

REVOCABLE LIFETIME TRUSTS

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INTRODUCTION

A revocable lifetime trust (a/k/a "living trust" or "revocable trust") is a document, established by an individual during his or her lifetime, which is fully revocable and amendable, and which is managed for the individual's benefit during their lifetime. At the individual's passing, the trust functions much in the same manner as a Will and distributes property to the beneficiaries named by the individual in the trust.

In discussing Wills and other estate planning matters with clients, one of the most asked questions is, "Do I need a "living trust?" The answer depends on an individual's particular situation. Generally, revocable lifetime trusts will be appropriate (1) for clients who currently live or intend to live in a state which subjects its probate procedures to extensive judicial supervision (Illinois does not); (2) for clients who want to set up a mechanism to manage their assets in the event of disability (e.g., to avoid court guardianship proceedings and supervision); (3) for clients who want their dispositive scheme to be protected from public scrutiny; or (4) for clients who have tangible assets in other states and wish to avoid ancillary probate procedures in those states.

A revocable lifetime trust has no estate tax advantages over a Will.

The purpose of this memorandum is to describe in detail revocable lifetime trusts and to outline more fully those factors which justify use of these trusts and how those factors may apply to a particular individual's situation.

GENERAL DESCRIPTION OF REVOCABLE LIFETIME TRUSTS

During his or her lifetime, an individual may establish a revocable trust (thus becoming the "grantor" of the trust), to which he or she then transfers some portion (or all) of his or her assets. Most commonly, the grantor names himself or herself as trustee. The grantor may, however, name one or more other individuals or a Bank as trustee or co-trustee. That situation will most often occur when either (i) the grantor is not able to or should not manage assets, or (ii) the grantor does not want to be burdened with the task of managing assets. There are no adverse income tax effects by having the grantor act as trustee of this type of trust. As discussed below, the trust is treated as a "grantor income trust" -- i.e., all income is taxed to the grantor -- regardless of who acts as trustee.

Often times the grantor will transfer all of his or her assets to the trust. These transfers (i) will need to happen if the objective of the living trust is to avoid probate, (ii) should happen if the objective of the trust is to provide a mechanism to manage assets in the event of disability, and

(iii) need not happen if the objective of the trust is merely to ensure privacy. (Each of these objectives is discussed in more detail later in this article.)

The transfer of assets to the trust is accomplished by the re-registration of the transferred assets in the name of the trustee; e.g., title to stock may read, "Robert Harrison, as trustee of the Robert Harrison Declaration of Trust." Once the transfers are complete, all relevant documents of title (e.g., bank account agreements, stock certificates, deeds and the like) will indicate that the assets are held in the trust.

The trustee is responsible for managing the property transferred to the trust in accordance with the terms of the trust document. Generally, these terms will direct that all of the income be paid to the grantor for life, together with so much of the principal of the trust as the grantor may direct or as the trustee may determine. The trustee may also be authorized to make distributions (including gifts) to other persons, such as the members of the grantor's family. To a large extent, an individual may tailor the specific terms of the trust to his or her own situation. However, practical concerns, such as the cost of drafting elaborate new provisions, should counterbalance extravagant or whimsical desires.

Since the trust is revocable, it may be amended or terminated by the grantor at any time during his or her

lifetime (assuming of course that the grantor is at that time competent).

Upon the death of the grantor, the trustee will continue to hold and administer the trust property under the terms of the document. These provisions are usually the same as those which the grantor would place in his Will. In fact, the grantor's Will is usually reduced to a relatively short and simple document, referred to as a "pour-over Will" since the estate assets "pour-over" (i.e, are distributed) into the trust.

CONSEQUENCES OF REVOCABLE TRUSTS DURING LIFETIME OF GRANTOR

The primary benefits during lifetime of revocable lifetime trusts are two-fold. First, if the trustee is one other than the grantor, the grantor may shift to another the responsibility of the day to day management of his or her property. (A similar result may be obtained through the use of agency and investment advisory accounts and powers of attorney.)

