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LIVING TRUSTS: SO MUCH SNAKE OIL?

by Robert A. Wade, Esq.

The popular press has touted living trusts as the perfect estate planning solution for virtually everybody. However, whenever I encounter such claims, I smell snake oil. Seldom have I found an estate planning tool (with the possible exception of good old wills and powers of attorney) that is an essential part of *everyone's* estate plan.

Estate plans are heavily dependent upon many individual factors, and rarely do I see two plans that are exactly alike. Accordingly, I always look closely at the claims of any estate planning technique which purports to be "the answer."

With that in mind, I would like to examine the advantages of living trusts (also known as revocable trusts). I think that most of the financial planning pundits are overstating the advantages of such trusts and underplaying their disadvantages. This does not mean that I never recommend the establishment of a living trust. Indeed, I have recommended living trusts for several clients. In the right circumstances, the living trust is an important—or even ideal—element of a proper plan.

The advantages

The first major stated advantage of living trusts is the avoidance of probate. Establishing a living trust often obviates the necessity of having a will. And, if a will is necessary, probate costs (including court costs, legal fees, accounting fees, and the like) are lessened.

A second major advantage is the avoidance of undue publicity and the public recording of property transfers which occur with wills.

A third significant advantage is flexibility. In short, revocable living trusts are, well, revocable.

A fourth important advantage of living trusts is that they can provide for the management of one's assets in the event of incapacity.

These stated advantages are very important, and there is some truth to each of them. The trouble with the claims, however, is that they do not fully de-scribe the extent of the advantages, and virtually no one ever looks at the disadvantages of setting up a living trust.

A closer look

Let's look at the first stated advantage: namely, that the existence and funding of a living trust obviates the need for a will. This claim is based on the fact that a living trust can have "willlike" dispositive provisions.

If you were to set up a trust and fund it with assets, you could provide that during your life you would

receive all of the income from the trust and as much of the principal as you desired. On your death, you could provide that the trust's assets would be distributed to your spouse (outright or in trust), to your children, or to other beneficiaries.

The argument goes that one could put one's entire estate into a living trust, thereby eliminating the need to have a will at all. If a will is needed, the amount of property subject to probate would be so ridiculously small as to engender minimal probate costs.

Living trusts can, indeed, be substitutes for wills. However, I think it would be extremely rare to find a circumstance where an individual would not need a will anyway. No matter how completely funded a trust is, there is almost certainly going to be some property that is going to pass by will.

Personal effects, for example, are not an ideal type of asset to be held by a trust. It is also questionable whether one's home should be held in trust name. Holding real estate in a trust name can complicate sales later on.

Even if you manage to put away all of your assets at any one point into a trust, you will, at some later point, probably acquire other assets. If you are unable to transfer those over to trust name before you die, the lack of a will would create a problem. So, in my opinion, a living trust cannot exist independently of a properly drafted will.

As to the claim that a living trust will reduce probate costs, there is some truth in that. How much of a reduction depends on the size of the estate. If you have a smaller probate estate (the assets in a living trust are not subject to probate), the filing fees will be proportionately smaller. However, I think that these costs are generally overstated as a percentage of one's estate.

Flexibility

Another cited advantage of living trusts is their flexibility. Giving the grantor the ability to amend or revoke the trust means that he or she isn't encumbered with a trust mechanism which, if it becomes burdensome, cannot be changed or eliminated altogether (hence the name revocable trusts).

Revocable living trusts are flexible. Recognize, however, that not setting up a trust at all is even more flexible. Proponents of living trusts state that one can deal with the property as if it is one's own. By naming oneself as trustee, one can invest as he or she desires, and use the income and principal just as if he or she were the owner of the property. But if you look closely at what the proponents are saying here, they use the term "as if' a great deal. One can act *as if* one owns the property. That is because in a very real sense, one is not really the owner. Even though one may be the grantor, the trustee, and the sole beneficiary, there has been created a legal mechanism wherein these three functions have been legally separated. If you only want flexibility, there are better alternatives. There must be other reasons besides flexibility for establishing a living trust.

Keeping it quiet

Another purported advantage is the lack of publicity attendant to living trusts. It is asserted that wills and other probate documents are matters of public record. This is quite true.

A living trust is not necessarily filed with a court on one's death, and therefore, the terms are not open to public scrutiny. Again, there is truth to this claim. Depending upon what the trust provides for on one's death, there may never be any public scrutiny of the contents of the trust.

