

THE LIVING TRUST - WHO SHOULD HAVE ONE?

Karen Sinchak-Higby, an Arizona attorney with more than thirty years of experience in trust work, respected author and lecturer in the area of trusts, gives her views about the need for trusts . . .

The living trust has become one of the most useful tools in estate planning. I am frequently asked by clients, "Is a trust right for me?" Below are the guidelines I have developed to help individuals determine if they should create a trust.

1. **If I want to avoid probate for my heirs, is a living trust the best tool?**

The first and foremost reason for creating a trust is to avoid probate. **Probate** is the court proceeding required at death to settle one's affairs. In Arizona, probate is required if the decedent's equity in real estate exceeds \$75,000 in value or if his or her other assets combined exceed \$50,000 in net value. This is true whether or not there is a will.

The process of probate generally takes six months to two years; it can continue much longer. A simple probate will cost around \$2,500; a typical probate costs 2-5% of the estate value. Aside from the time and expense involved in probate, the best reason to avoid it is the inconvenience. Using the court system at any time for any reason is at best unpleasant.

When your goal is to make your affairs simple and convenient for your heirs, a living trust is the best tool to use.

CAVEAT: A PERSON WHO IS UNTRAINED OR UNSKILLED IN ESTATE PLANNING SOMETIMES RECOMMENDS JOINT TENANCY AS A WAY TO AVOID PROBATE. HOWEVER, THE PITFALLS OF JOINT TENANCY ARE NUMEROUS AND SERIOUS. A LIVING TRUST DOES NOT HAVE ANY OF THOSE PITFALLS.

2. **If my goal is to keep my affairs private, is a living trust appropriate?**

Unlike a will, a living trust does not usually become a part of the public record; no one but the interested parties have access to a living trust. There is no "contest" mechanism associated with living trusts, as there is with wills. It is far more difficult to challenge a trust than a will and very few challenges are successful. In most cases, a person with a living trust can count on his or her wishes being met without public notice and without challenge. Selecting the proper trustee to carry out the trust provisions is the key to its success.

When your goal is to keep your wishes private and not subject to challenge a living trust is an effective tool to use.

3. If we want our children to inherit without death taxes, should we have a living trust?

First, let me point out that a living trust does not save any taxes for the estate of an unmarried person; for the single person, a living trust is useful for other reasons. For a married couple, however, a living trust is clearly the best way to avoid estate taxes.

NOTE: AN ESTATE WITH A NET VALUE OF LESS THAN \$5.0 MILLION IN 2011 IS NOT SUBJECT TO ESTATE TAXES, EVEN WITHOUT A TRUST. EVEN THOUGH ESTATE TAX PLANNING CAN BE ACCOMPLISHED BY A WILL, THAT WILL MUST BE PROBATED IN ORDER TO SAVE THE TAXES. IT IS THE COMBINATION OF AVOIDING TAXES AND PROBATE WHICH MAKES THE LIVING TRUST SO ATTRACTIVE.

The basis for estate tax savings is simple: by dividing the estate into the two halves when one spouse dies (the husband's half and the wife's half) each half becomes entitled to a tax credit. Thus, twice as much wealth can pass to the final heirs free of any transfer taxes. A living trust must call for the division of assets when one spouse dies in order to obtain these tax advantages.

If you're married and your goal is to minimize taxes for your heirs, a living trust (AB type) is the best tool to use, but only if your net estate is greater in value than the available tax exemption or is likely to exceed that value when you are both deceased.

CAVEAT: A LIVING TRUST CAN ONLY SHELTER A CERTAIN AMOUNT; IT CAN NOT AVOID ESTATE TAXES ABOVE THAT AMOUNT.

An individual with assets in excess of the tax-free amount (\$5.0 million beginning in 2011) or a couple with assets in excess of the tax-free amount (\$10.0 million beginning in 2011) should seek legal counsel on additional planning options.

