Consumer Legal Guide

Your Guide to a Living Trust

ILLINOIS STATE BAR ASSOCIATION

ASK A LAWYER

WHAT IS A LIVING TRUST?

Most of us share the same objectives when it comes to planning our estate: 1) provide for our spouse and/or dependent children; 2) distribute our property; 3) plan for our disability; 4) organize our finances; and 5) reduce our estate taxes. Unfortunately, most of us fail to put together a plan that achieves all of these goals. There are many approaches that can be used; some are relatively simple, while others are quite complex. The choice of the right plan for your situation requires careful consideration after receiving qualified professional advice.

This pamphlet attempts to answer your questions about one of the most popular estate planning alternatives: the revocable living trust. The answers to these questions will give you a general overview of the advantages and disadvantages of using a living trust as your primary estate planning document.

WHAT IS A TRUST?

In its simplest form, a trust is the designation of a person or corporation to act as a trustee to deal with the trust property and administer that property in accordance with the instructions in the trust document. The person who creates the trust is known as the "grantor," "settlor," or "trustor." The persons who receive income or other distributions from the trust are called "beneficiaries." A trust in essence creates a duty for the person designated as trustee to hold and manage the trust property for the benefit of the beneficiaries as named in the trust document.

WHAT IS MEANT BY A "LIVING TRUST?"

Unlike a will which only becomes effective upon your death, a living trust (also called a "grantor trust" or an "inter vivos trust") goes into effect during your lifetime and in the vast majority of cases is revocable (capable of being changed, amended, or terminated). A living trust is created by a trust agreement document that specifies who is to be the trustee and that explains how the trust should be administered both during your lifetime and after your death, among other things. It is important to keep in mind, however, that the trust document merely sets up the trust, which will remain empty until it is properly funded, or in other words until assets are actually put into the trust. It is therefore essential that you properly transfer your chosen assets to the trust at some point.

You have a lot of flexibility when it comes to setting up your living trust. You may choose to name yourself as trustee and maintain control of the assets you put into the trust, or you may designate someone else. You can also name co-trustees, even if you are one of them. Similarly, you may choose to be the sole beneficiary of the trust during your lifetime and receive the income from the trust, or you can name other people. If you become incapacitated, the trust provides for a successor trustee to manage the trust assets. Upon your death, the living trust contains instructions for the distribution of your assets, just as a will would.

The primary difference between a living trust and a will is that assets held in trust do not have to go through the probate process. When you set up and transfer your assets to a living trust, the trust is considered the owner of your assets. When you die, there is no probate because the trust already owns your assets and not you. The assets are then distributed according to the instructions in the trust.

WHO CONTROLS THE ASSETS OF A TRUST?

The trustee named under the trust controls the assets of the trust. In a living trust, the individual who creates the trust in most cases acts as trustee. If you choose to act as your own trustee, you retain broad powers to control and use the assets you put into trust. When someone other than you is the trustee, the trust sets forth specific instructions for the investment and use of the trust assets during your lifetime. Typically, you will also be the beneficiary of the trust during your lifetime, which means that you have the right to receive all the income of the trust. This is true whether you or someone else is acting as trustee. As long as you are acting as trustee of a living trust that you created, no income tax returns nor accountings are required. You also may appoint someone other than yourself to act as trustee if you feel you want your assets professionally managed, or if you want them in the hands of an independent party, although this may lead to additional work such as the filing of a separate income tax return for the trust.

WHAT HAPPENS IF I BECOME INCAPACITATED?

One of the great advantages to a living trust is that it provides for comprehensive disability planning. If you become incapacitated, a living trust provides for a successor trustee to take over the control and maintenance of the trust. The successor trustee invests the trust funds and uses them for your benefit, according to the instructions in the trust. No other disability plan provides these complete instructions. The successor trustee cannot use the assets for his or her own benefit, although he or she may receive compensation (if allowed under the terms of the trust). Additionally, the trust avoids the necessity of having a family member or other person named as a guardian by the probate court to manage your assets.

HOW DO I FUND MY LIVING TRUST?

The primary disadvantage of a living trust is that, as previously mentioned, it must be funded to be effective. The trust controls only the assets which are registered in its name, so any asset that has not been transferred to the trust before your death will likely have to pass through probate, thus undermining one of the primary advantages to having a living trust. You should therefore have all of your assets transferred to the trust, (although there may be instances where leaving certain assets out of the trust is more beneficial or even necessary). This is not a problem when the trust is set up, but every time you acquire or exchange assets, you must make sure they are registered in the name of the trust. The amount of time and fees associated with retitling property depends on the number and type of assets you have, where they are located, and how they are titled.

