

EXCERPT FROM PRIMER ON AMERICAN TRUST LAW

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Revocable Trusts

What is a revocable trust? A revocable, inter vivos trust, also known as a living trust, is an express trust created by transferring legal title of property to a trustee while the settlor retains the right to revoke, alter, or amend the trust. The revocable trust is extremely popular because it provides a means of avoiding the time-consuming, costly, and very public probate system. A revocable trust maintains the advantages of a will (which can be changed at any time up to death) without actually transferring property to a beneficiary--thus maintaining maximum flexibility. The price for this flexibility is that the settlor is subject to federal estate and income tax on the property. Thus, although the revocable trust is not useful as a tax planning tool, it creates no new tax liability, maintaining the taxability of the property as if no trust were created.

All states recognize the living trust, however in most states a trust is irrevocable unless the settlor expressly reserves the right to revoke and defines the extent of the reserved powers. The Uniform Trust Code, however, reverses this rule, providing that a silent trust is presumed to be revocable. Good practice suggests, and most trust documents state whether the trust is revocable or irrevocable.

What are the advantages of a revocable trusts?

1) Costs are avoided because there is no need to change the title of trust assets at the settlor's death. Transferring title once to the trustee may be less costly than court costs, attorney's fees, and executor's fees during probate, although the additional cost of drafting and properly funding a revocable trust as well as a will must be factored in.

2) A typical estate will take longer to probate and administer, thus delaying distributions to beneficiaries.

3) Because a revocable trust is not recorded like a will, it is not subject to public scrutiny. Hence it shields persons of great wealth or fame from public curiosity and potential victimization.

4) Ancillary probate of property located outside the domiciliary state is avoided. Secondary probate proceedings out of state can be expensive and cumbersome.

5) Funded revocable trusts may be used in some states to defeat the rights of spouses and omitted children to share in probate assets. Although some states give the widow(er) rights in the trust that are equivalent to the spouse's elective share, forum shopping to create the trust in another jurisdiction may defeat that right.

6) Inter vivos trusts avoid ongoing court supervision which is imposed on testamentary trusts in some jurisdictions. Some probate courts require accountings, including the representation of unborn beneficiaries by a guardian ad litem. Also, nondomiciliary trustees may be appointed for inter vivos trusts, in contrast to the prohibition in many states against nondomiciliary trustees of a testamentary trust.

7) The settlor may choose the state in which to create the trust, shopping for a forum that is most favorable in its treatment of perpetuities issues, tax issues, and other legal matters. .

8) Contests of revocable trusts may be more difficult to win, making a trust a better strategy if a will contest is predicted.

9) A revocable trust, if fully funded during the settlor's life, can be a very effective device in planning for incapacity. In the event of the settlor's incapacity, the trustee will have control of the property to manage for the settlor's benefit. Absent a revocable trust or some other lifetime arrangement such as a durable power of attorney, a costly guardianship or conservatorship proceeding may be necessary.

But:

10) Probate is a better option in situations where it is advisable to cut off creditors' claims quickly. In all but a few states, there is a shorter limitations period for barring claims in probate than under revocable trusts.

11) The law of wills is more settled than the law of trusts.

12) There is no federal estate or income tax advantage to the revocable trust.

13) A revocable trust can be more costly to create than a will alone or will with testamentary trust. The need to register and retitle assets into the name of the trustee can add considerable expense.

14) During the lifetime of the settlor, the settlor, when engaging in financial or business transactions, must make certain that all assets remain in the trustee's names. Assets not transferred to the trustee must be probated, thereby defeating the main advantage of the revocable trust.

How are assets added to the revocable trust at the settlor's death? Assets may be added to the revocable trust by virtue of a pourover will. The pourover will merges the probate estate (or part of it) and other assets such as life insurance proceeds into a single trust with unified administration for meeting settlor's objectives. Originally, pourover wills incorporated an existing trust instrument by reference, making the incorporated document part of the will, effectively turning the living trust into a testamentary trust. The trust did not have to be funded so long as the trust document was in existence when the will was executed. In addition to incorporation by reference, pourover wills were validated under the theory of independent significance. This doctrine asserted that the trust had significance independent of the disposition of probate assets because the trust already had assets transferred to it. So long as the trust was funded, and despite any changes in the trust document subsequent to the execution of the will, assets could pour over from the testamentary estate into the independent inter vivos trust.

Since 1960, legislation has been enacted in all American jurisdictions to validate the pourover will. The Uniform Testamentary Additions to Trust Act (UTATA), revised in 1990 and incorporated into the Uniform Probate Code, is on the cutting edge of such legislation. It effectively rejects the preconditions of both incorporation by reference and independent significance: The current version of UTATA (unlike the original version) does not require a trust document to be in existence at the time the will is executed, so long as one is in existence at the time of the testator's death; nor does the UTATA require that the trust be funded prior to the pouring-over action of the will. If the trust is not created or is revoked prior to testator's death, the gift will lapse. The trust will be considered to be an inter vivos trust, not testamentary.