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What you should know about.....



Revocable ("Living") Trusts

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What is a revocable trust?

A *trust* exists when one person (often called the *grantor* or the *settlor*) gives property to another person (called the *trustee*) to hold and manage for one or more other persons (called the *beneficiaries*). Under the Ohio Trust Code, a revocable trust (sometimes also known as a "living trust") is a trust that the grantor can amend (change) or revoke (cancel) during his or her lifetime. Through the terms of the revocable trust, the grantor keeps all the benefits of any property placed into it for the rest of his or her life. The grantor also can be the trustee, but the grantor's spouse or a trust company also often serves as trustee. A revocable trust can be funded with any property such as bank and brokerage accounts, stocks and bonds, a home and other real estate. Some revocable trusts may not be funded initially, but rather at a later time or at the grantor's death. An attorney can help advise when a trust should be funded and with what property. The terms of a trust are described in writing in a document often called the *declaration of trust* or *trust agreement*. This document is signed by both the grantor and the trustee.

Why should I consider incorporating a revocable trust into my estate plan?

You may wish to create a revocable trust to accomplish one or more purposes. First, you may wish to fund a revocable trust in order to *avoid probate*. If you, acting as a grantor, register your property in the name of the trustee of a revocable trust, that property generally is neither probate property nor subject to the jurisdiction of the probate court after you die. Second, a trust can provide estate management for your family after your death. Finally, you may wish to create a trust to reduce or defer estate taxes. Before adopting a revocable trust, you should consult with an attorney.

What is probate?

When an Ohio resident dies owning probate property, a legal proceeding is begun (1) to determine the last valid will of the decedent, if any; (2) to determine the nature, extent and value of the decedent's assets that are subject to probate; (3) to establish the valid debts of the decedent; and (4) to establish the method of distribution of the assets to the heirs or beneficiaries of the decedent after payment of applicable debts, taxes and expenses. This proceeding is known as *probate*. A more detailed explanation of the probate process is available in the publication, "What you should know about . . . Probate," published by the Ohio State Bar Association.

Is use of a revocable trust the only way to avoid probate?

No. There are several other ways to avoid probate. For example, if you own assets jointly with one or more others who have rights of survivorship, those assets will pass by law to the survivor(s) when you die, and not be subject to probate. However, you should be careful before creating a joint account, because the joint tenant will have rights in the joint property as soon as you create the account. Payable-on-death (POD) bank accounts and any assets that are payable to beneficiaries according to a contract (such as proceeds from life insurance policies or pension benefits) will avoid probate, as will transfer-on-death (TOD) designations for real estate or transfer-on-death registrations for securities and motor vehicles. You would be wise to consult with an attorney before structuring your property to avoid probate, because avoiding probate may not always be in your best interests.

Will I save estate taxes with a revocable trust, compared with a will?

Estate taxes are not based on the way in which assets are passed down to beneficiaries. Rather, they are based upon the value of the assets you own, control or benefit from, and to whom the assets pass. Generally, avoiding probate does not decrease the estate taxes that must be paid. Depending upon the terms of your revocable trust, will, or through the use of certain probate-avoidance techniques, estate taxes may be increased, decreased or deferred. You may save substantial tax dollars for your family's benefit by getting advice about how to use these documents and techniques.

Will having a revocable trust avoid challenges by my beneficiaries or heirs?

Disgruntled heirs or beneficiaries can challenge the validity of a revocable trust on the same legal grounds as those available for challenging a will. It may be alleged that a revocable trust is invalid because the grantor was incompetent at the time of establishing the trust or was unduly influenced by some person to establish the trust in a particular manner. Further, although the period for challenging the validity of a will can be limited to three months, a longer time period (usually two years) is allowed for challenging the validity of a revocable trust. The cost of defending the validity of a will, where the executor acts in good faith, is payable from the probate estate. Similarly, the cost of defending the validity of a trust would be paid from the trust assets.

What are the advantages of a revocable trust compared to probate?

Compared to probate, there are many differences, but also some similarities in the manner in which property is administered in a revocable trust following the death of a grantor. Among the characteristics of administration of a revocable trust that a person may find desirable are:

Privacy. The terms of a revocable trust are contained in a private document, while the terms of a will, including the names of the beneficiaries, become a matter of public record once the will has been filed with the probate court. In addition, other information filed with the court during the probate process, such as the inventory of assets and the

written account of all receipts and disbursements of the estate, also become matters of public record. The administration of a revocable trust generally is not made public.

Control. The absence of any requirements to file a will or any other reports with a court increases the independence and control of the trustee, relative to an executor.

Lower costs. Some publications make extravagant claims about the extent of the costs of the probate process. The typical components of cost in the probate process are:

- court costs;
- appraisal fees;
- executors' commissions; and
- attorney fees.

While court costs will vary with the activity in the estate, presently a typical cost range will be \$200-\$250. A revocable trust would not bear these costs.

Appraisal fees typically will be incurred for estate tax purposes for real property, and may also be incurred for property such as expensive artwork and interests in private companies. A revocable trust will also incur these costs. In Ohio, if a decedent's gross estate exceeds \$338,333, the estate or trust must file an estate tax return. In order to accurately complete the estate tax returns, it will be necessary to appraise the value of the estate's assets. Appraisals also can establish the basis of estate property for federal income tax purposes.

Executors' commissions are set by state law and are based, generally, on a percentage of the value of the assets of the estate. At present, the commission varies between one and four percent of the value of the assets (combined with the income on those assets) depending on the nature, amount and title of the assets at death. However, spouses and other family members often act as executors and often waive any commissions. A trustee of a revocable trust also is entitled to a "reasonable" fee appropriate to the circumstances. Again, spouses and other family members who act as trustees often waive any such fees.