IS IT NECESSARY TO FUND MY LIVING TRUST?

You can choose to leave the trust unfunded during your lifetime and then have your assets transferred to it just prior to or after your death. Some attorneys who recommend living trusts prefer to leave the trust unfunded until a later "triggering" event such as a major decline in health. To accomplish this, you sign a power of attorney to your successor trustees when the trust is created that enables them to transfer assets from your name to the trust when you become incapacitated. You may also choose to execute a pour-over will that leaves all your assets to the trust (this kind of will is routinely prepared even with a funded trust in case assets are acquired later and are not properly transferred to the trust before your death). This arrangement avoids the headaches, paperwork, and expense of funding the trust when it is created. An unfunded trust does not avoid probate, but has all the other advantages of a funded trust, and probate itself can be a simple process. Unfunded trusts are also private, so if anyone did look up your will at the courthouse, they would know only that your will left your assets to the trust. Disposition of your trust's assets would remain private, however. Many people find these methods easier than the pre-death process of transferring and keeping assets in the name of the trust.

WHAT IS PROBATE?

Probate is a legal process for administering and managing estates of decedents and disabled persons. A court appoints and supervises a responsible individual or trust company, usually as designated by you in your will, who administers and distributes assets. If you have a will, the person appointed is called an "executor"; if you do not have a will, then the person appointed is called an "administrator." Probate is not necessarily a process to be avoided. In Illinois, a simplified version of probate is available that may, in fact, be helpful as families sort through issues that can arise at the time of someone's death. Probate has the advantage of involving a judge to help sort out disputes and supervise unsophisticated executors. It also has standard procedures for the orderly payment of claims and distribution of assets. Because a court is involved, however, probate can be somewhat cumbersome, with the need for preparation of special court documents and attorney appearances in court. With a sophisticated trustee or when all the beneficiaries are in agreement, avoiding probate may be desirable.

IF I HAVE A WILL, DO MY ASSETS HAVE TO GO THOUGH THE PROBATE PROCESS?

It is a common misconception that having a will avoids probate. A will must go through the probate process so that the court can declare it valid and give it legal recognition. But even so, there are still advantages to having a will. Much like a trust document, a will names an executor to handle your affairs and provides him or her with a set of instructions for distributing your assets. An important feature of a will is that it is inactive until your death, while a living trust (which is intended to avoid probate) needs to be funded and maintained during your lifetime. Also, a will is the best way to name a guardian for minor children. In Illinois, if the assets in your estate titled in your individual name have a gross value of less than $100,000 and do not involve real estate, then your will does not necessarily have to be probated. Your assets can instead be distributed after an attorney prepares a small estates affidavit.

To avoid probate for an estate worth more than $100,000 or for one that includes real estate, your property must either be held in a trust or pass directly to a beneficiary by operation of a beneficiary designation or pursuant to some special type of property ownership, such as joint tenancy. You can also avoid probate for residential real estate by using a Transfer on Death Instrument.

IS JOINT TENANCY AN EFFECTIVE WAY TO AVOID PROBATE?

Probate can be avoided by holding property in joint tenancy with another person or persons due to the fact that the jointly held property automatically goes to the surviving tenant(s) upon your death. However, there are several disadvantages to joint tenancies. To sell real estate, stocks, and many other types of assets held in joint tenancy during your lifetime, you must have the signature of all joint tenants. Thus, if your joint tenant is uncooperative or becomes incapacitated, you cannot readily sell or transfer your assets in their entirety. Bank accounts can be more of a problem because most deposit agreements give all parties the right to withdraw funds, meaning your joint tenant has the right to unilaterally withdraw funds at any time without your consent. In addition, if your joint tenant has creditor problems, the creditor can garnish the jointly held asset to satisfy the debt. Finally, adding someone as a joint tenant may be considered a gift to that person and a gift tax may be imposed. In summary, although there are advantages to using joint tenancy, they are usually outweighed by the disadvantages.

CAN A LIVING TRUST AVOID ESTATE TAXES?

Both a living trust and will, if properly drafted, can be used to reduce or eliminate estate taxes under certain circumstances, and especially for married couples. It is not necessary to create a trust to avoid estate taxes. Tax saving clauses that are included in your living trust are virtually identical to the tax saving clauses that would be included in your will. However, in addition to potential tax savings derived from a comprehensive estate plan, a living trust can also assist in organizing your finances. Thus, a living trust is well suited to both of these purposes.

