Seminars and articles about revocable living trusts have become prevalent in recent years. Many people, however, do not need living trusts. This pamphlet examines some of the claims concerning these estate-planning vehicles.

Living trusts do have certain advantages. For example, if a person owns real estate in more than one state, a trust may allow his or her estate to avoid additional probate proceedings in states other than his or her state of domicile.

If a person anticipates that his or her will may be contested, then it may be more prudent to establish a living trust, because a trust may be more difficult to challenge on theories such as incompetence or undue influence. In addition, if a person wants to designate a trust as the beneficiary of a qualified retirement plan, current regulations make it clear that the plan participant may use a revocable trust, but it is not entirely clear that a participant may use a testamentary trust, i.e. a trust under a will.

A living trust can also be useful if a person who is in poor health, or who does not want to be bothered with investment decisions, wants someone else to manage his or her assets. However, it generally is less complicated and less costly to use a durable general power of attorney for this purpose. While living trusts can be of benefit in these situations, they are not the best estate planning choice for most people in most circumstances.

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CLAIM: Living trusts reduce taxes.
FACT: Living trusts do not save estate, inheritance, or income taxes.

During the lifetime of the grantor (the person who creates the trust), the grantor is treated as the owner of the trust assets. Therefore, all of the income earned by the trust is included in the grantor's income. Similarly, when the grantor dies, the assets of the trust are included in the grantor's estate for federal estate tax purposes. All of the traditional methods of minimizing the federal estate tax (such as use of the unified estate tax credit, the unlimited marital deduction, and charitable deductions) can be incorporated into a will or a living trust. Thus, despite the claims of some living trust advocates, there is no income or estate tax advantage to establishing a living trust.

The Maryland inheritance tax actually may be due sooner if a decedent has used a living trust, rather than a will. The inheritance tax on non-probate assets held in a living trust generally is paid shortly after filing the information report, which is due within 3 months of the appointment of the personal representative. In contrast, the inheritance on probate (estate) assets generally is paid with the administration account, which is due within 9 months of the appointment of the personal representative.

After the death of the grantor, living trusts have several disadvantages for income tax purposes. Although an estate may select a fiscal year, a trust must have a calendar year. In addition, the federal income tax exemption is $600 for estates, but only $100 or $300 for trusts. However, as a result of the Taxpayer Relief Act of 1997, a personal representative may elect to treat certain qualified revocable trusts as part of the decedent's estate for the federal income tax purposes.

CLAIM: Probate must be avoided.
FACT: Probate in Maryland is relatively uncomplicated

Probate is the process whereby a court determines the validity of a will and supervises the distribution of the assets that a person owns individually, as opposed to assets that pass automatically upon death to beneficiaries or joint owners, such as life insurance proceeds, retirement plan proceeds, and jointly owned assets. Although advocates of living trusts stress that probate must be avoided at all costs, the evils of probate are greatly overstated. Certainly, there are court costs and legal fees associated with probate, but these future costs may be less than the immediate costs of setting up a trust. In addition, many of the costs associated with probate such as preparation of the federal estate tax return, will be incurred in administering a living trust as well.

Probate provides certain benefits that living trusts do not. The probate process allows supervision of estate administration by the probate court and provides notices to beneficiaries, who are given an opportunity to object. In contrast, a beneficiary of a living trust may have to sue a trustee in order to challenge the trustee's actions.

In some states the probate process can be time-consuming and expensive, but in Maryland it is relatively uncomplicated. Maryland allows a streamlined probate procedure for small estates (net estate $30,000 or less). Maryland also permits a less burdensome modified administration in certain circumstances if the residuary beneficiaries consist only of the decedent's spouse, children, or personal representatives. These options reduce the cost and administrative burdens that often are associated with probate.

In fact, in most states the actual probate fees are nominal, compared to other costs of estate administration, such as preparation of the federal tax return. In Maryland, for example, the probate fee for an estate of between $500,000 and $750,000 is $750. The cost of preparing a federal estate tax return and a fiduciary income tax return (both of which may have to be prepared whether a will or a revocable trust is used) could be several times the cost of the probate fee.

