ANSWERS TO COMMON QUESTIONS ABOUT

REVOCABLE LIVING TRUSTS

WHAT IS A REVOCABLE LIVING TRUST?

"Revocable" means that it can be revoked or amended at any time. "Living" means that it is established and operational during life, as contrasted with a Testamentary Trust which is set up by one's Will and is operational only after death. A "Trust" is the holding and managing of assets for another's benefit. A person who sets up a trust may be called Grantor, Settlor or Trustor. The one who holds and manages the assets is the Trustee. Those persons for whose benefit the trust is set up are the Beneficiaries. In all states, a person may be Settlor, Trustee and lifetime Beneficiary of his or her own assets, if desired. There is no legal requirement that there be a corporate Trustee (such as a bank) or an independent Trustee.

WHAT IS THE CHIEF DIFFERENCE BETWEEN A REVOCABLE LIVING TRUST AND A TESTAMENTARY TRUST?

The chief difference is that a Revocable Living Trust (also called "inter-vivos" Trust) takes effect during life, while a Testamentary Trust is set up by the terms of one's Will and takes effect after death, thereby being subject to probate. The Revocable Living Trust (to the extent of the assets in the Trust) avoids probate entirely.

REVOCABLE LIVING TRUSTS HELP AVOID PROBATE. WHY IS THAT SO BENEFICIAL?

Probate is a court-supervised procedure for transferring assets from a deceased person to his beneficiaries. The process often involves lengthy delays and substantial administrative expenses, including legal fees. Trust asset distributions are not as prone to delays, and in trust administration some administrative expenses can be avoided or substantially reduced.

ARE THERE ANY OTHER REASONS FOR HAVING A REVOCABLE LIVING TRUST?

Yes. Some of the advantages over Testamentary Trusts include:

A. *DISABILITY* - the Revocable Living Trust can eliminate incompetency proceedings in court and is a private alternative to court appointed guardianship of the property.

B. *LESS SUBJECT TO ATTACK THAN A WILL* - the privacy of a Revocable Living Trust as well as the fact that it does not need to be executed with the same legal formalities as a Will make it less susceptible to contest by dissatisfied heirs.

C. *CHARITABLE GIFTS* - it may facilitate gifts to charities in states where there are restrictions on charitable gifts by Will.

D. *INCOME FOR FAMILY* - the flow of income for family members is not interrupted on the death or disability of the Grantor.

E. *PROPERTY IN SEVERAL STATES* - multi-state probate can be avoided.

F. *SELECTING STATE LAW* - provides more flexibility in selecting the state law that is to govern than does a Will.

G. *RECEPTACLE FOR DEATH BENEFITS* - it may receive death benefits from qualified employee benefit plans and insurance on the Grantor's life, both of which need not go through probate.

H. *BUSINESS CONTINUITY* - enables a going business to continue without interruption.

I. *OPERATION OF TRUST* - Grantor has opportunity to observe an independent trustee operating the Living Trust and to make any desired changes.

Two general benefits common to trusts are:

1. *INDEPENDENT ASSET MANAGEMENT* - either a trusted, responsible individual or corporate Trustee may, if desired, be appointed to serve if the Grantor is unable or prefers not to manage the assets, or upon Grantor's death.

2. *CONTROL AFTER DEATH* - Assets may be managed for beneficiaries long after Grantor's death.

J. *STATE DEATH TAXES* - reduces possibility of multiple state death taxes.

K. *AMENDABLE* - it is easier to amend than is a Will. Formalities of Will execution are not required.

L. *FLEXIBLE* - can provide for "over-all" estate plan during life, upon death, and after death.

HOW DOES THE REVOCABLE LIVING TRUST OPERATE?

Typically, in a "one-party" Trust, the Grantor manages his assets as Trustee for his own lifetime benefit. In a husband/wife situation, they both can manage their assets (the same as before) as Co-trustees until the death of the first spouse. The trust then continues to be managed for the survivor's lifetime benefit by either the surviving spouse solely, by a Successor Trustee such as a trusted and responsible individual or trust department, or by both serving as Co-Trustees. Upon death of the survivor, distribution can be made immediately to the designated beneficiaries, or the trust may be continued for the benefit of minor children, for example, with distribution to be made at a later time or times. Each of these details are spelled out in the Trust according to the Grantor's desires. There is great flexibility.

