



FROM THE SCHUMAN & ISELT, LLC RESOURCE LIBRARY

# LIVING TRUSTS

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Living trusts are a hot topic. Anti-lawyer activists claim that everybody should have a living trust instead of a will, and that the only reason lawyers write wills is to protect extravagant fees in probate. Lawyers claim that con artists and hucksters are using scare tactics to sell unnecessary and harmful trust kits. Actually, a living trust is a tool that's useful for some people and inappropriate for others. For instance, Joe prepared a living trust for his father Stanton and one for Stanton's mother before that—but he has a will for himself, and has advised his brothers and sister that wills are better for them.

We hope this memo will help you understand what a living trust is, how it works, and whether or not it's the best choice for you. We'll try to highlight some of its costs and benefits so you can make a sensible decision.

## LEGALESE 101

There's a blizzard of technical terms to confuse our discussion. A living trust is the same thing as an inter vivos trust; it usually works along with a pour-over will; and it has almost nothing to do with a living will. We need to straighten out a bunch of these words before we begin.

### Will

A will tells what happens to your property at your death. The executor is the person you name in the will to carry out the instructions you give. Your will only applies to property you own in your own name. It does not apply to property you hold in a trust; to a pension plan or other account with a named "payable on death" beneficiary; to property you hold as joint tenant with somebody who survives you; or to a life insurance policy payable to a specific person. Also, your will does not have any effect until your death. For example, designating a person as executor in your will does not give the person any legal rights during your lifetime.

### Power of Attorney

While a will has no effect until death, a power of attorney is the opposite: it applies while you are living, but, with a few exceptions under Illinois law, it stops when you die. A power of attorney allows you to designate somebody called your agent to act on your behalf during your lifetime. You can also use the document to give instructions to your agent. A property power of attorney lets your agent deal with your property by, for example, paying bills and filing tax returns. A health care power of attorney lets your agent give instructions to health care providers.

We have a different memo, "Planning for Disability with the Power of Attorney," to explain the power of attorney.

## Living Will

An instruction about termination of treatment when you have a terminal illness is called a living will. You may sometimes see a similar paper referred to as an advance directive. There's a little more information about living wills in "Planning for Disability with the Power of Attorney."

We usually recommend against living wills for Illinois residents. If you want to protect yourself from "being kept alive on machines" or "living like a vegetable," a Health Care Power of Attorney will probably work better.

## QTIP Trust

Q-TIP is a brand name, but QTIP is an abbreviation. It stands for qualified terminable interest property. A QTIP trust sometimes reduces estate tax. We can make a QTIP trust in a will or in a living trust. QTIP trusts are hard to explain, which isn't surprising since they are defined in the tax code. "Explanation of QTIP Trusts" is a memo where we try.

## Living Trust

The main functions of a living trust are to avoid probate, protect you in case of disability, and make it easier for your survivors to transfer your assets. It can do much of the work of a property power of attorney and also the work of a will.

People sometimes refer to a living trust as a revocable trust (because you keep the power to change or revoke the trust at any time); a loving trust (because the phrase sounds good); a self-declaration (because you usually make the trust effective by declaring yourself trustee); or a trust inter vivos ("between living persons:" lawyers like Latin; this phrase distinguishes a living trust from a testamentary trust which is written in a will).

A living trust does not have any automatic tax advantage over a will. There are sometimes ways to reduce taxes using trusts, but you can use the same strategies just as effectively with a will.

# HOW A LIVING TRUST WORKS

If we decide to write a typical living trust for you, you will sign a trust paper. It will set out all the rules for the trust. You will be called the "grantor." While you are able to take care of your own affairs, you will also be the trustee (who manages the trust) and the beneficiary (for whom the assets are managed). You will keep the right to revoke or amend the trust at any time.

## Avoiding Probate

The trust will tell what happens to property in the trust, and who takes care of it, after you die. Hopefully, the trust will own all your property, so this part of the trust works like a will...but



better. Property which passes according to a will must go through probate: first the executor must be appointed by a judge, then the property must be transferred to the executor, and finally it must be transferred by the executor to the people named in the will. Property which is in a trust, on the other hand, can be distributed by the successor trustee without any court involvement.

