

Estate Planning

Revocable living trusts: advantages, drawbacks and misconceptions.

By Eva Stark, JD, LL.M.



While working on an estate plan or revising an existing plan, clients are often baffled by a common estate planning tool: the revocable living trust. How is it different from a will? What exactly does it accomplish? What are its advantages and drawbacks?

Wills vs. Revocable Living Trusts

Clients are likely familiar with the idea of a will — a document that governs how an individual's assets will pass at death. Executing a will can ensure that the decedent's wishes will be carried out instead of having assets distributed in an unintended manner under default laws set by the state.

However, as important as a will is, it might not determine how all—or most—of an individual's assets will pass at death. Many assets, known as "non-probate" assets, pass outside of the will. Assets passing outside the will generally include those held in trust (including a revocable living trust) or assets that pass by beneficiary designation, right of survivorship, or a similar method.

A revocable living trust is an arrangement where a trustee is selected to hold legal title to assets and to manage the assets for the benefit of the trust's beneficiaries. Unlike a will, which takes effect only at death, a revocable living trust takes effect immediately upon execution. While the settlor is alive,

the settlor is usually the trustee and beneficiary of the trust and the settlor generally may revoke the trust or withdraw assets from the trust at any time. At the settlor's death, the trustee distributes assets to (or continues to manage assets for the benefit of) the settlor's beneficiaries, who are most typically the surviving spouse or descendants. A revocable living trust only governs the management or disposition of assets that are transferred to the trust (technically, to the trustee). Settlers typically transfer ownership of various assets to their trust during their lifetime. In addition, a "pour-over" will may be used to channel probate assets to the trust through the probate process.

Advantages of Revocable Living Trusts

A distinctive advantage of a revocable living trust is that assets transferred to the trust during lifetime escape probate. At the settlor's death, assets in a revocable living trust can be immediately distributed by the trustee under the provisions of the trust instrument instead of having to undergo a potentially drawn-out and costly probate process.

Another benefit of a revocable living trust is that it allows for privacy in estate disposition. While a will is filed with the probate court and may become public, a trust instrument is generally not filed in court and is rarely shared in its entirety with third parties. We all periodically see sensationalized news stories about how a recently deceased high-profile celebrity may have disinherited a child or died owning this or that. While the average person's probate proceedings will not attract such levels of scrutiny, there might still be peace of mind knowing that one's estate plan will generally remain private.

A revocable living trust also allows for property management by the trustee or successor trustee in the event of the settlor's incapacity. While management of an incapacitated person's assets may otherwise be accomplished through a durable power of attorney, relying on a durable power of attorney may be more burdensome in certain circumstances.

A decedent's will must generally be probated in every jurisdiction he or she owned real property at death. Depending on the nature



of the probate process in the jurisdictions involved and the number of jurisdictions or properties at issue, this may be relatively painless or more drawn-out and costly. In contrast, the trustee continues to just hold assets under the terms of the trust at the settlor's death—generally no probate is required anywhere.

Drawbacks

One potential drawback of a revocable living trust is the upfront cost and hassle. In addition to executing the trust document, assets generally need to be transferred to the trust upon its creation or as the settlor acquires new assets. This may entail drafting and filing deeds for the transfer of real estate, documenting the transfer of closely-held business interests, updating account ownership documents, changing beneficiary designations, or similar tasks, all of which necessitate not only the client's time and attention but may require the time and advice of attorneys.

Creating a revocable living trust may also add unnecessary complexity in certain circumstances—especially where the client's objectives can be accomplished through other methods. For example, a testamentary trust (i.e., a trust outlined in a will to take effect at death) may be used to provide for the client's desired property disposition, create trusts for surviving spouses and descendants, or to incorporate basic estate tax planning strategies.

Common Misconceptions

When clients think of their assets being placed into a revocable living trust, they often mistakenly assume that the trust will provide creditor protection. A revocable living trust generally does not protect assets from the settlor's creditors. Upon the settlor's death, the trust becomes irrevocable and the trust might offer creditor protection for the beneficiaries if assets remain in trust and the trust is drafted with provisions for creditor protection under applicable laws.

Another common misconception is that creating and funding a revocable trust will place assets outside the settlor's taxable estate or will reduce estate taxes. Assets held in revocable living trusts are generally part of the settlor's taxable estate. As previously noted, assets held in trust are not part of the settlor's probate estate, an entirely different concept. The probate estate is the part of the estate that must undergo the probate process to be disposed of under the will or intestacy laws.

Many clients also mistakenly believe that once a revocable living trust is properly executed, their intended plan is fully in effect and nothing more

is needed to implement it. However, if assets intended for trust ownership are not properly transferred to the trust during the settlor's lifetime, they will remain part of the client's probate estate (assuming the asset is a probate asset), will undergo probate, and will be distributed under the client's will and not necessarily the revocable living trust. As a result, if the trust is not properly funded during lifetime, the intended benefits and advantages for having created the trust may be lost.

Clients should discuss with their attorneys exactly what assets should be transferred to their revocable living trust during their lifetime and

how to properly implement any intended transfer.

The Importance of Professional Advice

For some clients, a revocable living trust-based estate plan may offer important added benefits as compared to a will-based estate plan. For others, the drawbacks of a revocable living trusts may outweigh potential benefits. When devising an estate plan, it will be important for clients to understand and weigh the benefits and drawbacks of revocable living trusts with their advisors in light of their particular goals and circumstances.



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