DOES A REVOCABLE LIVING TRUST INCREASE TAXES?

A. *FEDERAL GIFT TAX* - No. Because it is revocable, there are none.

B. *FEDERAL ESTATE TAX* - No. If set up properly, a married couple can greatly reduce (or eliminate) Federal Estate Tax upon the death of the survivor.

C. *FEDERAL AND STATE INCOME TAX* - No. The income of the Trust is treated as though there were no Trust since it is revocable. One is taxed on income the same as before the Trust was set up.

IF I PUT ASSETS IN THE REVOCABLE LIVING TRUST, DOES THAT MEAN I HAVE TO GIVE UP CONTROL OVER THOSE ASSETS?

No. The Revocable Living Trust can be terminated or changed any time by the Grantor. This is true whether or not the Grantor is also the Trustee. The Grantor (or Grantors in a husband/wife joint Trust) retains absolute full control of the assets to the same extent as before placing the assets in the Trust. He can freely add to or remove assets from the Trust, and can sell or exchange Trust assets any time.

WHAT IS A "POUR-OVER" WILL?

It is a Will operating in conjunction with a Living Trust, providing for any assets owned by Grantor outside of the Trust at time of death to be "poured-over" into the Trust. Those assets are then distributed according to the terms of the Trust. It may also be used to transfer certain assets (such as personal articles to a surviving spouse) directly and not in trust. It is generally preferable that the Executor of the Will and the Successor Trustee be the same person in order to coordinate administration and reduce potential problems.

THE REVOCABLE LIVING TRUST SOUNDS TOO GOOD TO BE TRUE. ARE THERE ANY DRAWBACKS?

If any negative statements could be made, they would be that (1) the expense of establishing the Trust is greater than a simple Will; (2) the Trust must be funded to be effective; (3) assets placed into a trust which a husband and wife owned as tenants by entirety lose the protection from creditors afforded to tenancy by entirety property; and (4) post-death income tax consequences regarding Subchapter-S stock, assets generating passive activity losses, assets likely to depreciate in value and non-taxation by Maryland of estate income, need to be carefully considered. Offsetting these drawbacks are the following considerations: (1) cost of setting up a Revocable Living Trust can be less than most people expect, and is certainly a low-cost investment considering the many benefits and later dollar savings; (2) funding the Trust is relatively easy. Basically it amounts to re-titling assets into the Trustee's name. This may be done by simple deed, assignment, bill of sale, changing an account name (e.g. savings account), etc.; and (3) umbrella liability insurance, which is readily affordable, may be purchased to provide added liability protection.

Formerly, fiduciary income tax returns (1041) had to be filed, and Federal Employee Identification numbers obtained. Congress has eliminated both requirements where the Grantor is also the Trustee, i.e. a self-trusteed Trust. Income from trust assets is reported on the Grantor's 1040 return, and the Trust is identified by the Grantor's social security number.

POST-DEATH INCOME TAX CONSIDERATIONS

(1) A trust may not hold Subchapter-S stock for more than two years after death occurs; (2) passive activity losses ("PALs") arising from rental real estate and limited and general partnerships should generally not be placed in a Revocable Trust since post-death income tax treatment of passive losses is better in an estate than in a trust; (3) regarding depreciating assets, an estate may elect to recognize gains or losses occurring post-death; a trust can recognize gain but may not recognize any losses occurring post-death; and (4) post-death income earned by assets in an estate are not subject to Maryland income taxes; when those assets are held in a trust, that same income is subject to Maryland income tax.

SEEK COUNSEL

The many advantages of the Revocable Living Trust are readily available, but competent legal counsel experienced in Revocable Living Trusts should be sought in order to enjoy fully the benefits and to avoid the pitfalls that improper planning and drafting could inadvertently produce.