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MontGuide

Revocable Living Trusts

by Marsha Goetting, Ph.D., CFP®, CFCS, Extension Family Economics Specialist and Professor, Montana State University-Bozeman

Defines and explains the benefits, shortfalls, costs and tax consequences of living trusts.

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ALTHOUGH REVOCABLE LIVING TRUSTS HAVE existed for many years, they have recently gained more visibility. You may have read newspaper advertisements for free seminars on the benefits of a revocable living trust, or perhaps you've seen television commercials suggesting that everyone should have one. You may also have been approached by door-to-door salespersons who tell you that a revocable living trust is appropriate for everyone.

Legitimate educational seminars on trusts and other legal and financial topics are sometimes offered by attorneys, financial planners and trust officers from banks and trust companies. Understandably, these professionals want to promote their expertise through these programs. There are some promoters, however, who give the impression that living trusts can solve almost every estate planning and financial problem imaginable.

Unfortunately, in their haste to make a sale, some promoters of revocable living trusts are providing inaccurate information. For instance, some sales representatives begin by describing the expenses of probate and give the impression that a revocable living trust will prevent all probate hassles and eliminate settlement costs and estate taxes. Other promoters suggest that a revocable living trust eliminates income taxes. And, some have claimed that if assets are transferred to a trust, they are totally protected from nursing home costs.

A revocable living trust can be an excellent tool for handling some types of financial affairs. But it is not an appropriate choice for everyone. Before you make a decision to establish a revocable living trust, invest time and effort in learning what it is. Also investigate alternative legal arrangements that may accomplish your goals more effectively, such as a durable power of attorney (MT199001HR), a will (MT198906HR), or a testamentary trust. (These Montguides are available from your local Extension Office or Extension Publications - see back page for ordering information.)

What is a Revocable Living Trust?

A **revocable living trust** is a legal arrangement by which an individual shifts ownership of property (such as securities, a home, real estate, bank accounts, certificate of deposits, stocks, bonds, life insurance) from personal ownership into the legal ownership of the trust. A revocable living trust is just what the name implies – one that is created during an individual's life, but that can be changed or terminated at any time. In Montana, unless a trust is expressly made irrevocable by the document that establishes it, it is considered revocable.

The person whose assets are placed in the trust is called a **settlor**, other terms are the **trustor** or **grantor**. The settlor must actually change the title of ownership of each asset that will be placed in the trust from his or her name to ownership by the trust. Merely setting up a trust agreement does not place any property into the trust – a separate re-titlement is needed for each asset. Property that continues to be owned in a person's own name, held in joint tenancy, or owned as tenants-in-common is not owned by or disposed of by the trust. Life insurance and retirement plan benefits that name a beneficiary other than the living trust are not disposed of by the trust. Typically, a settlor reserves the right to amend the trust, change the beneficiaries, name a different trustee, change the date of termination, or ultimately, to revoke the trust and have the property titled back in his or her name.

A **trustee** manages the trust's assets according to the directions in the trust agreement. The trustee can be the person creating the trust, a friend or family member, several individuals, a corporate entity (such as a bank or trust company) or any combination of these. As the initial trustee, the settlor can maintain full control of the trust until his or her death or incapacity.

When the settlor relinquishes the trustee role, a **successor trustee** takes over. The successor trustee has legal responsibility for administering the trust prudently and solely for its beneficiaries, and must keep the beneficiaries reasonably informed. Naming more than one successor trustee is advisable, given that a trustee may die or become incapacitated. The successor trustee should be trustworthy and have good business and management capabilities.

Except in a dispute among the beneficiaries, or between beneficiaries and the trustee, which is brought before a court, the trustee is not required to make an annual accounting to the court system. Sometimes, as a check on one another, two or more co-trustees are appointed.

Some settlors prefer to make a financial institution, such as a bank's trust department or trust company, their successor trustee. An institution can assure stability in the trustee role. Many institutional trust departments, however, may not accept small trusts or trusts that do not generate income. When selecting a bank or trust institution as a trustee, the settlor should examine the financial credibility of the institution's trust department. Questions to ask include: How long has the trust department been in existence? What are the qualifications of its personnel? What rate of income and growth has the trust portfolio achieved recently, and historically? What are the fees for administration and services? Are the quoted fees competitive with other banks or trust companies?

The **trust agreement** document contains instructions to the trustee regarding investment and management of the trust assets, who is to receive income from the trust, and what happens to the trust if the person creating the trust becomes incompetent or dies. The trustee can do only what the trust agreement specifies. Ultimately, the trust agreement provides that the trust be terminated and assets distributed to the beneficiaries.

Beneficiaries are named by the settlor and can be individual(s) who formed the trust, friends, family members, a college or university, hospital, library, charity or other organization. Unless the beneficiaries are the trust settlors, they have no control over the trust.

