Estate Planning Part 2 - Should You Use a Trust or a Will for Your Estate Plan?

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In his will, Farmer Brown left 500 acres that had been in the family for four generations to his son. Farmer Brown expected the son to continue the family tradition, but the son was more interested in a regular job. He had been working on the farm only because Mom told him Farmer Brown could not do it without his help. The son put up a "For Sale" sign after the funeral, and seven months later he sold the farm and moved to Montgomery where he had friends, more entertainment, and more time to enjoy both. He got a job at the Hyundai plant and bought Mom a condo.

This situation could have been prevented if Farmer Brown had used a **trust** instead of a will for his estate plan. The farm could have been left in trust for the son's benefit. If the son worked the land he could live there and enjoy the profits from the farm. If he did not work the farm, the trustee could have rented the land and paid the income to Mom for her support. The trustee could continue to rent the land until a grandchild was interested in farming the land.

The point of the story is that if you use a will for your estate plan, you have no control over what your beneficiaries do with the property. However, with a trust, you can control the timing and condition of the disposition of your assets.

Trust. A trust is essentially a contract between a settlor (the person who creates and funds the trust, also known as grantor) and the trustee (the person who has legal title to the assets, and manages and distributes those assets according to the instructions in the trust document). The beneficiaries of the trust have equitable title to the assets in the trust, but not legal title, and the right to enforce the terms of the trust. A trust can be revocable, meaning that the settlor can amend the trust document or remove assets from the trust. Some people refer to this type of trust as a "living" trust, but living has no meaning; the trust is either revocable or irrevocable. A revocable trust does not require a separate tax identification number, and the grantor will continue to file an individual income tax return and treat the assets in the trust as his own. An irrevocable trust is what it says. The settlor cannot change the terms of the trust or remove assets from the trust after its creation and funding. The irrevocable trust is a separate legal entity and the trustee must file a separate tax return (Form 1041) with a separate tax identification number. Assets transferred to an irrevocable trust constitute a completed gift and remove the assets from the settlor's estate, which may require the donor/settlor to file a gift tax return (Form 709).

Timing and Condition of Disposition. A grantor can determine when the beneficiary will obtain the benefit of an asset in the trust. As a simple example, the grantor may provide that the beneficiary will receive a third of the assets when he attains the age of 25 years or graduates from college, whichever occurs first; half of the remaining assets when the beneficiary attains the age of 30 years; and the remainder of the assets when the beneficiary reaches the age of 35 years. Or, the grantor may allow his children to receive the income from the trust during their lifetime with the remainder to his grandchildren. **Condition** refers to some event that must occur before a beneficiary can receive a distribution from the trust. For example, the grantor may want to give his grandchildren $500 for making the dean's list; $2,500 if they graduate from college; and another $2,500 if they have a 3.5 GPA when they graduate. Many people who have worked hard during their life want their children to *work* rather than live off their efforts; so, the condition they use is, match my child's

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earned income $0.50 per $1.00 if they have a college degree and $0.25 per $1.00 if they do *not* have a college degree, effectively requiring the children to work to earn a distribution from the trust. And, as a sad commentary on American life, "Test my child three times randomly during the year for illegal substances. If my child tests positive or refuses to be tested, then the Trustee shall not make a distribution to that child until he attends an in-residence drug rehabilitation program and passes a random drug test."

Avoiding Probate. Some individuals are concerned with privacy. A will is offered for probate, and the will and a record of the proceedings are recorded in the Probate Judge's Office where they become a matter of public record. Remember from Part 1, some assets are not subject to the probate process. A typical example is something with a beneficiary designation, such as a life insurance policy or a retirement account. A trust is *not* subject to the probate process either; so, it is not recorded in the Probate Judge's Office. Another reason to avoid probate is the cost and court supervision involved. For example, in Alabama the personal representative's allowable fee is five percent of the estate, and the estate has to pay attorney's fees and court costs. The advertisement in the newspaper is required whether you have a will or a trust, even though the trust is not probated. However, creating a trust is usually more expensive than writing a will. Even though you avoid the cost of probate, the trustee will continue to manage the assets for the life of the trust; so, there is usually an annual trustee's fee which may not be large if the trustee is your brother, but corporate trustees have fee schedules and minimum asset requirements.

Asset Management in Case of Incapacity. If you use a trust, you will not need a power of attorney, because the successor trustee acts in the same capacity but with more responsibility. An attorney-in-fact (authorized by the power of attorney) has the authority to sign your name and could, for example, sell your house. A successor trustee could also sell your house but is required to use the funds for your benefit.

Another problem with probating an estate is finding all of mom's property, especially if she lived in another city. Parents may not share all of their financial information with their children, and when the parent dies, the child may not be aware of the life insurance policy on mom. The advantage (and possibly disadvantage, see below) of a trust is that property has to be transferred to the trustee, even if the trustee is mom, and there should be a record of the transfer. So, it should be easier for the children to identify mom's assets if they are in a trust.

Creditor protection. An irrevocable trust provides protection against creditors' claims. A revocable trust becomes irrevocable upon the settlor's incapacity. Dad could leave his assets to mom outright or in an irrevocable trust. If mom is 89 years old and still driving, there is a chance she could become involved in a traffic accident that was her fault. If a jury awarded the plaintiff more than the limits of mom's insurance policy, she would be liable for the remainder. If dad left mom his assets outright, they may be lost as a result of the lawsuit. On the other hand, if dad had left the assets in an irrevocable trust for mom's benefit, then the creditors would not have access to those assets since mom does not own them. In fact, the trustee would have the choice of giving mom assets or providing for mom's care, and rather than giving mom assets that the creditors could attach, the trustee would pay mom's nursing home bill, etc.

A revocable trust does not provide creditor protection. If you can take assets out of the trust, then the court can make you take assets from the trust to satisfy creditors. In addition, a trust that was revocable prior to death is also subject to creditors' claims.

Beneficiary designation. Dad may be survived by his third wife. If he leaves her everything outright, his children from prior marriages may not receive anything. Dad could leave his assets in trust for the benefit of his wife. As long as the trust pays all of the income to the surviving spouse and does not make payments to any other beneficiary, the trust qualifies for the unlimited marital deduction. Dad would specify the beneficiaries that would receive the assets at the surviving spouse's death instead of the surviving spouse controlling the disposition. In addition, assets in trust are not susceptible to the spousal election.

A Trust Only Disposes of Assets in the Trust. If the settlor purchases an asset, such as an automobile, and takes title individually instead of in the trust, then the trust will not control that asset. Prudent estate planning would require a "pour-over" will (assets not in the trust are poured over into the trust for distribution) for that situation. If all of the assets are in the trust, it will not be necessary to probate the will.

In summary, if your children are mature, there are no special situations, and your plan is simply, "all to my spouse if they survive, otherwise, equally to my children," then all you need is a will. However, if you want to control *how and when* your beneficiaries receive your assets, then you need to consider a trust.

Photo by Colin McRae