HOW DOES A MARRIED COUPLE INCORPORATE TAX PLANNING INTO THEIR ESTATE PLAN?

A discussion of the specifics of the income and estate tax obligations imposed on decedents and their assets and the various planning techniques that can be used to help minimize taxes is beyond the scope of this pamphlet. A brief introduction of the topic, however, is still helpful. In general, other than income taxes, there are several taxes now applicable to decedents who were residents of Illinois and whose property was located in Illinois: the Federal Estate and Gift Tax and the Illinois Estate Tax (property located in other states and countries may be subject to additional taxes).

In effect, every person may give away during life and upon death a certain amount without incurring any tax obligation. For purposes of the Federal Estate and Gift tax, this amount is $5,430,000 as of 2015 (this number is subject to change each year, however, because the federal exemption amount must be adjusted for inflation as necessary). In addition, the State of Illinois now taxes the estates of decedents that are valued in excess of $4,000,000 (unlike the federal exemption, this amount does not require an adjustment for inflation each year). Any person whose estate exceeds these levels may need to use special estate planning techniques to take advantage of tax saving opportunities available through careful planning with the advice of an attorney.

In addition, the transfer of assets to a spouse during life or at death is not subject to a gift or an estate tax, either at the federal or state level. CAUTION: However, it is not necessarily the best tax avoidance plan to simply leave 100 percent of one's assets to a surviving spouse, as this may increase the value of the surviving spouse's estate beyond the exemption levels. The applicable exemption is determined in the year the individual dies. If your surviving spouse leaves an estate of less than the applicable exemption, no estate taxes will be due. However, without proper planning, an estate tax may be due if the surviving spouse's estate exceeds the applicable exemption amount - and estate taxes are very steep. The goal, therefore, of estate tax planning for married couples is to take advantage of the applicable exemption of both spouses, thus doubling the amount that can be left estate tax-free.

HOW DO WE TAKE ADVANTAGE OF BOTH EXEMPTIONS?

Traditionally, the primary way for a couple to take advantage of both spouse's exemptions was the use of a bypass trust. Under this technique, a couple must first divide their marital property so that upon the death of the first spouse, his or her solely owned assets can be used to fund a bypass trust up to the applicable exemption amount. The surviving spouse receives income from the bypass trust, but does not have direct control of the assets. Upon the death of the surviving spouse, the trust assets pass to the couple's heirs or other beneficiaries. The assets in this exempt trust, including appreciation in value, are not included in the estate of the surviving spouse and are not subject to the estate tax. Thus, when the surviving spouse passes away, his or her own applicable exemption will be applied to his or her estate.

Recent legislation, however, has made it much easier for married couples to take advantage of both spouse's federal exemptions by implementing the concept of "portability" in the federal estate tax system. This new provision made the applicable federal exemption "portable," meaning that the amount of the exemption that is not used by the first spouse to die can be transferred to the surviving spouse. In other words, couples can now take advantage of both spouse's federal exemptions without using a bypass trust. Portability is not recognized in Illinois, however, and thus applies only to the federal estate tax exemption and not the Illinois estate tax exemption. And even further, relying fully on portability in estate tax planning without considering how it could affect state estate taxes may result in paying taxes that could have been avoided altogether by using a bypass trust or some other similar technique.

Thus, in order to take advantage of both spouse's federal and state exemptions, proper estate planning is essential. Difference between the federal estate tax system and the Illinois estate tax system can lead to the unnecessary payment of estate taxes if they are overlooked. Developing a comprehensive plan that will eliminate or minimize estate taxes for both spouses can become very complicated and thus you and your spouse will probably want to seek the advice of an attorney.

CAN I PLAN FOR ESTATE TAXES IF I AM NOT MARRIED?

Single persons cannot shelter twice the applicable exemption from estate taxes in the same way as married couples, but there are other methods of reducing estate taxes. These methods are centered on making gifts during your lifetime to reduce the size of your estate. Normally the gifts are made to the persons who would receive your property at the time of your death. The tax rules regarding gifts are very complex, however, and a competent estate planning attorney should therefore be consulted for a full explanation of the alternatives.

DOES A LIVING TRUST SPEED UP THE DISTRIBUTION OF MY ASSETS?

