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Questions and Answers About Living Trusts

THE BASIC COMPONENTS of most estate plans consist of a living trust, a will, and a durable power of attorney. These documents are intended to provide for the management of your personal finances and personal care by the persons you choose to act for you during any period of incapacity and to settle and distribute your estate following your death.

Everyone has an "estate" because nearly all of us own things. The word "estate" means what we own without regard to the value of our things. There are various reasons why you should use a trust plan like this even if your estate is modest. There are important reasons why using joint ownership, gift transfers, and other less complicated means can cost you and your family far more than the price of a well-made trust plan.

Many of these reasons require knowledge that you probably do not have, so they seem to defy a "common sense" approach to estate planning. However, much of this knowledge is obtainable through books and the Internet, if you are willing to spend a substantial amount of your time to find and learn it.

Your lawyer can provide you with the knowledge relevant to your situation and help you create the plan that fits your particular needs and preferences. This is the better consumer choice because estate planning is a situation where "going cheap" most often costs more, much more without it. If your plan needs are simple, your lawyer should be able to provide you with a "simple" trust that meets those needs.

1. What is a living trust?

A living trust can be an important part—and in many cases, the most important part—of your estate plan. It combines the functions of a power of attorney (an agency where someone (the agent) is appointed to act for you (the principal)) and a will into a single legal document that operates well beyond the capabilities of both.

The trust document defines how the trust will operate during your lifetime and following your death, who will perform these tasks for you (the *trustee*), and who will receive the benefit (the *beneficiaries*) of the trust's resources (the *trust estate*). The trust is adaptable because, as long as you are not incapacitated, you can change (*amend*) it as needed during your lifetime to meet changes in your situation and/or your preferences. It also is possible to terminate (re*voke*) the trust at any time (unless you are incapacitated) so you are not locked into the arrangement.

A typical living trust will name the trust maker (the *Settlor*, also called the trustor or grantor) as the initial Trustee. Because the Trustee is the legal owner of the property in the trust estate, your trust is "funded" by transferring the assets you select into your Trustee's name as the Trustee of your Trust. So, until something happens to you, you remain in control of your assets and how they are used during your lifetime.

You should name at least one successor trustee (a person or an institution) who will manage the trust's assets if you ever become unable or unwilling to do so yourself, and to settle and distribute your estate following your death.

One way to understand the living trust is by examining its components. Typically, the trust document your lawyer prepares for you will group similar provisions into a sections called "Articles" that are combined into an integrated whole. For example, the first Article might cover the creation of the trust and your intentions for the trust. Another Article would cover the persons you intend to benefit from the trust and the timing in which those benefits will accrue. For example, your trust agreement:

- Gives the trustee the legal right to manage and control the assets held in your trust.
- Instructs the trustee to manage the trust's assets for your benefit during your lifetime.
- Names the *beneficiaries* (persons or charitable organizations) who are to receive your trust's assets when you die.
- Gives guidance and certain powers and

authority to the trustee to manage and distribute your trust's assets. The trustee is a *fiduciary*, which means he or she holds a position of trust and confidence and is subject to strict responsibilities and very high standards. For example, the trustee cannot use your trust's assets for his or her own personal use or benefit without your explicit permission. Instead, the trustee must hold and use trust assets solely for the benefit of the trust's beneficiaries.

2. What can a living trust do for me?

The trust can be appreciated from the perspective of what it is able to do: the benefits to you and your beneficiaries, as compared with the non-trust alternatives (joint ownership, signing authority on your bank account, etc.) aimed at the same goals. There is a lot of information on the internet comparing living trusts to other estate plan arrangements. Here are a few of the main reasons to go with a trust.

It can help ensure that your assets will be managed according to your wishes-even if you become unable to manage them yourself.

It allows you to remain in control of your assets and finances because you can name yourself as the trustee any time you are capable, and you may select who you wish to take over as trustee when you are not able, including naming several individuals or institutions in the order of priority you set.

Having your estate held in your trust preserves your privacy and keeps your assets and finances out of the probate process, which is far more expensive than the cost of a trust plan, shifts control of your estate to the probate judge and the person appointed to act for you under the judge's control: a conservator in the case of your incapacity, and an executor or administrator after your death.

