

How a Living Trust Fits Into Your Estate Plan

Trusts avoid probate expenses for your beneficiaries.

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Last month we wrote about the importance of having a well-drafted, recently reviewed will as the foundation of an estate plan. Although we think everyone should have a will, increasingly living trusts are being used as an important tool in your estate-planning kit. In this article, we'll review what living trusts are and how they work.

TYPES OF TRUSTS

Trusts are created while you're alive (inter vivos) or through your will at death (testamentary). Trusts can be revocable, where you can change the terms while you are alive or irrevocable, where the terms can't be changed. Most people choose to establish a revocable living trust, since it allows them the flexibility to change the trust's terms and retain control of the assets.

Once you retitle your assets from your name into a revocable trust, they're removed from the probate estate but are still included in your taxable estate. Assets transferred to an irrevocable trust are taken out of both the probate and the taxable estate; the intention is that the grantor (you) will be unable to take back these assets. Doing this has additional tax consequences beyond the scope of this article. In most cases, a living trust will be enough to keep your assets out of probate and clearly state your wishes.

WHAT'S INCLUDED IN A LIVING TRUST?

A living trust is a legal document that names a trustee (or trustees) whose job it is to carry out the trust's terms. In a revocable living trust, you are typically the trustee of your own trust, thus controlling your assets as long as you're able.

In the trust document, you name successor trustees who will act on your behalf should you die or be unable to manage your assets. These might be family members, friends, an attorney or the trust department of a bank. Note that trustees acting on your behalf are entitled to charge a fee for their services. In our experience, it is relatively uncommon for friends or family members to charge a fee, though they may if there is significant time and effort involved. Banks and attorneys will almost certainly charge a fee.

You can specify the fees paid to the trustee in the trust document, either as a flat fee or a percentage of the total

trust assets. If you don't specify them, state laws generally determine the maximum fee allowed. For larger trusts, a fee of 1% of trust assets is common. If the administration of your trust takes an extended period of time after your death, these fees may be charged annually.

After specifying the trustees and the fees, the trust document will cover much of the same ground covered in your will. The trust lists your beneficiaries and includes instructions to the trustee as to how you want the trust assets managed and distributed.

WHO ARE THE PARTIES INVOLVED?

The "grantor" is the person creating the trust and placing assets in the trust. The "trustee" is the person or entity responsible for fulfilling the terms of the trust. A "successor trustee" will serve if the trustee can't or declines to serve. The "beneficiaries" are the people or organizations intended to get financial benefit from the trust.

HOW DOES A LIVING TRUST WORK?

Once you set up a living trust, you should retitle your assets to the trust's name. For instance, if your brokerage and checking accounts are held in the name of "Alice Adams," they now will be held in the name of "Alice Adams Living Trust, Alice Adams Trustee under the Trust agreement dated April 15, 2024."

To change the registration of your accounts, you notify your broker and banker in writing of your desire to change the title on your accounts and provide them with a copy of the trust.

You then open new accounts in the name of the trust and transfer your assets from your existing accounts to the new trust accounts. Although the title of your account has changed, if you're the trustee of your own trust, you can continue to manage your accounts just as you've done in the past.

For the most part, once the accounts are retitled, it will be "business as usual" with the only difference being the longer trust name on the accounts. For tax purposes these accounts will still be under your tax ID and income will continue to be taxable to you and reported on your return.

Transferring real estate into the trust's name can be more complicated, as you must transfer the deed to the name of the trust. Some states assess tax or fees when you change registration, although there may be a carve out for simple change to a living trust. Your estate attorney can advise you as to which assets should be retitled in the trust's name and which should not.

The No. 1 mistake we see with living trusts is the



failure to retitle the assets. We have seen more than a few instances where someone paid the lawyer to put together the trust but failed to retitle all of their assets into the name of the trust. For a living trust to work, the assets themselves must be transferred into the trust's name.

ADVANTAGE OF LIVING TRUSTS

Why should you bother to set up a living trust in addition to your will?

- **Avoids Expense of Probate.** If your assets are passed to your beneficiaries by a will, your estate will have to go through the probate process. This involves fees that don't have to be paid if your assets are titled in the name of a living trust. These probate fees vary from state to state.
- **Speeds the Distribution of Estate Assets.** If you have put all your assets in the living trust's name, your asset distribution will be expedited because going through the probate process takes time and costs money. We find this particularly true when transferring assets in a brokerage account.
- **Helps if You Own Property in Other States.** If you own property in more than one state, the executor of your estate may be required to open probate administration in each state where property is located. If the property is in the living trust's name, this problem can be avoided.
- **Avoids Publicity.** Without a living trust, your will and the amount of your estate becomes a matter of public record. For those seeking privacy, a living trust offers a solution.
- **Avoids Confusion About Whom You Want to Act on Your Behalf.** If you become incapacitated, the trust document clearly defines that your successor trustee should handle your affairs.

DISADVANTAGES OF LIVING TRUSTS

- **Cost of Having the Trust Prepared.** It does cost money to have a living trust document prepared for you and transferring the assets into the trust's name may involve some fees. If you don't have that many assets and your estate is relatively small, it may not be worth the cost of setting up a living trust.
- **Time and Effort.** As noted above, once the trust is signed, you have to take the time to transfer all appropriate assets to the trust. This can take time and effort, but as noted, if you don't complete this step, the trust won't be worth the paper it's printed on.
- **No Protection From Creditors.** A revocable living trust offers no asset protection. In some states transferring your property to an irrevocable living trust can protect it from creditors. There are limitations on the protection, but this may be an advantage.

LIVING TRUST ONE COMPONENT OF ESTATE PLAN

Establishing a living trust doesn't obviate the need for a will. The will is the document in which you name the executor or personal representative of your estate. Often

A living trust is a legal document that names a trustee (or trustees) whose job it is to carry out the trust's terms.

this person is the same as the successor trustee, but you need a will to make it official.

If you have some assets that aren't in the living trust's name, the will dictates what happens to these assets. These include things like heirlooms and personal possessions. If you have minor children, your will documents your wishes for who will be the guardian if something happens to you.

Often when a living trust is prepared, we're asked if the retirement accounts should be retitled in the trust name as well. You can't put an individual retirement account (IRA) or 401(k) account into the name of your trust while you are living. For these accounts, the beneficiary designation indicates who gets these assets at your death. Even if your will or trust document contains instructions for your IRA, the beneficiary designation takes precedence. So, it's of utmost importance to coordinate your beneficiary designation with the rest of your estate plan. If you make changes to who gets what in your trust, make sure you take a fresh look at your beneficiary designations as well. We'll go into greater detail about beneficiary designations in future articles.

CONCLUSION

A living trust is just one part of a comprehensive estate plan. It's a particularly useful tool for handling the distribution of your financial and other valuable assets, and for establishing how you want your assets distributed when you're gone. However, it leaves unaddressed your wishes and the instructions you'd like in place when it comes to health care. In our next article we will cover the health care components of a good estate plan.

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