Proponents of living trusts argue that a grantor can establish maximum trustee commissions that are lower that Maryland's statutory personal representative commissions. Unlike in New York and some other states, personal representative commissions in Maryland are not mandatory. Instead, they are optional and are subject to a statutory cap (9% of the first $20,000 and 3.6% of the balance of the estate). Furthermore, in certain situations it makes sense for a personal representative who is also a beneficiary to elect to receive the greatest commissions possible. This may result in overall tax savings because an estate may deduct the commissions at the federal estate tax rate (37%-55%), but the personal representative pays taxes on the commission at his or her personal income tax rate (which may be as low as 15% for federal income tax purposes).

If a person wishes to avoid probate, a living trust is not the exclusive method of doing so. Probate property generally includes only those assets that a person owns individually. Jointly owned property passes automatically to the surviving joint owners without going through probate. Similarly, life insurance proceeds and retirement benefits pass directly to the designated beneficiaries. A life estate deed also will pass property to the remainder person without going through probate. So will other forms of ownership, such as a "pay on death" account.

If a person decides to utilize a living trust, he or she must transfer all of his or her assets to the trust in order to avoid probate completely. If any assets have not been transferred to the trust prior to death, the estate will have to go through probate anyway. In some situations the value of the assets may be low enough to permit use of the small estate procedure. Nevertheless, improper or incomplete transfer of assets to the trust may result in full-scale probate in any event.

CLAIM: Only living trusts can be used to manage affairs and avoid guardianship.
FACT: A durable power of attorney can avoid guardianship.

Some living trust proponents argue that a living trust saves the cost and time involved in getting a guardian appointed. However, a durable general power of attorney can be used to manage the financial affairs of an incompetent person in lieu of living trust or a guardianship. A power of attorney generally is less expensive and more efficient than a living trust. Even if a guardian of the person has to be appointed to make medical or residential decisions, an attorney-in-fact appointed by a durable general power of attorney could make decisions concerning assets and financial affairs.

CLAIM: Living trusts save time and money.
FACT: Living trusts often cost substantially more than a will.

Proponents often argue that living trusts save the time and money associated with probate, including court costs and legal fees. In many situations, however, the decision whether to use a living trust comes down to whether a person wants to "pay now, or pay later." There are legal fees for setting up the trusts and transaction costs involved in transferring assets (such as fees for preparing and recording a deed to transfer real estate into a living trust). In the worst case scenario, the result is "pay now, and pay later." If all of the assets have not been transferred to the trust prior to death, the person's individually-owned assets will have to go through probate anyway, The only person who is better off in this situation is the attorney who gets to set up the trust and administer the estate.

More importantly, a grantor must spend his or her own time and money in order to establish a living trust. Any potential savings through avoidance of probate would only benefit his or her beneficiaries, in what may be the distant future. In real economic terms, the initial costs may be greater than any savings that ultimately are achieved. For example, if a person pays $2,000 to establish a living trust at age 50 and dies at age 75, the real cost of the trust is what an investment of $2,000 would have earned during the intervening 25 years. Assuming a modest 5% rate of return, the $2,000 would have grown to more than $6,700. Thus, the person's beneficiaries would have to save $6,700 in probate costs just to break even.

Even if someone sets up a living trust, he or she still must have a will to transfer any assets that have not been transferred to the trust prior to death. Also, in some states, such as Florida, a living trust must be executed with the same formalities and witnesses as a will. In addition, a person who establishes a living trust still should have a power of attorney. In the event of incapacity, the power of attorney would allow someone else to manage assets that have not been transferred to the trust prior to the incapacity.

Living trusts also can cause administrative hassles. After transferring assets to the trust, the grantor no longer owns the assets in his or her own name. Even if the grantor is the trustee, many retail establishments may be hesitant to accept a check from a trustee. In addition, it generally is easier to make changes to a will, through an amendment or "codicil," than to make changes to a revocable trust.

