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What You Should Know About Revocable Living Trusts

1. What is a Revocable Living Trust?

A revocable living trust is an alternative to a traditional will as the main component of an estate plan. Because assets owned by a revocable living trust bypass the court-supervised probate process, the primary benefit of a revocable living trust is to avoid probate court interference upon the extended incapacity or death of the trustmaker.

The word *revocable* means that the trust may be amended, and its assets may be revoked while the trustmaker remains alive and competent. The word *living* means that the trust is established while the trustmaker is alive, as opposed to a testamentary trust that is established after death.

The secondary benefits of a revocable living trust include:

- Robust contingency planning
  A comprehensive trust document will address a wide assortment of contingency scenarios that may occur before or after the death of the trustmaker. For example, the trust document should address how to reallocate inheritance if a named beneficiary predeceases the trustmaker.
- Freedom to choose a preferred fiduciary
  A revocable living trust nominates a successor trustee to manage the trust assets upon the resignation, incapacity, or death of the trustmaker. When an estate plan relies solely on beneficiary designations to transfer assets upon death, there is uncertainty about who has authority to gather assets, protect the home, pay administrative expenses and taxes, negotiate debts, resolve disputes, and distribute inheritance. However, a revocable living trust permits the trustmaker to choose the individual or entity who will manage these critical tasks.
- Ability to restrict or protect inheritance for the beneficiaries
  A revocable living trust facilitates the restriction and/or protection of inheritance allocated to individual beneficiaries. For example, the trust document may permit the successor trustee to restrict inheritance for a young or immature beneficiary until an age higher than the usual default age of 18 or 21 years. Also, the trust document may allocate assets to a beneficiary-controlled inheritance trust that uses well-established trust laws to protect inheritance from an ex-spouse or a judgment creditor.
- Enhanced privacy
  Information about assets passing to named beneficiaries through a revocable living trust need not be disclosed to people who have no direct interest in the trust. This

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permits a successor trustee to withhold confidential information from people the trustmaker chooses to exclude as beneficiaries.

- Unites the allocation of inheritance into one controlling document
  By aligning an assortment of asset types with the trust, whether by retitling them or naming the trust as the beneficiary of others, the trust document can tie all the assets together into one plan when allocating inheritance.

2. How does a Revocable Living Trust work?

A revocable living trust is created when an individual or married couple signs a written document that describes rules and procedures for the management of assets to be held by the trust. Although a trust must own something to be valid, a new trust is essentially an empty basket.

A person creating the trust is called a trustmaker (alternatively, a trustor or grantor) and a person responsible for managing the trust is called a trustee. The trustee will manage the trust assets for the benefit of one or more beneficiaries. In most cases, a trustmaker will also be named as the initial trustee and beneficiary.

Many types of assets may be contributed to the trust during the lifetime of the trustmaker, including real estate, bank accounts, investments, and business interests. A revocable living trust may also be named as the pay-on-death beneficiary of these same types of assets, and the beneficiary of life insurance policies and tax-advantaged retirement accounts after the death of the trustmaker.

The trust assets avoid probate because there is no immediate change of ownership at the death of the trustmaker. The trust remains the owner, and the owner is still alive. The reason why probate courts exist is to ensure the proper handling of assets held by a deceased owner, but with a revocable living trust the owner cannot die. A successor trustee takes control of the trust assets without any court involvement and may proceed to hold or distribute the assets as directed by the trust document.

A revocable living trust is tax neutral during the lifetime of the trustmaker. Any taxable income attributable to a trust asset is reported on the income tax return of the trustmaker.

3. Who should have a Revocable Living Trust?

Many Arizona residents mistakenly assume that they are not wealthy enough to benefit from a revocable living trust. However, Arizona law requires probate procedures when a person dies with more than $300,000 of real estate equity or more than $200,000 in cash accounts and non-retirement investments unless there is a surviving joint owner or a named beneficiary. These exceptions have their own disadvantages, so every Arizona resident owning assets worth more than these minimum amounts should at least consider the potential benefits of a revocable living trust versus the cost and hassle of establishing one.

You may be an even better candidate for a revocable living trust in these situations:

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- If you own real estate in more than one state.
- If you are married and have one or more children from a prior relationship.
- If you want to disinherit someone.
- If you have reason to be concerned about possible dementia or Alzheimer's.

4. How is a Revocable Living Trust superior to a Durable Power of Attorney?

The primary reason for signing a durable power of attorney is to name someone to take control of your financial affairs in the event of your extended incapacity. However, it is common for a financial institution to reject a valid durable power of attorney and instead rely solely on the authority of a court-appointed conservator. This is because financial institutions often have internal policies to reject a durable power of attorney signed many years earlier or not drafted using a proprietary form. This is not a concern when an account is owned by a revocable living trust because the financial institution would have pre-approved the retitling of the asset into the name of the trust. This obligates the financial institution to honor the terms of the trust document, which should include specific provisions establishing the terms under which a successor trustee can act on behalf of a trust.

5. What are the disadvantages of a Revocable Living Trust?

The primary disadvantage of a revocable living trust is the hassle of establishing it. To achieve its objectives, the revocable living trust must be fully funded. This means that you must retitle real estate, bank accounts, non-retirement investment accounts, and business interests into the name of the trust. Although these tasks are usually not difficult, they do require time and commitment by the trustmaker to complete.

A secondary disadvantage of a revocable living trust is the higher set-up cost when compared to the alternatives of relying solely on beneficiary designations or a traditional will.

Both disadvantages warrant a cost-benefit analysis because a fully funded trust is likely to offset the initial hassle and cost if the trustmaker becomes incapacitated or dies.

About the Author

Thomas J. Bouman provides legal counsel in the areas of estate planning, estate administration, and asset protection. He brings a highly systematic approach to the practice of law, which is critically important when wading through the complex, and often bizarre, legal requirements associated with estate and trust law. Mr. Bouman is the author of the Arizona Estate Administration Answer Book and a prominent member of WealthCounsel, the nation's premiere organization of estate planning attorneys.

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