Second, and perhaps the most compelling reason for the use of this type of trust in Illinois, is as a means for providing for management of property if and when a person becomes disabled or incompetent. If the grantor has transferred most of his property into the revocable trust and then becomes incompetent, the trustee is fully authorized and enabled to continue to manage the property for the benefit of the grantor and his family according to the terms of the trust document. This can be done very easily if the trustee is someone other than the grantor. However, even if the

grantor is the trustee, the document can and should include a mechanism for determination that the grantor has become disabled and for appointment of a successor trustee. Typically, this is accomplished simply by the sending of a letter, signed by the grantor's personal physician and by specified members of his family, to the successor trustee. That is, no court involvement is required to have the successor trustee appointed.

By allowing for the funds to be managed for the grantor's benefit without the need to have a guardian appointed, several advantages are achieved. Most importantly, the publicity, costs and delays involved in guardianship proceedings before the probate court can be avoided.*/ For anyone who has had to deal with court-supervised guardianship proceedings, they know the potential aggravation that can come from each of those disadvantages.

If the grantor is concerned about providing for disability but does not wish to transfer assets into the trust immediately, a power of attorney can be given to a member of the family which specifically authorizes the subsequent transfer of assets into the trust where they can then be managed by the trustee according to the terms of the trust instrument.

Should the grantor be concerned about gift tax at the time the lifetime revocable trust is established? No; because the trust is revocable and subject to change at any time by the

*/ Note, a durable power of attorney could be used to achieve some of the same results although we do not believe it to be as effective and flexible an approach as the revocable trust.

grantor (during the grantor's competency), the transfer of assets to the trust is not considered a completed gift for gift tax purposes. However, if the trust document provides for distributions to someone other than the grantor and the trustee makes such distributions or if the trustee makes such distributions pursuant to the specific directions of the grantor, a gift of the amount actually distributed is made as of the time of the actual distribution.

A revocable trust is treated as a "grantor trust" for income tax purposes. Thus, all income received by the trust is treated as if received directly by the grantor and all expenses paid by the trust are treated as if paid directly by the grantor. In short, the trust is generally disregarded for income tax purposes.

**CONSEQUENCES OF THE REVOCABLE TRUST AFTER
THE PASSING OF THE GRANTOR**

The primary benefits of the revocable trust after the passing of the grantor are five-fold:

- Continuous Management of Assets,
- Avoiding the Costs and Delays of Probate,
- Avoiding Ancillary Probate in Other States,
- Insuring Privacy, and
- Providing Flexibility in Disposing of Non-Probate Assets.

Continuous Management of Assets

When an executor is appointed after a person dies, it may take the executor a certain amount of time to become familiar with all of the affairs of the decedent, to take possession of all of

the assets and to begin administering the estate under the terms of the Will. If the property was transferred to a revocable trust during the decedent's lifetime, and if the trustee was someone other than the grantor, the usual problems faced by a new executor can be avoided and continuous management of the assets can be maintained.

Avoiding the Costs and Delays of Probate

Assets which were transferred to the trust during the grantor's lifetime are not subject to probate proceedings. The Trustee may administer them according to the terms of the trust without supervision by the probate court. The complications resulting from probate procedures relating to inventories, claims periods, current and final accounts and the like may be avoided. Generally, this simplifies the administration of the property, avoids court costs and may result in some reduction in attorneys' fees and executor's fees.

Importantly, however, probate in Illinois has been simplified; continuous court supervision of the administration of an estate is, in the majority of estates, not necessary. Therefore, the potential savings by "avoiding probate" in Illinois are not substantial and may under certain situations be outweighed by the costs of establishing and administering the trust. On the other hand, if the grantor changes domicile from Illinois to a state which requires substantial court supervision of probate (such as Florida), use of the revocable lifetime trust solely as a means of avoiding probate may be justified.

Avoiding Ancillary Probate in Other States

If the decedent owned real estate located in a state other than the state of his legal residence, separate or "ancillary" probate proceedings in the second state will often be required in order to transfer title to that property. Ancillary probate can significantly increase the costs and delays involved in administering an estate. If, however, the property was placed by the decedent into a revocable trust, the trustee may administer the property and distribute it to the beneficiary or beneficiaries under the trust without ancillary probate proceedings.