Some advocates argue that a trustee may distribute the assets of a living trust on the day of the grantor's death, whereas an estate cannot be distributed until after the period allowed for creditors' claims has expired. However, immediate distribution of trust assets generally will not be possible if, for example, the trust is responsible for paying the grantor's debts, funeral expenses, legal fees, or death taxes, or if assets of the trust must be appraised for the federal or state estate or inheritance taxes.

CLAIM: Living trusts can be used to avoid creditors.
FACT: Living trusts <u>cannot</u> be used to avoid creditors.

During the lifetime of the grantor, assets in a revocable trust are treated as owned by the grantor and therefore, are subject to the grantor's creditors. A grantor may place a spend-thrift clause in a revocable trust so that a beneficiary's interest in the trust cannot be attached by the beneficiary's creditors. However, the same clause may be used in a will. Thus, a revocable trust provides no additional protection from creditors, In fact, when a person dies with a will, creditors have six months from the date of death to make a claim against his or her estate, while the statue of limitations for making a claim against a trust is three years - and it is not always clear when the three-year period commences.

Maryland also provides special protection for certain assets owned by a husband and wife as tenants by the entirety. For example, a creditor of only one spouse may not be able to seek satisfaction of the debt from assets owned in tenancy by the entirety. This protection is lost if the couple splits the property into tenancy in common interests in order to transfer the property to their respective living trusts.

Advocates also argue that living trusts must be used to decrease the amount that a surviving spouse is entitled to receive from the deceased spouse. However, in Maryland, a surviving spouse is entitled to a portion of the deceased spouse's probate estate, and may also be entitled to a portion of the property over which the decedent maintained dominion and control during his or her lifetime. Because a grantor of a revocable trust may alter or revoke the trust at any time prior to death, such assets may be subject to the right of election of a surviving spouse.

CLAIM: Living trusts ensure privacy.
FACT: Living trusts do <u>not</u> ensure privacy.

With probate, the terms of a will, and the decedent's assets, become a matter of public record. Living trusts do not guarantee that a person's assets will remain free from public scrutiny. For example, in order to open an account for the trust, many banks and brokerage firms require that the grantor provide a copy of the trust agreement. In addition, in Maryland a schedule of the trust assets must be filed with the Register of Wills, and thus becomes public record. It may be possible, however, to keep the trust document itself from becoming a matter of public record.

CONCLUSION

In certain limited situations, living trusts may be useful estate planning vehicles. This may be the case if a person owns real estate in more that one state, desires to have someone else manage his or her assets currently, or anticipates a will contest. Nevertheless, in most cases the immediate costs and administrative burdens involved in setting up a living trust and transferring assets to it outweigh any potential savings that may be realized by avoiding probate in the future.

A person considering a living trust should make sure that he or she has all of the facts concerning the advantages and disadvantages of these estate planning devices so that he or she may make an informed decision. It also is important to determine whether a person advocating living trusts is admitted to practice law in Maryland and practices in the field of estates and trusts. It is wise to avoid mass-marketing advertising and high-pressure sales tactics.

Living Trusts:

GET THE FACTS!

These common claims about living trusts are frequently made...

- **LIVING TRUSTS** REDUCE TAXES.
- PROBATE MUST BE AVOIDED.
- **ONLY LIVING TRUSTS CAN BE USED TO** MANAGE AFFAIRS AND AVOID GUARDIANSHIP.
- LIVING TRUSTS SAVE TIME AND MONEY.
- LIVING TRUSTS CAN BE USED TO AVOID CREDITORS.
- LIVING TRUSTS ENSURE PRIVACY.

... but how much truth is in these claims, and does it affect me or my loved ones?

Prepared jointly by the Estates and Trusts Section Council of the Maryland State Bar Association and the Register of Wills Association of Maryland. Nothing contained herein is intended to advise anyone as to the legal remedies for any particular circumstance

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