STRAIGHT TALK ABOUT LIVING TRUSTS

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A living trust is a valuable tool for managing assets, avoiding guardianship, and avoiding probate. Because of the large amount of interest generated in **living trusts**, the following discussion answers some common questions. By reviewing this information, you will have a general understanding of living trusts and will be better able to decide whether you need one and, if so, what kind.

WHAT IS A LIVING TRUST?

A living trust is a written agreement between an individual, called the "grantor," and a "trustee" regarding the receipt and management of property and the distribution of the property on the death of the grantor. The grantor transfers the "legal" title of the property to the trustee and either retains the beneficial interest or transfers the beneficial interest to a third party.

IS THERE MORE THAN ONE TYPE OF LIVING TRUST?

A **living trust** can be either **revocable** or **irrevocable**. The revocable trust is the most flexible arrangement that does not involve gift tax consequences.

There are three different types of revocable living trusts. These different types are "**full-service**," and the "**self-administered**" living trusts.

In a **full-service** living trust, the grantor transfers the legal title to the assets to a corporate or other professional trustee. This trustee is responsible for the management and investment of the assets during the grantor's life and after the grantor's death.

A **self-administered** living trust arrangement involves the re-registration of the title to the assets in the grantor's name "as trustee." Until disability or death, the grantor holds both the legal title and equitable title to the property and has full management and investment authority and responsibility. Upon disability or death, a "successor" trustee has the assets re-registered in the name of the successor trustee and begins the management and investment functions.

WHAT ARE THE ADVANTAGES AND DISADVANTAGE OF A "FULL SERVICE" LIVING TRUST?

Assets included in a full-service living trust are not part of the grantor's "probate" estate. In addition, creating a full-service trust and placing all assets in the trust will normally avoid the necessity of a guardianship if the grantor becomes unable to mange his or her financial affairs since management is provided by the trustee. During the grantor's life, the grantor may retain the right to direct the distribution of income and principal from the trust and direct the investment or the trust assets. Professional investment advice and professional management is available. In case of disability, management will continue without the necessity of re-registering the assets in the trust. The trustee may pay the grantor's bills and will provide accurate accountings of the transactions in the trust on either a monthly or a quarterly basis. The trustee must also apply for a separate identification number for the trust and begin filing separate fiduciary income tax returns (Form 1041) for the trust immediately. The fee for "full-service" trust arrangements is normally based on the value of the trust assets and the amount of the income generated. This yearly fee is approximately 1% of the asset value of the trust. Since fees vary, the grantor should contact the professional trustee which the grantor plans to name to determine their exact fee.

WHAT ARE THE ADVANTAGES AND DISADVANTAGES OF A "SELF-ADMINISTERED" LIVING TRUST AGREEMENT?

As with the full-service, the self-administered living trust assets will avoid probate and guardianship if all assets are transferred to the trustee. The grantor uses his or her social security number for the trust and no separate income tax return is required. Since the grantor acts as his or her own trustee, no current trustee's fees will be paid. Upon the disability or death of the grantor, however, the assets must be re-registered in the name of the successor trustee. As will be discussed, it is difficult in many cases to determine when the grantor becomes "disabled." In addition, the re-registration process will normally cause a delay in the income stream while the asset are being re-registered. No professional management or investment advice, other than advice from brokers and financial advisors which is available to an individual who does not create a trust, is provided until the assets are registered in the name of the successor trustee. When a professional successor trustee receives title to the trust assets on disability or death, a full trustee's fee is charged. A trusted family member may be named as successor trustee to minimum or eliminate the successor trustee's fee.

DOES A LIVING TRUST AVOID GUARDIANSHIP?

A living trust is often created to provide for the grantor and his or her family in case of incompetency of the grantor. In addition, living trusts eliminate the need for a public finding of incompetency and the delay and expenses associated with a guardianship.

A **full-service trust**, which is funded with all of an individual's assets, provides an effective vehicle to manage an individual's assets in case of incompetency and will eliminate the need for a guardianship if all assets are transferred to the trust. Since the professional trustee is given the authority and direction to manage and invest the assets of the trust, there is no need for a public finding of incompetence. In many cases, the individual can be given a "veto" right over changes of investment with a time limitation attached to the veto. If the individual fails to respond because of disability, changes in the investment portfolio can be made without a finding of incompetence.