The trust agreement should identify what is to be done with the trust property at the termination of the trust (often at the death of the settlor) and what happens to a beneficiary's share if he or she dies before the trust terminates. The settlor may wish to consider writing safeguards into the trust so that beneficiaries cannot transfer their trust interest to a third party or to protect beneficiaries' trust interests from creditor claims. The revocable living trust assets are not protected from creditor claims against the settlor nor does a trust insulate the settlor from claims of a surviving spouse.

Considerations in Forming a Living Trust

To determine whether a living trust would fit into your financial planning goals, consider the following: tax and probate consequences of your estate, your level of investment experience, incompetency concerns, the cost of setting up a trust, and management aspects or management fees if someone else manages the trust.

Tax Consequences. A revocable living trust is sometimes promoted as a tax avoidance tool, but it does ***not*** provide tax savings. Income earned in a revocable living trust is taxed to the settlor, and must be reported on his or her personal state and federal income tax returns. No federal gift tax is due at the creation of a revocable living trust because the trust can be changed at any time.

State and federal law requires the value of all property assets in a revocable living trust to be included in the settlor's estate upon death. Thus, trust assets must be included when federal estate taxes are determined.

The estate of most Montana residents, however, will not be large enough to be taxed. The federal estate tax only affects estates valued above $5.49 million in 2017. The Montana inheritance tax was repealed by legislative referendum in 2001. No Montana inheritance tax is applied to the value of real and personal property that passes to a decedent's beneficiaries.

Probate Costs vs Living Trust Costs. Trusts often are promoted by the claim that they avoid probate costs. While it is true that value of assets in trusts are not included in probate because the property was retitled to the trust, trust fees are a consideration. Trust fees are usually based on a percentage of the trust's income or principal, with annual minimums ranging from $500 to $2,500. A paid trustee's management fees over the life of the trust could exceed the cost of probate.

Probate in Montana is not nearly as burdensome as in other states that have not adopted the Uniform Probate Code (UPC). The Code specifically exempts the following from probate: assets in living trusts, property owned as joint tenants with right of survivorship, payable-on-death designations for deposits, transfer-on-death registrations for securities, and life insurance payable to a named beneficiary, (see *Nonprobate Transfers,* MT199509HR or *Probate in Montana,* MT199006HR.)

When property is subject to probate, heirs have the right to request an attorney to handle the case on an hourly-fee basis, which may be less than the allowable percentage under the UPC. In Montana, the maximum fee (without court approval) for an attorney cannot exceed one and one-half times the amount allowable to the personal representative. The personal representative is entitled to reasonable compensation for services, which is not to exceed three percent of the first $40,000 and two percent in excess of that amount. Any fee in excess of the percentage requires court approval.

Example: On a $200,000 estate, the maximum fee (without court approval) a personal representative could receive is $4,400 and the maximum fee (without court approval) the attorney could receive is $6,600:

Personal representative fee computation:

$40,000 x .03 = $1,200
$160,000 x .02 = $3,200
$1,200 + $3,200 = $4,400

Attorney fee computation:

$4,400 x 1.5 = $6,600

Another argument for revocable living trusts is that assets will pass more quickly to heirs than under probate. There are rare circumstances when disputes with the Internal Revenue Service or extended disagreements among family members can cause delays. Even so, in most cases, the administration of a revocable living trust is no more time efficient than that of a will in probate. Before deciding on a revocable living trust to avoid probate, consider how much of your property would be subject to probate, the cost of probate and other methods available for minimizing probate costs.

Settlor's Level of Investment Experience. Inexperienced investors may prefer placing assets in a revocable living trust and have professionals manage the investments. For instance, a recent widow had very little investment experience and did not want to be responsible for investing the sizable amount of money she received upon the death of her husband. Although she is willing to learn more about investing, she needed the emotional security of having someone manage her assets for her, so she established a revocable living trust.

Protection for Incompetency. Advancing age, serious illness, or an accident may render a person incapable of either supervising his or her investments and business, or handling day to day payments needed for his or her well being. A revocable living trust could be a good management tool in this case. To make the trust workable, assets would be transferred into the trust while the settlor is competent, or an agent, under a durable power of attorney, would be given the authority to make transfers into the trust if the settlor became incapacitated. At the settlor's death, the trust would become irrevocable, and any remaining assets would be distributed according to the directions in the trust agreement. A will can be drafted to "pour" into the trust any assets that weren't transferred before death. The trust agreement needs to describe how and who is to determine you are incompetent, and directs how your financial affairs are to be managed by the successor trustee.