4. If one of our goals is to protect the greatest amount of wealth for the surviving spouse, can a living trust help us?

Although most discussion of living trusts revolves around probate and taxes, there is another element which bears mention: protection from creditors.

When a living trust is properly drawn, at least half of all assets (and in some cases all of the assets) can have protection from "outsiders" in the hands of the surviving spouse. Arizona, like most states, has a spendthrift law which prevents persons other than a trust's

beneficiary from having any access to the trust's assets. For the surviving husband or wife, this translates to the ability to have a significant portion of the assets protected for his or her use only.

For example, if the surviving spouse has a long-term illness and qualifies for medicaid, the assets of the deceased spouse do not count as "resource" subject to the government's spend-down rules, if the trust is properly drawn. This is true even though the surviving spouse may have the use and enjoyment of the deceased spouse's assets.

The deceased spouse's half of all assets may also be protected from a judgement creditor or a subsequent spouse, in a properly drawn trust.

For a couple who wants the greatest level of protection for the surviving spouse so that assets can be used exclusively for that spouse, a living trust is an appropriate tool.

CAVEAT: NOT ALL LIVING TRUSTS HAVE CREDITOR PROTECTION FOR THE SURVIVING SPOUSE; THE LEVEL OF PROTECTION VARIES FROM STATE TO STATE. THERE IS NO CREDITOR PROTECTION IN THE LIVING TRUST FOR THE COUPLE WHILE BOTH SPOUSES ARE LIVING.

5. Is it true that a living trust can also save income taxes for the surviving spouse?

Arizona is one of the nine community property states. There is a little known and often overlooked feature of community property which can result in significant **income tax** savings for a surviving husband or wife.

This is because of federal and state laws which give a new **cost basis** to community property assets when one spouse dies. In the hands of the surviving husband or wife, assets which have appreciated in value can be sold without income taxes! Although this result can be achieved without a living trust, a probate is often required to get the same result.

For a couple with appreciated assets who wants to obtain the income tax advantages of community property, a living trust is the best tool to use.

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I am sometimes asked what is the "down-side" of a living trust, because it has so many obvious benefits. Having been involved in hundreds of trusts over the course of more than two decades, I've learned that not all trusts are created equal. Those who prepare trusts (lawyers and non-lawyers alike) have varying degrees of skill and

experience. A properly drawn trust can easily accomplish all of its intended objectives; an improper trust cannot.

The estate planner who finds out everything that's important to you is far more likely to design a trust which meets your needs. The key to finding that estate planner is to choose the one who listens to you carefully.

Many trusts are based upon forms prepared by bank lawyers or other individuals who have a specific objective in mind, such as obtaining control and management of the estate when there is a death or incapacity. An attorney may not have the knowledge or skill to guide you into a trust plan which meets your personal objectives. An example is a trust which puts a bank in charge of the estate rather than the surviving widow or widower, even when that spouse has the capacity to manage on his or her own. Most of the complaints I have heard about the living trust stem from this loss of control, a problem not really related to the living trust but to the draftsman who prepared it.

The cost of creating a trust does not necessarily reflect the quality of the trust. There's no such thing as a "standard" fee for creating a trust. Instead, each attorney or non-attorney who prepares a trust is free to charge whatever he or she deems appropriate. The result is that the cost of creating a trust can be "cheap" or "expensive" or anything in between. No one is more disappointed in fees than the client who pays for a living trust and later learns that he doesn't have the right trust and that he must pay again. The best way I know to avoid this problem is to take care in selecting your trust preparer: choose someone who has plenty of experience with cases similar to yours, choose someone you feel a strong and positive "connection" to; discuss the preparer's personal and professional philosophy about estate planning to determine if he or she shares your fundamental values.

CREATING A LIVING TRUST IS ONE OF THE MOST IMPORTANT THINGS YOU WILL DO IN YOUR LIFE. IDENTIFY SOMEONE WITH THE EXPERIENCE AND SKILLS WHICH MATCH YOUR NEEDS AND EXPECT TO PAY A FAIR PRICE.