Other means of appointing someone to manage your finances for you may be effective, but have their disadvantages that make them inappropriate as the centerpiece of your estate plan. For example:

A power of attorney appoints someone to act on your behalf to do the things specified in the power of attorney document. These powers are useful, but they are not the answer to financial management for you because the institutions with which your agent may deal are not required to honor the power. If that occurs, your purpose in making the power of attorney is thwarted and the alternative to acquiring the authority necessary to act for you can only be obtained through an expensive conservatorship proceeding. In contrast, because the trustee is the legal owner of the trust assets, he or she must be responded to as any owner of property.

A Will comes into effect on your death. It names who will administer your estate (your executor or administrator) and who will receive your assets remaining after your debts, claims, taxes and other obligations you or your estate may have are settled.

Your Will must go through formal probate process in most situations. As mentioned elsewhere in these materials, probate And at your death, the trustee-similar to the executor of a will-would then gather your assets, pay any debts, claims and taxes, and distribute your assets according to your instructions. Unlike a will, however, this can all be done without court supervision or approval.

3. Should everyone have a living trust?

No. Young married couples without significant assets and without children, who intend to leave their assets to each other when the first one of them dies do not need a living trust and would not benefit from having a living trust.

One reason is that lifetime management is built into the marital laws so that, if either spouse is incapacitated, the other has full authority to continue to manage their estate without anything else. Another reason is that a formal probate will not be required because transfer of a deceased spouse's estate to the surviving spouse can be accomplished by a special procedure that is relatively quick and low cost.

Individuals who do not have significant assets and have very simple estate plans also may not need a living trust, unless the type of assets you own and/or your individual circumstances suggest otherwise. Your lawyer can help you determine this.

Finally, anyone who wants court supervision over the administration of his or her estate should not have a living trust. The greater the value of your assets (particularly if you own real estate), the greater your need for a living trust. And having a living trust could be important in the event of an accident or sudden illness.

4. How could a living trust be helpful if I become incapacitated?

If you are the trustee of your own living trust and you become incapacitated, your chosen successor trustee would manage the trust's assets for you. If your assets were not in a living trust, however, someone else would have to manage them. How this would be accomplished might depend on whether your assets were separate or *community* property.

If you are married or in a registered domestic partnership, assets acquired by either you or your spouse or domestic partner while married or in the partnership and while a resident of California are *community property*. (*Note:* In domestic partnerships, earned income is not treated as community property for income tax purposes.)

On the other hand, any property that you owned before your marriage or registration of your partnership, or that you received as a gift or inheritance during the marriage or partnership, would probably be your *separate property*.

In California, community property could be managed by your spouse or registered domestic partner if he or she is competent. If you own separate property (or are not married or in a registered domestic partnership) and you become incapacitated, such assets could be managed by an agent or *attorney-in-fact* under a power of attorney (*see #12*). Without planning, your separate property assets would be subject to a probate court proceeding called a *conservatorship*.

During the conservatorship process, a judge could determine that you were unable to manage your own finances or to resist fraud or undue influence. The court would then appoint someone (a *conservator*) to manage your assets for you. And the conservator would report back to the court on a regular basis.

Your conservator might be someone whom you previously nominated. Or, if no one had been nominated, it might be your spouse, registered domestic partner or another family member. If none of those persons are available, then it might be the public guardian.

Conservatorship proceedings are designed to help protect you at a time when you are vulnerable or incapable of managing your assets. However, they are also public in nature and can be costly because of the substantial court intervention. In addition, conservatorship proceedings may be less flexible in managing real estate or other interests than a well-managed living trust.

5. How could a living trust be helpful at my death?

The assets held in your living trust will be managed by the trustee and distributed according to your directions without court supervision and involvement. This can save your heirs time (delayed distribution) and money (the cost of probate is substantial). And because the trust would not be under the direct management of the probate court, your assets and their value (as well as your beneficiaries' identities) would not become a public record. Your heirs and beneficiaries would still have to be notified about the living trust and advised, among other things, of their right to obtain a copy of the trust.

If your assets (those in your name alone) are not in a living trust when you die, they would be subject to *probate*. Probate is a court-supervised process for settling the decedent's final debts and obligations (what remains owing on credit cards, filing final tax returns, etc.) and transferring assets to the beneficiaries listed in one's will.

