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LIVING TRUSTS - THE PROS AND CONS

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One of the areas frequently addressed by financial planners is Living Trusts. Thanks to a great deal of attention by "media experts," clients or potential clients frequently have a great deal of questions about the appropriateness of a Living Trust for their situation. Although there are some specific circumstances where a Living Trust may be appropriate, the advantages of Living Trusts are, in general, not significant enough to warrant this financial planning tool for all Pennsylvania residents. It is a very worthwhile consideration in certain circumstances.

A. What is a Living Trust?

A Living Trust is a form of Revocable Trust which can be used in place of a Will to dispose of a person's property at death. Generally, the Grantor of a Living Trust places all of his or her assets into a separate legal entity called a Trust. The Grantor retains the right to amend or revoke the Trust during his or her lifetime. The Grantor normally appoints him- or herself as the sole Trustee or, as in the case of a married couple, both as Co-Trustees during their lifetimes, provided they do not become disabled or incompetent. If the Grantor becomes incompetent during his or her life, a successor Trustee would assume control of the assets. Upon the Grantor's death, the assets in Trust pass to the Grantor's named beneficiaries, either outright or in further Trust, according to the terms of the document.

B. Advantages.

There are several situations where a Living Trust offers significant benefits to potential Grantors. A Living Trust is generally recommended when an individual is diagnosed with a debilitating medical condition or disease which is likely to render him or her incompetent in the future. In such a situation, the Grantor establishes a mechanism for the management of his or her finances during the period of incompetency and assures that the assets will pass to the intended beneficiaries upon his or her death. This can also be accomplished with a Durable Power of Attorney, which is more frequently used to address this potential situation. However, there are a number of limitations and disadvantages to a Durable Power of Attorney, such as the fact that the attorney-in-fact can act on behalf of the Grantor when the Grantor is not incapacitated as well as after incapacity occurs.

Another benefit of a Living Trust is that the Trust can be named as the beneficiary of Qualified Plan proceeds, life insurance proceeds or other contract benefits which could otherwise be liened by creditors if paid to the person's estate. However, most of these types of assets will permit specifically naming a beneficiary who is paid directly by the Qualified Plan, life insurance company or other contract entity or a Trustee indicated in a Will.

A Living Trust may also be beneficial for a person who frequently moves back and forth between two or more jurisdictions, or who is planning to retire to another jurisdiction, but wants a person or institution in his or her home state to continue to look after his or her financial affairs, either during his or her lifetime, after death, or both. For instance, a Pennsylvania resident may have a long-standing relationship with a Pennsylvania bank or individual located in Pennsylvania. If this individual retires to Florida, under Florida law, such an individual would be barred from serving as an executor of the estate of a Florida resident (unless there is some family relationship). By naming a Pennsylvania bank or individual as Trustee of a Living Trust, the asset is considered to be in Pennsylvania and controlled by Pennsylvania law. Therefore, the Pennsylvania bank or individual would be qualified to act a Trustee and manage the person's assets during his or her lifetime, after death, or both, depending upon the terms of the Trust and irrespective of where the person may reside.

C. General Misinformation.

There are a number of frequently cited advantages to Living Trusts which are given much attention by the general media. These misconceptions can be summarized as follows:

1. “Living Trusts save taxes.” Prudent estate planning, with or without a Living Trust, may employ the use of certain provisions intended to save taxes (in particular, estate, inheritance and/or generation skipping transfer taxes). The employment of such devices is not unique to Living Trusts and, in general, any device available to avoid estate, inheritance or generation skipping transfer tax which can be utilized in a Living Trust can also be incorporated in an estate plan using a Will without the necessity of a Living Trust.
2. “Living Trusts avoid probate.” It is correct that assets properly transferred to the Trust will not have to pass through probate administration. Unfortunately, a frequent problem with Living Trusts is that there are often assets which are either intentionally or inadvertently not transferred to the Trust. As a result, prudent advice dictates that an individual establishing a Living Trust also have a Will and then the assets passing through the Will will pass through the probate process.

Avoidance of probate is a significant advantage if an individual wishes to avoid establishing a public record of his or her assets. High profile individuals, or individuals who have testamentary desires to favor persons other than the natural objects of their bounty, may wish to employ this device so that the public in general or disinherited individuals cannot make a trip to the Courthouse and review such individual’s personal financial records.

3. “Living Trusts eliminate probate costs.” It is true that by avoiding probate administration, a Living Trust can save money by avoiding the costs normally associated with probate administration. However, this statement does not focus on the net savings (if any) attained by the use of a Living Trust. The net savings will

depend upon the person's particular situation and the state or county of domicile. Some states have fees based on the value of the estate. These fees are low in some jurisdictions and higher in others. Some states have a flat fee which is the same regardless of the size of the estate. The flat fee is usually a nominal amount to cover filing costs. The informed individual will have knowledge of the probate fees in his or her county of domicile in order to make a decision as to whether the savings to be enjoyed through the use of a Living Trust warrant the up front cost of (1) drafting a Living Trust, (2) transferring all of his or her assets to the Living Trust and, (3) payment of any on going administration expenses connected with the Living Trust.

In many cases, the use of a Living Trust will not eliminate probate, since it does not eliminate the necessity for a Will. A Will should always be used to supplement the Living Trust in order to (1) provide for omitted properties, (2) provide a mechanism for determining claims of creditors, and (3) facilitate payment of estate taxes and general administrative matters. No matter how simple the supplementary Will is, it still needs to be probated in order to be effective. Accordingly, there may be some probate costs involved notwithstanding the existence of a Living Trust.

4. "Living Trusts reduce or eliminate the cost of estate administration and the involvement of the legal community." Counsel fees and other costs are not unique to the administration of estates which pass by way of a Will. Whether assets pass through a Living Trust or through a Will, certain administration expenses will be incurred. Assets will need to be valued as of the date of death (for inheritance or estate tax purposes), some or all of the assets may need to be retitled and/or distributed, creditors will need to be identified and paid, death tax returns will need to be prepared and filed other returns may also be required (i.e., final lifetime personal income tax return for the decedent, gift tax returns, personal property tax returns and/or fiduciary income tax returns), and an account and /or release agreement may be required before the administration is complete. If an attorney is involved, the counsel fees will more likely be affected by the type and amount of work involved than by the type of documents through which the assets pass.

5. “Living Trusts allow for immediate distribution of assets.” Many proponents of Living Trusts claim that assets held in a Living Trust can be distributed to the decedent’s beneficiaries more readily than assets subject to probate administration. A Trustee who makes a substantial distribution without waiting for determination of taxes or creditor claims may find him- or herself personally liable for such taxes or claims. Accordingly, a prudent Trustee will generally wait until such issues are resolved before making distributions to the beneficiaries. These are the same factors which affect the timing of distributions of estates which pass through probate administration.

D. Conclusions.

It should be clear that, in certain circumstances, a Living Trust is a viable and recommended Estate Planning option. Living Trusts can be useful in certain situations. However, they are not panaceas appropriate to every individual or couple.