*But the trust only controls property owned by the trust.*

Here's an example. Let's say Isaac's will left everything to Jacob. Isaac changed his mind and wanted to leave everything to Esau, and he decided to use a trust to avoid probate. He wrote a trust saying that, after his death, all the trust property would be distributed to Esau, but he never changed his will.

When Isaac died, he had some bank accounts which he had changed to show that they were in the trust. Bank records showed the owner of those accounts as "Isaac, Trustee of the Isaac Trust." Following Isaac's death, the successor trustee distributed those accounts to Esau as Isaac intended.

But what if Isaac forgot to change the bank records on a few accounts? What if there were accounts whose records showed "Isaac" instead of "Isaac, Trustee of the Isaac Trust"? Those accounts would go to Jacob according to the old will.

The point of the story is this: The trust controls only that property owned by the trust, nothing else.

## **We have three ways to make sure the trust works**

*First, we'll try to change the name on everything you own.* We call this process "funding the trust." You'll need to change the name on bank accounts and brokerage accounts. You may even need to close each of the old individual accounts and open new trust accounts instead. Every stock certificate will have to be surrendered and reissued. You'll sign a quitclaim deed for every piece of real estate, giving your interest to the trust.

There are advantages to having a trust and advantages to skipping it. But there are no advantages to having a trust that doesn't work. If you die with too much property in your own name, your estate will need to go through probate even if you have signed a trust, paid for it, and have done almost all the paperwork to fund it.

Even if we successfully fund the trust, your work isn't done. Whenever you open a new account, or buy new stock or a home, you will have to remember to put the new property in the trust, too.

*Our second tool is a backup.* You'll sign a paper saying that you want your trust to own everything—even a bank account that shows your name individually. Once in a while, a bank might accept this paper, and release an account without probate, even though the account registration is individual.

*Our third tool is a second backup.* This third tool is a "pour-over" will—a simple will leaving everything to the trust. We call it a pour-over will because it has almost no substantive

provisions. All it does is direct that any assets still held in your own name at the time of your death should be poured over into the trust. The pour-over will won't let you avoid probate, but at least it will make sure all the property goes where you intend.

## Disability Planning

The trust serves another function besides standing in for the will: it can do most of the work of a property power of attorney.

Most of us have a time—temporary or extended—during which we can't take care of our own affairs. A living trust allows somebody else to handle most of your business for you.

Here's an example from Joe's own experience. Joe, Joe's father, and Joe's grandmother Ida were all co-trustees of her living trust. For ten years after they set up the trust, Ida was able to handle everything by herself, so Joe and his Dad didn't do anything. After she passed 90, she started having trouble with her income tax returns, and Joe started helping out. Over the next six or seven years, Joe did more and more. Joe was already listed on all her accounts as a co-trustee, so there were no formalities, no papers to sign, no doctors or courts or even lawyers to be involved. He just started acting.

Ida's trust was unusual in having three trustees from the start. More typically, the grantor starts out as sole trustee, and successors begin to serve only when necessary. One advantage of this typical structure is that it's less trouble to set up; but this advantage is partly offset by the fact that the successor trustee will have to jump through hoops if and when he or she needs to act. A second advantage of the typical structure is that the successor trustee can't meddle in your affairs when it's not necessary. But that shouldn't be a problem anyhow. If the person you have named as successor agent is somebody you can trust to take care of your affairs when you can't, he or she is surely somebody you can trust to stay out while you can.

## IS A LIVING TRUST FOR YOU?

All this sounds like a lot of work—and it is. A living trust is heavy artillery. Sometimes it's better to stick with a will system, with just a will and a property power of attorney. In general, the tradeoff is between costs now and costs later. The will system costs less now, in dollars as well as time and inconvenience. But the power of attorney is less convenient and efficient than a trust at the time of disability, and the will is less efficient than a trust at death. The trust system is more expensive and cumbersome to set up but works more smoothly later.