After your death, a petition would be filed with the court (usually by the person or institution named in your will as the executor). After notice is given, a hearing would be held. Then your will would be admitted to probate and an executor would be officially appointed. An inventory of your assets would be filed with the court and notice would be given to your creditors so they could file claims. The process would end once the court approved a final distribution of assets. This takes at least 6 months to accomplish before distribution can occur, often times much longer. If your survivors have immediate financial needs and are entitled to support from your estate, permission from the court is required for the executor to pay you anything. That procedure usually increases the legal cost.

Probate can take more time to complete than the distribution of property held in a living trust. In addition, assets tied up in probate are not be as readily accessible to the beneficiaries as those held in a living trust. And the cost of a probate is often greater than the cost of managing and distributing comparable assets held in a living trust.

6. Who should be the trustee of my living trust?

Many people serve as trustees of their own living trusts until they become incapacitated or die. Others decide they need assistance simply because they are too busy, or too inexperienced or do not want to manage their day-to-day financial affairs, or have limiting health problems that do not necessarily cause mental incapacity.

Choosing the right trustee to act on your behalf is very important. Your trustee will have considerable authority and responsibility and will not be under direct court supervision.

You might choose a spouse, adult child, domestic partner, other relative, family friend, business associate, or professional fiduciary to be your trustee. The professional fiduciary could be a licensed, registered individual, or a bank or trust company licensed by the State of California. You may also name co-trustees. Be careful in doing so, however, because a committee of two or more persons does not always act efficiently.

Discuss your choice with an estate planning lawyer. There are many issues to consider. For example, would the appointment of one of your grown children cause a problem with his or her siblings? What conflicts of interest would be created if you name a spouse, child, business associate, or partner as your trustee? And will the person named as your successor trustee have the time, organizational ability and experience to do the job effectively?

7. How are my assets put into the living trust?

Once your trust has been signed, an important task remains. To avoid court-supervised conservatorship proceedings if you should become incapacitated, or the probate process at your death, your assets must be transferred to the trustee of your living trust. This is known as *funding* the trust. It is important that all of your assets having a title document (including bank accounts) be transferred into your trustee's name as trustee of your new trust.

Deeds to your real estate must be prepared and recorded and required notification given to the Assessor's office. Bank accounts and stock and bond accounts or certificates must be transferred as well. These tasks are not necessarily expensive, but they are important and do require some time and paperwork.

A living trust can hold both separate and community property. This makes it convenient for spouses and registered domestic partners to plan for the management and ultimate distribution of their assets in one document. (*Note:* While registered domestic partners have many of the same rights as spouses, be aware that federal tax law does not provide the same tax benefits for domestic partners as it does for spouses.)

If you own real estate in another state, you might (depending on that state's law) transfer that asset to your trust as well to avoid probate in that other state. A lawyer from that state can help you prepare the deed and complete the transfer. If the real estate is located in California, a California lawyer should prepare the deed and advise you on transferring such property.

A lawyer can help you transfer other assets as well. For example, you should consider changing the beneficiary designations on life insurance to the trust. As for the beneficiary designations on a qualified plan (such as a 401(k) or an IRA), you should seek a qualified professional's advice because there are serious income tax issues involved and special provisions required to be part of your trust to make that happen.

8. What are the disadvantages of a living trust?

Because living trusts are not under direct court supervision, a trustee who does not act in your best interests may, in some cases, be able to take advantage of you. (In a probate, direct court supervision of an executor reduces this risk.)

In addition, the cost of preparing a living trust could, in some cases, be higher than the cost of preparing a will. However, it depends on the particular estate plan. The difference in cost may not be significant if the estate plan is complex or if the consequences of not having a trust will be expensive in the long run to you or your beneficiaries.

Also, keep in mind that a living trust can create additional paperwork in some cases. For example, lenders may not be willing to lend to a trust and may require that real property be taken out of the trust (by a deed) before they will agree to a loan on that real property.

9. Why do I still need a will If I have a living trust?

Yes. Your will affects any assets that are titled in your name at your death and are not in your living trust or some other form of ownership with a right of survivorship. If you have a living trust, your will would typically contain a *pour over provision*. Your will simply states that all assets not owned by your trust should be transferred to the trustee of your living trust after your death. (This does not mean, however, that your beneficiaries can avoid going through probate for these assets.)

Your will can nominate guardians for your minor children as well. Any assets that are held in a trust for your children would still be managed by the trustee.

10. Will a living trust help reduce the estate taxes?

No. While a living trust may contain provisions that can postpone, reduce or even eliminate estate taxes, similar provisions could be placed in a will to accomplish the same tax planning.