On the other hand, in the case of a **self-administered living trust**, the grantor's spouse, physician, or trusted advisor must determine that the grantor is unable to "manage their financial affairs" before the standby or successor trustee can take over the management and investment responsibilities. It is not advisable to leave this determination solely to the individual's spouse or trusted advisor since an intervening incompetency of the spouse or trusted advisor can leave no one able to make this decision. In addition, it may be difficult to persuade a physician to find that the grantor is unable to manage their financial affairs. Because of the current "malpractice crisis," many physicians are reluctant to make such a determination. In addition, a family physician may be unqualified to make this decision since the physician is unfamiliar with the complexities of the grantor's finances.

DOES A LIVING TRUST ELIMINATE DELAY IN TRANSFER OF ASSETS CAUSED BY PROBATE?

Living trusts have been advocated because they provide a quick distribution of the assets to the ultimate beneficiary after death. Generally, if the estate must file a federal estate tax return, the Internal Revenue Service will take approximately one year, if no taxes are due, and between eighteen and twenty-four months, if taxes are due, to give final estate tax clearance. Most trustees are reluctant to make final distribution of the assets until the estate tax proceeding has been concluded. Consequently, final distribution of assets from a living trust involved in an estate which is required to file a tax return cannot be made any quicker than if the assets were probated.

In the case of an estate which is not required to file a federal estate tax return (generally a gross estate of less than $5,490,000 in 2017), the time in which the assets can be distributed depends on the nature of the trust. Since **full-service trust** assets are in the name of the trustee, distribution can take place immediately. Many trustees are hesitant, however, to make distributions until the three-month estate "claims period" expires. Likewise, the trust limitations period is six months after notice of the trust is received by the beneficiaries of the trust and four to five years on contracts made by the trustee. Since the three-month "claims period" applicable to probate proceedings is not applicable to living trusts, assets in the living trusts are subject to the claims of creditors **longer** than they would be in a probate proceedings.

Until final distribution, however, the income and part of the principal will be available to the ultimate beneficiaries of the trust. **Self-administered living trust** assets must be re-registered in the name of the successor trustee after the death of the individual; creating the trust. In most situations, the transfer agent will require a copy of the trust document and the death certificate. Therefore, the re-registration process will take approximately the same amount of time as re-registration through probate. Consequently, there is no decrease in the delay associated with the re-registration of assets if a self-administered living trust is created.

DOES A LIVING TRUST PROVIDE MORE PRIVACY?

According to the Florida probate statues, the Will is a public document and is available for inspection by anyone after death. On the other hand, a Living Trust is generally available for inspection only by beneficiaries of the trust. In the case of a self-administered living trust, a transfer agent will normally require a copy of the trust document before re-registering the assets in the name of the successor trustee. In addition, unless a successor trustee is named in a deed to real estate owned by the trust, a copy of the trust document must be recorded in the public records to show the name of the successor trustee.

The Florida probate statutes provide that an inventory must be filed with the court. This inventory is a confidential document which is only available for inspection by the interested parties in the estate. These interested parties generally include the beneficiaries under the will and any creditors who have been acknowledged but not paid. Likewise, the beneficiaries of a trust are entitled to receive accounting showing the value of trust assets.

IS A LIVING TRUST HARDER TO CONTEST THAN A WILL?

The terms of both a will and a trust may be contested by beneficiaries or other interested parties. In the case of a will contest, there are well-defined procedures embodied in statutes and case law connected with challenges to the validity of a will. A will contest is heard by the probate court which is familiar with and has special rules for these types of proceedings.

On the other hand, an action to contest a trust is heard in the general civil division of the circuit court and the rules of civil procedure apply. The procedures regarding a trust contest are generally more complicated and will be more expensive than a will contest.

DOES A LIVING TRUST PROVIDE FOR CONTINUITY OF MANAGEMENT?

A **full-service living** trustee has full power and authority to manage and invest the trust assets. The grantor has an opportunity to evaluate the trustee's management and investment skills during his or her lifetime and the opportunity to provide input to the trustee can fulfill his or her wishes after the grantor's death or disability.

A **self-administered** trustee has no current management or investment responsibilities. Consequently there is no continuity of management and the individual creating the trust cannot evaluate the trustee's management or investment performance.

CAN A LIVING TRUST DEFEAT THE CLAIMS OF CREDITORS OR LIMIT A SPOUSE'S "ELECTIVE SHARE"?

The laws of the State of Florida provide that an individual cannot create a trust to defeat the claims of creditors. Consequently, the living trust vehicle is not effective for this purpose.