Insuring Privacy

One of the consequences of avoiding probate proceedings is the ability to maintain greater privacy with regard to assets and distribution of the estate. When an individual dies, the Will is filed with the Clerk of the Probate Court and becomes a matter of public record, available for the inspection of any person who might be interested. Thus, many of the details of the estate plan are open to the public. These documents are also public records. If the revocable trust is used as the primary tool in the estate plan, the dispositive provisions are not made public.

Flexibility in Disposing of Non-Probate Assets

Non-probate assets have become a large component in many estates. These include life insurance benefits, annuities, death benefits under retirement and deferred compensation plans, payable-on-death accounts, and certain partnership interests. These assets usually are paid directly to a named beneficiary and,

thus, escape the costs, delays and vulnerability to claims of creditors associated with probate assets. However, an individual may not want all of the assets to pass outright to a specific individual. By naming a revocable trust as the beneficiary of these assets, the grantor retains broad flexibility in providing for the administration of the assets (e.g., these assets can continue to be held in trust) and dividing the benefits among various family members while preserving the benefits of probate avoidance. (It should be noted that many of the same results can be obtained by naming a testamentary trust created under the Will as the beneficiary of such assets.)

Estate Tax Consequences of Revocable Trusts

We recently read a New York Times article which stated that revocable lifetime trusts could be used as a mechanism to avoid estate taxes. The implication was that the revocable lifetime trust offered greater estate tax planning opportunities than a Will. That implication is incorrect. Because the grantor retains the right to amend or terminate a revocable trust, all of the assets in the trust at the grantor's death are included in the grantor's estate for estate tax purposes. All of the estate tax planning techniques used in connection with these trusts (marital deduction gifts, QTIP trusts, credit shelter trusts and the like) are also available when trusts are created under one's Will.

Post-Mortem Income Tax Planning

Use of the revocable trust may diminish somewhat the options available for post-mortem income tax planning. The probate

estate can be used as a separate income tax taxpayer and some opportunities (minor under the current income tax tables) for splitting income may be lost if there is no probate estate. The revocable trust is also subject to various income tax rules which differ from the rules applicable to estates, particularly the provisions relating to the "throwback" tax on accumulated income, the choice of a calendar year, and the payment of estimated tax. Prior to the compression and decrease of tax rates, these factors were relevant in larger estates where there was a potential for major tax savings through post-mortem tax planning.

CONCLUSION

The revocable living trust offers certain benefits which are not available in an estate plan based solely on a Will. These advantages relate primarily to the ability to provide easily for capable and continuous management of property in the event of the disability or death of the individual client and the ability to avoid costs, delays and publicity involved in probate court proceedings.

The disadvantages of the revocable trust relate primarily to implementing and maintaining the plan before its real benefits begin to accrue. The plan is more complicated because it involves two documents, the trust instrument and the pour-over Will, which must be carefully coordinated. Since the full benefits of a revocable trust will be realized only if most of the individual's assets are transferred into the trust, there will be the additional effort and cost involved in actually transferring

assets to the name of the trustee and, if the grantor is not the trustee, preparing and filing income tax returns. For instance, title to an individual's brokerage accounts, bank accounts, stock certificates, profit sharing plans, real estate, limited partnership interests and the like should all be transferred to the trustee.

Individuals using the revocable trust/pour-over Will scheme must be willing to incur added expense so that their documents can be finely tuned to their particular situation. It has been our experience that the maxim -- "you get what you pay for" -- is most appropriate to the living trust situation (and to estate planning in general). It is to our dismay that a large source of our business is contested estate litigation generated by sloppy drafting by practitioners or lack of attention to detail by clients.

Each situation must be examined carefully to determine whether the benefits of the revocable trust outweigh the costs involved. The Lord, Bissell & Brook estate planning department can make recommendations, but ultimately the decision rests with each client.

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