to know that your successor Trustee has the power to take a certain action, and they will want to see the specific reference to such power in the trust document itself. Thus, a Living Trust should contain an exhaustive listing of the types of powers or actions that a trustee may need to take.

As you can see from the foregoing discussion, the particular terms and provisions of your Living Trust will determine whether the Trust will provide value and protection for your loved ones, or expense and disappointment. It makes sense to review your Trust with an experienced estate planning attorney to make sure you and your family are securing all the benefits a Living Trust Plan can provide.

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