11. Will I have to file an income tax return for my living trust?

No, not during your lifetime. The taxpayer identification number for accounts held in the trust is your Social Security number, and all income and deductions related to the trust's assets are reportable on your individual income tax returns.

Separate tax returns for your trust will become necessary when your trust becomes irrevocable, such as after your death. These are called fiduciary tax returns and, most often, show that the net trust income has been passed through to the estate beneficiaries leaving nothing to be taxed to the trust or estate.

12. What other estate planning documents should I have?

A *durable power of attorney for property management* could be helpful if you ever become incapacitated. It deals with assets that were not transferred to your living trust before you became incapacitated and any assets that you receive afterward. With this power of attorney, you appoint another individual (the *attorney-in-fact*) to make financial decisions on your behalf.

This power of attorney, however, cannot replace a living trust because, among other things, it expires when you die. It cannot provide instructions for the distribution of your assets after your death.

However, it can provide the means to transfer assets to your trustee that have not yet been "funded" into the trust.

Another function of the durable power of attorney is to authorize your agent to handle things that the trustee cannot do. These typically relate to your personal care (hiring care providers, obtaining health care services, etc.); planning involving your long term care, life insurance, benefits and retirement planning; and your personal income tax affairs, including the power to file tax returns for you when you are unable.

You might also consider setting up an *advance health care directive*. This allows your attorney-in-fact (your agent) to make health care decisions for you when you can no longer capable of making them for yourself. In your *advance health care directive*, you may state your wishes regarding life-sustaining treatment, organ donation and funeral arrangements as well. A health care directive also allows an authorized agent to access your medical information, which could be important in light of strengthened federal privacy laws.

13. What other kinds of trusts are there?

Testamentary trusts and irrevocable trusts are two other types of trusts:

- **Testamentary trusts** are trusts that are based on instructions in your will. These trusts are not established until after the probate process. They do not address the management of your assets during your lifetime. They can, however, provide for young children and others who would need someone to manage their assets after your death.
- **Irrevocable trusts** are trusts that cannot be amended or revoked once they have been created. These are generally tax-sensitive documents. Examples include irrevocable life insurance trusts (ILITs), irrevocable trusts for children (Minor's Trust), and charitable trusts established under specific criteria in the Internal Revenue Code. A qualified estate planning lawyer can assist you with these types of documents.

14. Who should draft a living trust for me?

A qualified estate planning lawyer can help you

prepare your living trust, as well as a will and other estate planning documents (see #17).

While other professionals and business representatives may be involved in your estate planning, a living trust is a legal document, which should be prepared by a qualified lawyer.

Ask the professional about his or her qualifications. And ask yourself whether the advisor might have an underlying financial incentive to sell you a particular investment, such as an annuity or life insurance policy. Such a financial incentive could bias that professional's advice.

A living trust is often held out as an enticement or "loss leader" by offices that are not staffed with competent and qualified estate planning lawyers. Unfortunately, some sellers of dubious financial products gain the confidence and private financial information of their victims by posing as providers of trust or estate planning services.

Trust-in-a-Box: Also be very cautious about document preparation offers where you purchase a trust and related documents at a low fee that you fill out yourself at home or on the provider's internet site. It is my experience that these documents are "one size fits all" that provide you with terms and provisions in your trust, power of attorney and will that have no bearing on your specific needs and fail to anticipate some issues that, if they are not covered by your form documents, will require expensive legal help to fix or undo the problems they create. Also, there often are errors in how they tell you to make changes to your trust such that the changes you attempt to make are not legally valid or enforceable. I have dealt with many of these "canned" trust plans which has resulted in some failed estate plans and in all cases has cost the client far more than if they had come to me in the first place.

15. Should I beware of "promoters" of financial and estate planning services?

Yes. There are many who call themselves "trust specialists," "certified planners" or other titles that suggest the person has received advanced training in estate planning. California is experiencing an explosion of promotions by unqualified individuals and entities which only have one real goal: to gain access to your finances in order to sell insurance-based products such as annuities and other commission-based products. To better protect yourself:

• Consult with a lawyer or other financial advisor who is knowledgeable in estate planning, and who is not trying to sell a product which may be unnecessary-before considering a living trust or any other estate or financial planning document or service.

• Always ask for time to consider and reflect on your decision. Do not allow yourself to be pressured into purchasing an estate or financial planning product.