Alternatives to a revocable living trust for those concerned about incompetency include durable power of attorney (see *Power of Attorney*, MT199001HR), which is a written, usually notarized document in which one person gives another the power to act on his or her behalf. This power could include selling property, depositing or withdrawing funds from checking or savings accounts and paying bills. A durable power of attorney is simpler and less costly than a revocable trust, avoiding the expense of a guardianship proceeding in court. A revocable living trust agreement cannot provide for others to make health care decisions for the settlor. A health care power of attorney is the appropriate tool for appointing someone to make your health care decisions if ever you are unable to speak for yourself, and to give instructions for health care providers to follow if you are unable to direct your health care.

Cost of the Trust. Before you decide on a trust, know the cost of setting up and paying for the management of the trust, and the estimated cost of distributing trust assets after the settlor's death. Setting up a living trust may cost more and take more time than preparing a will. Trustee management fees may be payable if you cease to be your own trustee.

Management Aspects. A revocable living trust may make managing your financial affairs more complicated. If you are the trustee, you must function as a trustee. For the trust to work properly, you must transfer title of all your assets to the name of the trust. As new assets are acquired, you must title them in the trust's name, that is if you want those assets to be subject to the trust agreement. If you buy and sell assets frequently, this process may become burdensome. As trustee, you may find it more difficult to deal with stockbrokers, life insurance companies and other financial institutions.

When transferring assets into the trust, financial institutions – brokerages, mutual funds, life insurance companies, credit unions – need to know who has what powers under the trust agreement. Some companies have a form on which you provide them the necessary information, some ask for a summary of the trust agreement and some require a copy of the entire trust agreement.

Many financial institutions will not loan money to a trust. For example, to refinance a home mortgage when the home is owned by the trust, you may have to transfer the house out of the trust, complete the refinancing, and then transfer the house back into the trust. If you have real estate that is used for collateral on business loans, the additional paperwork due to the trust ownership of the property could become cumbersome.

Protecting Assets from Nursing Home Costs

Trusts have been touted as the ideal solution for Montana residents who wish to protect assets from the costs of long term care. Promoters have descended upon the state using the door-to-door approach to sell trusts, claiming that if individuals transfer property to a trust, their assets are totally protected from nursing home costs. **This claim is not true.** Since the revocable living trust can be changed at any time by the person who formed it, the income and assets in the trust are considered available to cover nursing home costs under current Medicaid rules (see *Medicaid and Long Term Care Costs*, MT199511HR). Those concerned about nursing home costs may wish to investigate whether a long term care insurance policy would meet their financial planning goals (see *Long-Term Care Partnership Insurance in Montana*, MT201202HR.)

Montana's Self Sufficiency Trust (MSST)

A unique way for a family to provide supplemental services for a disabled individual without jeopardizing his or her government benefits is Montana's Self Sufficiency Trust. The MSST allows families to set aside funds for a disabled member without fear of rendering that individual ineligible for government benefits that provide long term support. Donors to MSST set up individual trust accounts that are pooled for investment purposes. The trust income can then be used either to expand services or to supplement existing services for family members who need lifelong care.

Placing funds in MSST requires that families develop a Lifecare Plan for the beneficiary of their individual trust account. The Lifecare Plan describes the types of supplemental services that the trust income will buy. Lifecare Planning Counselors can help families write plans that appropriately meet the beneficiaries' individual needs.

The MSST was created by state statute and operates as a nonprofit corporation with a volunteer board of directors. The process for creating an individual trust account in MSST is relatively simple, but families do need legal assistance in executing a Transfer Document that names the trust beneficiary and transfers funds or assets into MSST. For additional information, contact:

Parents Let's Unite for Kids
516 N. 32nd, Billings, MT 59101-6003
http://www.pluk.org 1-800-222-7585

Proceed with Caution

Individuals who choose to utilize living trusts through kits purchased from the Web, bookstores, mail promoters or door-to-door salespersons should exercise a high level of caution about the legal arrangements they establish. Estate planning is a highly individualized and legally complicated procedure, and it is unlikely that a package or kit (often completed after a single interview with a sales representative) or a standard computer-generated trust program can provide appropriate documents for unique family situations. In fact, revocable living trust documents sold by a company based out of state may not satisfy Montana's legal requirements. Setting up an appropriate trust requires careful drafting, planning and execution by legal counsel.

Before establishing a living trust, make a list of your financial planning objectives. Then discuss your needs with professionals such as an attorney, a trust officer, a certified public accountant and/or a certified financial planner. They may suggest an array of financial planning tools that could help achieve your goals.

Disclaimer

This publication is not intended to be a substitute for legal advice on revocable living trusts. Rather it is designed to create an awareness of the need for financial planning, and to help families become better acquainted with a revocable living trust and its role in estate planning. Future changes in trust laws cannot be predicted and statements in this MontGuide are based solely on laws in force on the date of publication.

Acknowledgments

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