An executor may hire an attorney to assist in the administration of a probate estate. Similarly, a trustee may hire an attorney to assist in the administration of a revocable trust following the death of the grantor. If the terms of the revocable trust do not require the preparation of an inventory or the preparation of accounts, as typically they do not, the attorney fees generally will be lower for services to the trustee because time related to probate filings will not be incurred. However, the cost of attorney advice and services with regard to income tax and estate tax issues is likely to be equivalent whether provided to the executor of a will or to a trustee.

Speed of transfer. A trustee could begin making distributions of assets to beneficiaries moments after the death of the grantor. An executor cannot make distributions until he or she is appointed by the court after the will is admitted to probate, but this appointment generally occurs within days after death and, once appointed, the executor is legally empowered to distribute all the probate assets to the beneficiaries. However, it is not necessarily prudent for either a trustee or an executor to immediately distribute assets.

An executor may be personally liable for the claims of creditors left unpaid by the estate as well as any unpaid federal and Ohio estate taxes. Consequently, the executor generally will not make final distribution to the beneficiaries until the executor is satisfied that all valid claims have been paid and all estate taxes have been finally determined and paid. The trustee of a revocable trust also may be held personally liable for unpaid estate taxes and, in some circumstances, unpaid creditors.

Avoidance of multiple probate proceedings. Finally, if homes or other real property are owned in a number of different states, a revocable trust may be especially useful for avoiding separate probate proceedings in two or more states.

What are the disadvantages of a revocable trust compared to probate?

Lifetime effort. Implementation of a revocable trust is often more time consuming than establishing a will. The mere signing of a revocable trust agreement will not effectively avoid probate UNLESS the grantor's assets are re-registered, re-titled or otherwise validly transferred to the trustee of the revocable trust during the grantor's lifetime. Any assets acquired AFTER the revocable trust is created also must be transferred to the trustee. Otherwise, these after-acquired assets may be subject to the probate process.

Lifetime costs. While a revocable trust may have cost advantages relative to probate following death, a will generally has cost advantages relative to a revocable trust during an individual's lifetime. The costs associated with creating a revocable trust generally are more than those for creating a will. The execution of a revocable trust does not replace the need for a will. A will generally names an executor to administer assets that were not transferred to the trust during the grantor's lifetime. Further, the will is the appropriate document to name guardians for minor children. In addition, there are costs incurred in properly transferring assets to the revocable trust during lifetime. If the trustee is not the grantor or a member of the grantor's family, periodic trustee fees usually will be incurred if the revocable trust is funded.

Absence of court review. Generally, the administration of a revocable trust will not be supervised by any probate court except in very unusual circumstances. While this avoids the paperwork burden and expense imposed by the probate process, persons creating a revocable trust should consider that the trustee they appoint will not be accountable to a judge for the honest and accurate distribution of assets unless a beneficiary were to bring a lawsuit.

Taxation disadvantages. The Internal Revenue Code has some provisions that are more beneficial to estates than to trusts, but revocable trusts can elect to be taxed like an estate for a limited period to eliminate these tax differences.

Will a revocable trust help me while I am living?

A revocable trust may provide a structure for the management of a person's assets. This structure could be particularly useful if the trustee has investment expertise, such as a trust company, or the trustee retains investment counsel. The asset management function of a revocable trust can become particularly important if the grantor becomes incompetent or is otherwise incapable of handling financial affairs. If a revocable trust is in place, it may not be necessary to have the court appoint a guardian for the grantor's estate. Even if this becomes necessary, the trustee of the revocable trust, rather than the court-appointed guardian, would continue to have authority over property owned by the trust. One way to help reduce the need for a court-appointed guardian is for the grantor to have a *durable financial power of attorney*. Through such a document, an individual (called the *principal*) gives another individual (the *attorney-in-fact* or *agent*) the power to manage his or her assets. For more information about financial powers of attorney, see the Ohio State Bar Association's publication, "What you should know about...Financial Powers of Attorney."

Will my revocable trust save income taxes while I'm alive?

No. For all income tax purposes, you, as the grantor of the revocable trust, will have to pay taxes on the income earned by the assets transferred to the revocable trust. In most cases, the trustee of a revocable trust uses the grantor's Social Security number for income tax reporting and need not obtain a separate tax identification number. Generally, the trustee of a revocable trust does not file annual tax returns during the grantor's lifetime.

Will a revocable trust protect my assets against creditors?

Creditors are entitled to reach the assets of a revocable trust during the grantor's lifetime. Creditors generally may reach the assets of any trust to the extent that the grantor can enforce his or her own rights to trust assets. Upon the death of the grantor, it is uncertain under Ohio law whether creditors of the grantor may enforce claims against a revocable trust. A surviving spouse may not have elective share (*forced inheritance*) rights against a revocable trust as would be available against probate assets.

Can I preserve assets in a revocable trust and still qualify for Medicaid?

No. The assets in a revocable trust are *countable resources* for purposes of Medicaid qualification. The assets in the revocable trust are treated just the same as if they were owned by the grantor.

If I decide a revocable trust may be right for me, how should I set one up?

If you believe that a revocable trust may be right for you or if you are not sure if a revocable trust is right for you, consult with an attorney who is knowledgeable in probate, estate planning and taxation. After gaining information about you, your family, and your assets, and listening to your goals, your attorney will be able to discuss with you the best ways of achieving your goals and help you decide whether a revocable trust is best for you. To achieve the best results, the drafting of a trust agreement requires professional judgment.

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The information contained in this pamphlet is general and should not be applied to specific legal problems without first consulting your own attorney.

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