However, if a living trust provides for a continuing trust after the settlor's death, and names a trustee who

is not a beneficiary, there may be certain mandatory filing requirements with the court, depending upon the state. Even if certain court filings are not required of trustees, they may wish to have court approval for their actions. Trustees may also voluntarily file both the trust document and a record of their actions. It may be to their benefit to do so, and I know of no law that prevents them from doing so. So you see, the avoidance of publicity is possible but not guaranteed.

Grantors' incapacity

The other important advantage of living trusts is the ability of a successor-trustee to manage one's assets in the event of incapacity. Again, this is a very true claim. However, it should be noted that other documents will allow for the management of assets in the event of incapacity— specifically, durable general powers of attorney.

These can be established, in most states, much more easily and at less expense than a living trust. And, if one has not executed a "springing" power of attorney, the transition may even be smoother.

If the grantor of a living trust has been acting as the only trustee, then there will have to be some kind of a provision in the trust to allow for the possibility of his or her succession by another individual in the event of the grantor's incapacity.

Determining when the grantor is incapacitated, however, is not an easy issue, and is one that might very well end up bringing everything into court and thereby destroying any hopes for privacy. A durable general power of attorney, on the other hand, if executed to be currently effective, does not require proof of incapacity.

Be aware off the tradeoffs

Some of the stated benefits of living trusts are very real. It is important to note, however, that there are tradeoffs involved in setting up trusts. For one thing, setting up a trust costs money. The cost to set up a living trust can range anywhere from $500 to $1,500.

Although some individuals would exhort you to set up your own trust without the aid of an attorney, I would only ask how many people try to take out their own appendix to save themselves the cost of surgery. A wrong move, an error in drafting, and your financial house may come tumbling down.

As I have discussed, I believe that the claims on behalf of living trusts are somewhat overstated. As I also said, that does not mean I never use them. One simply has to weigh the costs and benefits, and recognize that only if one is selling snake oil can one claim to have "the" cure for everyone's estate planning troubles.

OTHER COSTS TO WATCH OUT FOR

To a certain extent, legal fees might be reduced somewhat when there is a living trust used as a will substitute. This is because many lawyers charge for estate administration based on the size of the estate. A smaller probate estate would mean lower legal fees. However, if there is to be a transfer upon death to a beneficiary from the trust, that will entail some legal maneuvering. Some of the required action may be easier, but there will probably have to be a lawyer involved. Moreover, many attorneys charge on an hourly basis, and therefore the amount that is charged depends upon the amount of work the needs to be done. A living trust may or may not reduce the amount of work that needs to be done.

Much of the work in estate administration (including the administration of a living trust) is tax-related. Living Trusts do nothing by themselves to reduce estate taxes or income taxes. Moreover, they do not eliminate the need for income tax filings or estate tax filings. Indeed, the existence of a living trust may create additional

income tax filing requirements.

There are also other costs. If one is the grantor, trustee, and sole beneficiary of a living trust, there are no current income tax or gift tax filing requirements. Add to the equation, however, an additional trustee who is not a beneficiary, and one suddenly has filing requirements for the trust.

In addition, fiduciary income tax law (as to tax law relating to trusts referred to) is no easy concept to master. May accountants and lawyers are unfamiliar with the concepts of fiduciary income taxation. Probate estates are subject to fiduciary income taxation as well; but without a living trust, there would be only one set of fiduciary income tax returns to be filed each year. With a living trust, the number of returns to be filed can be doubled.

Another costs of living trust is the time and expense of transferring title over to trust name, along with whatever difficulties result from trying to transfer titled assets out of the trust when selling them.

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Mr. Wade has extensive experience representing health care providers and related organizations. Mr. Wade focuses on physician contracting matters, including the formation of networks of physicians and health care institutions and practice valuations. Mr. Wade is also experienced in personal estate planning and estate and trust administration. An author of numerous articles on health care law and practice management issues, Mr. Wade has written for national and regional publications, including *Medical Economics, Ob-Gyn Management, Ophthalmology Times* and *Pennsylvania Medicine.* In addition, Mr. Wade authored a book, "Creating & Reaping Value Through Practice Ownership" for the American Academy of Ophthalmology. He has lectured and led seminars across the nation on health law, employment law, antitrust, financial, and other legal issues for national and local organizations. He has led seminars for many organizations, including the National Law Foundation, Pennsylvania Bar Institute, Pennsylvania Medical Society, American Academy of Ophthalmology, Association of University Professors of Ophthalmology, Vitreous Society, American Society of Cataract & Refractive Surgeons, American Gastroenterology Association, Maryland Society of Otolaryngology, American Society Of Cataract and Refractive Surgeons, and American Society of Refractive Surgeons. Mr. Wade is a magna cum laude graduate of Harvard Law School, and a Phi Beta Kappa graduate of the College of William and Mary.

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