The amount of time required for the distribution of assets for both living trusts and probate estates vary greatly depending on the circumstances. Probate estates usually remain undistributed for at least six months after the probate process has started to allow creditors an opportunity to present claims. A partial distribution can be made within the first six months if family members are in need. The trustee of a living trust has the same responsibilities as an executor in a probate administration: identify and transfer assets, render an accounting, pay creditors, file and pay estate and income taxes, and resolve any pending litigation. Usually this will take roughly the same amount of time as administering a probate estate. If a Federal Estate Tax return is due, the trustee or executor may elect not to distribute all of the probate or trust assets until the return is audited and the tax paid. Probate can be delayed by disputes in court.

A living trust does not automatically protect the trust assets from a dispute. Disappointed family members or creditors may file a lawsuit against the trust which could delay distribution. Most often, however, the length of the distribution process depends on how long it takes to liquidate the assets, regardless of whether they are held in a living trust or in a probate estate. For example, real estate will normally take longer to liquidate and distribute than will bank accounts.

CAN I AVOID CREDITORS WITH A LIVING TRUST?

This topic is controversial and should be discussed with your lawyer. In general, your assets cannot be "hidden" from your creditors by putting them into a living trust. At the time of your death, your trustee will pay off any final expenses and debts that may be outstanding. Moreover, because you retain control over the trust assets either by retaining the right to revoke the trust or by retaining the power to control the assets by acting as trustee, the assets held in a living trust will still be included in any calculation to determine if nursing home care, for example, is to be paid for by public aid.

In certain circumstances, so long your intention is not to defraud known creditors, it may be possible to use a living trust for the purpose of insulating your assets from the claims of certain creditors. Again, this should be discussed with your lawyer as the specific circumstances of every case must be carefully considered before relying upon this technique.

IS A TRUST MORE PRIVATE?

Like most court records, probate files are open to the public. Anyone can go to the courthouse and review your probate file which will most likely identify the value of your probate estate, your place of residence, and the names and addresses of your legal heirs. In Illinois, under the simplified procedure for probate administration known as "independent administration," an inventory and accounting do not have to be filed with the court, and therefore the key documents showing the assets of the decedent are not made public. Even though the independent administration process reduces the amount of personal information accessible to the public, a living trust nevertheless provides the ultimate in privacy because it does not pass through probate at all.

WILL A LIVING TRUST SAVE ME MONEY?

The cost of preparing a living trust as part of your estate plan is generally about the same as incorporating a similar estate plan in a will. There may, however, be additional costs associated with creating a living trust. These generally include the preparation of additional documents required to transfer assets into trust name and fund the trust. Although it costs somewhat more to have a living trust prepared and funded than to have a will prepared, the cost savings from a living trust occur after the death of the grantor. Because there is no probate involved, there are no court costs and no attorney's fees for preparation of probate documents or court appearances. In some instances, these savings are substantial. Even without probate, there may be fees for attorneys, accountants, and other professionals who assist the trustee in liquidating and distributing the assets of the trust. The trustee is normally entitled to a fee, just as an executor or administrator would be. In sum, while you might save money by creating a living trust instead of a will, the costs associated with estate planning are highly dependent on the situation and thus a living trust may end up costing you more than a will would have.

ARE THERE ANY SPECIAL ADVANTAGES TO HAVING A LIVING TRUST?

A living trust is especially useful if you own real estate in more than one state. The general rule is that real estate is probated where it is located. Owning real estate in more than one state will give rise to one main probate administration in the state of your legal residence and another (called "ancillary administration") in each additional state in which you own real estate. However, because probate is not required for property held in a trust, you can bypass probate anywhere by transferring your out-of-state real estate to a living trust. If you own a second home, vacation residence, or any other real estate outside your home state, a simple form of living trust to avoid ancillary probate of that real estate is often times appropriate.

HOW DO I CREATE A LIVING TRUST?

It is always important to have appropriate professional advice in tackling something as complicated as a living trust. In Illinois, only attorneys are allowed to assist in this process. If you need help finding a lawyer, see information on back panel concerning Illinois Lawyer Finder.

The use of a living trust is an important estate planning option. While a living trust can serve a number of valid purposes, it is generally not the only answer. Simply executing a living trust will not materially affect the disposition of your assets, will not save estate, taxes and may not reduce administration costs after your death. On the other hand, a well-prepared living trust as part of your overall estate plan has many benefits and will facilitate the implementation of a plan that meets your goals.

This pamphlet is prepared and published by the Illinois State Bar Association as a public service. Every effort has been made to provide accurate information at the time of publication.

For the most current information, please consult your lawyer. If you need a lawyer and do not have one, call Illinois Lawyer Finder at (800) 922-8757 or online **www.IllinoisLawyerFinder.com**

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