A living trust will defeat a spouse's "elective share" rights, which allow the spouse to elect against provisions of a Will and receive 30% of the elective estate if the property was an asset of the trust at all times between October 1, 1999 and the date of the decedent’s death. Property added to a living trust after October 1, 1999 is part of the elective estate and subject to the elective share rights of the spouse. A living trust cannot be used to defeat a spouse's homestead rights.

DOES A LIVING TRUST REDUCE FEES AND SETTLEMENT EXPENSES OF PROBATE?

Generally, it is more costly to create a living trust and a "pour-over" Will than a Will. In addition, the assets in the grantor's name must be re-registered in the name of the trustee for a living trust to be effective. The re-registration, in most cases, involves the cost of preparation of deeds, stock powers and other documents. If all of the assets of the grantor are held "tenancy by the entireties" with the grantor's spouse, the assets will generally have to be divided and separate living trusts for each spouse will have to be created and funded.

A full-service will involve immediate trustee's fees. On the other hand, a self-administered trust will not initially involve trustee's fees

In the probate of an Estate, the following fees are deemed by the Florida Statutes to be "reasonable". First, each personal representative is entitled to a fee equal to three percent (3%) of the probate estate to a maximum of six percent (6%). The attorney for the Estate is entitled to a fee equal to three percent (3%) of the probate estate, plus one-half percent (.5%) of the gross estate for federal estate tax purposes, plus a reasonable hourly fee for extraordinary services rendered. Although these personal representative's and attorney's fees can be challenged by the beneficiaries, the costs of determining these fees are deemed to be an expense of administration. Therefore, the personal representative and attorney are entitled to be reimbursed for the time and costs in proving their fees.

On the other hand, the attorney's fees associated with living trusts are two and one-quarter percent (2.25%) of the value of the trust assets plus one-half percent (.5%) of the gross estate for federal estate tax purposes for preparing the estate tax return, plus a reasonable hourly fee for extraordinary services rendered. Trustee's fees for a corporate trustee are generally based on the corporate trustee's fee schedule. Trustee's fees for an individual trustee are generally charged on an hourly basis.

Therefore, the percentage personal representative's fees and three-quarters percent (.75%) of the percentage attorneys' fees can be avoided by avoiding probate through the creation of a living trust.

DOES A LIVING TRUST REDUCE TAXES?

If the grantor retains the right to amend or revoke the trust agreement or receives the income of the trust during his or her lifetime, a living trust does not reduce income taxes. All of the income from the trust is taxed on the return of the grantor.

Likewise, if a trust can be amended or revoked or if income rights are retained by the grantor, the trust assets will be taxable in the grantor's estate for estate tax purposes. Consequently, creating a revocable living trust will not reduce federal estate taxes.

In fact, placing all of an individual's assets in a living trust will reduce the "postmortem" income tax planning opportunities available to the personal representative and the trustee. A trust which does not distribute all of its income is subject to the "throwback" rules. An estate is not subject to these rules. Consequently, an estate income can be accumulated or distributed among the various beneficiaries of the estate to minimize the estate income taxes. Likewise, trusts are required to file a "calendar year" tax return. Estates are exempt from this requirement during the first two years of administration. Therefore, taxation of income on assets passing through probate can be deferred. Finally, trusts are required to pay estimated taxes on their income. Estates are exempt from this requirement for two years. Consequently, if the estate income is large, income taxes may be saved by having some property pass through probate rather than having it all pass through a living trust.

WHAT DOES THIS ALL MEAN TO YOU?

The **full service living trust** provides professional management and professional investment opportunities. It also provides a vehicle for managing property after disability and ensures that the income from assets will be available after death to maintain an individual's spouse and family. It normally involves immediate fees and costs.

The **self-administered trust** provides no additional management or investment opportunities. There are not costs involved while the grantor serves as trustee. No death taxes are saved after death as a result of the creation of a self-administered living trust. Personal representative's fees and attorney's fees associated with probate are saved. If a corporate trustee is named as successor trustee, fees are payable according to the trustee's fee schedule. An individual successor trustee is entitled to a reasonable fee. Difficulties may arise in activating the trust after disability and delays will occur in the re-registration of the trust assets after disability or death. After the successor trustee takes over the management of the trust assets, professional management and investment services are available. Although the problems associated with determining "disability" and re-registering the assets may cause delays, these delays are superior to a guardianship which require a public finding of incompetency and thousands of dollars in attorney's fees, medical expert's fees, and court costs.

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