• Know your cancellation rights. California law requires that sellers who come to your home to sell goods and services (not including insurance and annuities) that cost more than $25 must give you two copies of a *notice of cancellation* form to cancel your agreement. You, the buyer, may cancel this transaction up until midnight three business days later. You have 30 days to cancel insurance and annuity transactions.

• Be wary of organizations or offices that are staffed by non-lawyer personnel and that promote one-size-fits-all living trusts or living trust kits. An estate plan created by someone who is not a qualified lawyer can have enormous and costly consequences for your estate. Do not allow yourself to be pressured into a quick purchase.

• Be wary of home solicitors who insist on obtaining confidential and detailed information about your assets and finances.

• Find out if any complaints have been filed against the company by calling local and state consumer protection offices or the Better Business Bureau.

• Insist on the person's identification and a description of his or her qualifications, education, training and expertise in estate planning. Also, keep in mind that legal document assistants are not permitted to give legal advice. And paralegals must work under the direct supervision of a lawyer. (As a precaution, ask to speak directly to the supervising attorney if you are not given an opportunity to do so.)

• Always ask for a copy of any document you sign at the time it is signed.

• Report high-pressure tactics, fraud or misrepresentations to the police or district attorney immediately.

16. How much does a living trust cost?

The cost of your living trust plan depends on your individual circumstances and the complexity of documentation and planning required to achieve your goals and objectives.

The costs also may vary from lawyer to lawyer. Generally, the costs will include the lawyer's charges for discussing your estate plan with you and for preparing a living trust agreement, your will, power of attorney or other necessary legal documents; supervision over their execution; and services or instructions for funding your living trust. A qualified estate planning attorney can give you a reasonably accurate estimate of these costs based on his or her level of knowledge and experience in this area.

It is crucial to keep in mind that a living trust is a very important part of your estate plan. Avoid being lured by promotions for extremely low-cost living trusts without checking out those who are making the offer. They most likely are “loss leaders” intended to get your business. Also keep in mind that these persons have no ethical obligations to you as your lawyer does; such as the duty of unwavering loyalty only to you, the duty to act competently in providing legal services to you, the duty to keep your confidences, etc. These obligations add exceptional value to your estate plan and its success in meeting your goals.

If you retain a lawyer, you should understand what services are to be provided and how much they will cost. California law generally requires that a lawyer explain, in writing, the nature of the services to be rendered, the cost of those services and the payment terms. Some lawyers charge a flat fee for estate planning services. Others charge on an hourly basis or use a combination of both types of fees. Your lawyer is required to have a written agreement with you for the provision of services in which the issue of cost is thoroughly addressed.

The information provided on my web site (***phaweslaw.com***) and our initial, no cost consultation typically provides sufficient means of determining your planning needs before you commit to the legal cost of preparing and implementing your plan.

17. How do I find a qualified lawyer?

If you do not know a lawyer who is qualified to help you with your estate plan, ask someone whose judgment you can trust-a friend, an associate or an employer, for example. You may call a local State Bar-certified lawyer referral service. I belong to an organization of professionals who regularly do estate planning and elder law matters: the National Academy of Elder Law Attorneys. This is a great source of information in this area of law and for locating the right lawyer in or near your community. You may use their website at ***naela.com***.

Some lawyers who work in the trust and estate planning area are "certified specialists in estate planning, trust and probate law." This means that they have met certification standards set by the State Bar of California. Like me, not all lawyers who have such experience and expertise in estate planning have sought such certification. For a list of specialists and more information on the certification program, go to the State Bar website at: ***www.californiaspecialist.org***.

If you decide to hire a lawyer, make sure that you understand what you will be paying for, how much it will cost and when you will be expected to pay your bill. Again, this information is required to be provided to you and as part of your fee agreement with the lawyer.

For more information, see the State Bar pamphlet How Can I Find and Hire the Right Lawyer? You can order this pamphlet and other State Bar consumer pamphlets free of charge by sending an e-mail to ***pamphlets@calbar.ca.gov***. To find out how to order the State Bar's consumer publications by mail, call 1-888-875-LAWS (875-5297). Or visit the California State Bar's Web site (***www.calbar.ca.gov***) where you'll find the pamphlets as well as information on how to order them.

Some of the content of this article has been taken from the American Bar Association’s pamphlet on estate planning. If you wish to see the pamphlet you may find it on their web site.