## Setup Paperwork

Setup paperwork is easier with the will system. You'll need some formal procedures to sign a will, but once it's signed you may not have to do any follow up paperwork at all. The paperwork to set up a power of attorney is both simple and cheap. You can even use a statutory printed form for the power of attorney if its provisions suit you.

To make a trust work, on the other hand, you have to change ownership of virtually everything you own. That means changing the registration of every bank account, stock, and other asset whose ownership is registered anywhere. You must probably sign a deed to give your house to the trust, and it's usually a good idea to change the registration on your car.

## Changing Your Plan

If you change your mind about something in your plan, you should see a lawyer, whether you have a will or a trust. However, simple changes should not be slow or expensive in either structure.

You need a formal, witnessed execution ceremony to change a will. Changes in a trust can be less formal. Usually, this means that changes in a trust can be made by mail while I'll usually ask you to come to my office to change a will. So changing the trust is a little simpler. That's an advantage if you want to change it, but it's a disadvantage if there is a lawsuit later about what you meant or whether you really meant to make a change at all.

## Maintenance Paperwork

The will and power of attorney sit in the background, unnoticed, until they are needed. The trust, by contrast, requires some attention every time you buy or sell an asset. When you sell something, you will have to sign as trustee or the paperwork may be rejected. If you buy something, you will have to remember to buy it in the name of the trust, or the plan may be frustrated and your property may have to go through probate after all.

The trust will probably not need to file an income tax return until later. So long as you are the active trustee, the trust doesn't even need a taxpayer ID.

## Enforcement Problems

Some banks and stock transfer agents may still be reluctant to recognize powers of attorney. However, Illinois law makes asset holders liable for damages if they refuse without a good reason. We have not had much trouble since this law was passed.

## When You Need Help

Whether you use the trust or the power of the attorney, you decide when your agent or co-trustee is allowed to act. With either system, you can allow your helper to do business immediately; you can withhold authority until a judge declares you incompetent; or you can write any rule in between. Since you have the same options with either system, this question shouldn't affect your choice of which system to use.

## Follow-Up Paperwork

A living trust requires more paperwork for you when you create it, but less work later, for your trustee, if you're incapacitated or when you die. On the other hand, a will and a property power of attorney require less paperwork for you when you create them, but more later for your agent if you're incapacitated and for your executor following your death.

## Secrecy

Probate proceedings are public like any other court proceeding, while trusts are usually administered privately. Unless you are very sensitive about your privacy or have a particular reason to believe somebody will be snooping, though, secrecy doesn't matter much. While wills must be filed with the clerk of court, they are rarely looked at. The executor of your will probably won't have to disclose your assets publicly unless there's a fight—in which case the trust would not give your secrets much protection anyhow.

# RECOMMENDATIONS

Here are some things to consider when you are deciding whether to prepare a living trust.

- \* *Do you have dependents?* On your death, will they have access to insurance proceeds, income, or accounts other than your estate? Property which goes through probate isn't available until several months after your death. Even if nobody is likely to suffer hardship during those months, people may be inconvenienced. If a delay is unacceptable, then you need a living trust.
- \* *Who are your beneficiaries?* Are you willing to pay fees now to save them money later? Do you want to take care of paperwork now so they won't have to do it later? If it will be easier for you to do paperwork now than it will be for them to do paperwork upon your incapacity or after your death, then you may want a living trust.
- \* *Do you have real estate outside Illinois?* Out-of-state real estate makes probating a will very complicated while, if you have a living trust, it's almost as easy to add your vacation lot to the living trust as it is to add your savings account. If you own real estate outside the state where you live, you should probably have a living trust.
- \* *Are there children from a prior marriage?* Are you concerned about divorce? Sometimes a trust can work like a prenuptial agreement or postnuptial agreement. If you have a spouse, but want most of your property to go to somebody other than him or her, a living trust might help.

For most people, we think the biggest question is life expectancy. After all, if you live forty years after you prepare your plans, you'll probably change them several times, and forty years is a long time to keep all your accounts registered in a trust name. There's also a discount factor: probate costs may be many years in the future while you must pay the living trust setup costs now. In the end, we usually recommend a will and property power of attorney for younger people in good health and a living trust to people who are older or have other reasons to expect a shorter future.

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