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PLANNING WITH A LIVING TRUST

How to Give What You Have to Whom You Want in the Way You Want!

Earning money and spending it are two of life's greatest pleasures. Deciding who gets it when you are gone is a task most people would rather ignore. In fact, only about 30% of Americans have taken the time to plan their estates, and unfortunately many of those who have are led to believe that a simple will is all they need.

Let's look at the process of estate planning. Estate planning is simply giving your property to the people you want, when you want, in the way you want. But unfortunately, *it doesn't happen automatically!* There are some powerful obstacles out there preventing you from distributing your estate according to your wishes. These problems can be broken down into three categories: probate, death taxes and conservatorship.

What is Probate?

Let's look at the issue of probate. Whenever someone dies with assets still in his or her own name, those assets have to be probated. Probate is one of the most misunderstood of all legal proceedings. Many people confuse it with taxes. Probate has nothing to do with taxes. Probate is an ancient legal procedure whose chief purpose is to change the title of assets owned by a deceased person into the names of his or her heirs.

Everyone owns assets of some kind and title is generally held in their names. When they die, those assets cannot be transferred without the names on the title being changed.

The Probate Court is essentially the only institution authorized to change the title of assets owned by a dead person.

In addition to changing the title, the Probate Court looks after many legal loose ends after death. For example, the court may resolve disputes, protects creditors rights, require the filing of asset inventories and estate accountings, and then authorize the distribution of the estate assets to the beneficiaries named in the will. If there is no will, the assets are distributed according to the state law of intestacy.

Disadvantages of Probate

Probate sounds appealing so far, doesn't it? Well then, why are so many people telling us we should avoid probate? Are there any disadvantages? Absolutely.

For starters, probate can be expensive. First, an attorney usually is employed to prepare the initial court filings and handle the other legal aspects of probate. Your family has to pay court filing fees to initiate the probate process. In addition to substantial attorney's fees, probate costs may include publication costs, executor fees, and bond premiums.

Any Will can be challenged by a disgruntled heir. Probate court oversees such will contests, which tend to be very time consuming and expensive.

Any inventories of your assets which are filed with the court are also a matter of public record. Unscrupulous salesmen have been known to use probate records to locate targets for their shoddy products and investments.

Probate will not only occur in the state of your domicile, but also in every state where you own real estate. Moreover, if your executor lives out of state, the probate court may require that he post a bond equal to the size of your estate to insure that he fulfills his duties.

The largest expenses in most probates are usually the attorney fees. In Colorado, the attorney is allowed to charge whatever is reasonable, without limitation, and usually based on a standard hourly rate of $300 to $500 per hour. There is no upper limit to what these fees may be and the courts generally will review probate fees only upon formal request of your family.

Some people have wondered why attorneys will offer to prepare a will for such a low fee, such as $100, when they know the attorney will spend several hours drafting the document and meeting with them. The answer, of course, is that the attorney expects to get the probate and to more than make up for it there.

Probate may also take a long time. The average length of time for probate is nine months to two years, but there are many cases which take several years. Even very simple probate estates require six to eight months before significant distributions can be made.

Another major disadvantage of probate is that it is a matter of public record. The names and addresses of your spouse, children, anyone mentioned in your will, and even persons being disinherited are available to the public during the probate process.

Remember, probate has nothing to do with taxes.

Death Taxes

In addition to probate, many families must also face the prospect of death taxes. There are many different kinds of taxes levied by the government. Each of them tax our rights to engage in certain economic activities. For example, the income tax is a levy on our right to earn income.

The sales tax taxes our right to purchase personal property. The gift tax taxes our right to give property to others while we are alive. And last, but certainly not least, the federal government taxes us when we die on our right to leave property to our families.

This tax is called the federal estate tax. Like all other taxes, this one began as a rather modest tax. When it was first seriously imposed in 1916, it had a maximum rate of 10%. Today, the estate tax rate is 40% (2018) and, when combined with the generation skipping transfer tax, may exceed 60% on large gifts to grandchildren!

Estate Tax Exemptions

Congress has, however, given us some relief from this enormous death tax burden. Under current law, the first $11.58 million (2020, indexed for inflation) of a decedent's estate is exempt from the federal estate tax.

This is called the Unified Gift and Estate Tax Credit. So, currently, if your estate is less than $11.58 million on your date of death, your family will pay nothing in federal estate taxes. Colorado does not have its own estate tax, but many other states impose their own tax on estates.

So what exactly is taxed? The federal estate tax is what we call an "everything tax." That means that all assets owned by a decedent on the date of death are included in the estate tax calculation.

For example, did you know that even the death benefits (and not just the cash value) of your life insurance policies are usually included in your taxable estate?

That means if you have a $1,000,000 life insurance policy, $700,000 equity in your home, $2.3 million in your IRA, and $9,000,000 in other assets, the federal government will value your estate at $13 million. $11.58 million of your estate would be exempt from tax, but the $1.42 million above the exemption would be subjected to the current estate tax rate of 40% (2020). Thus, your estate tax payable would be $568,000!

Unlimited Marital Deduction

There is also an unlimited marital deduction available to married couples. All transfers of wealth between spouses are tax exempt, with the exception of transfers to a non-U.S. citizen spouse.

This means that when the first spouse dies, any amount of property or assets can be transferred to the surviving spouse, free of federal estate tax. This is called the "unlimited marital deduction." For example, billionaire Bill Gates could leave his fortune on his death entirely estate tax-free to the lucky Mrs. Gates.

However, before we applaud the federal government for its generosity, let's remember that all they're really waiting for is for the surviving spouse to die! Because when the surviving spouse dies, there is no longer a marital deduction. Federal estate taxes can now be levied on the entire estate in excess of the exemption amount.

Note, however, if a timely estate tax return is filed on the first death, the surviving spouse can "pick up" the deceased spouse's unused exemption. Unfortunately, most people plan their estate without thinking about estate tax consequences. Few surviving spouses file estate tax returns when not required to do so. Such returns can be quite expensive and time-consuming.

For example, if you plan your estate with a "simple will," you will not only find your estate tied up in the probate court, but your family will have to pay federal estate taxes on every dollar over the exemption amount. As mentioned earlier, the tax rate on the excess is 40%. For those with larger estates, this tax could be an enormous burden on your family.

To compound the problem, the federal government wants its taxes nine months after your death. It does not want your real estate,

jewelry, or furniture. The IRS wants cold hard cash.

If there isn't sufficient cash in your estate to pay the government and the probate lawyers, your survivors could be forced to sell your most cherished, valuable assets, perhaps at a large discount, to raise the necessary cash.

Conservatorship

Up to this point, we have focused on the legal consequences of your death. But what happens if you become disabled before you die?

We are not talking here about the loss of a leg, or even being confined to a wheelchair. What we are talking about is a complete breakdown of your mental well-being to the point where you are no longer able to make financial decisions, perhaps due to an accident or Alzheimer's disease. Who is going to make all of the decisions concerning your assets?

Before your family, or even your spouse, is allowed to take over your financial responsibilities, the court must approve and then closely supervise them. This is known as a "conservatorship" procedure.

This can be a most humiliating, expensive and time-consuming legal matter. The person designated by the court to manage your assets must inform the court about all financial dealings made on your behalf. All income and expenses must be reported, down to the penny.

But don't blame the legal system. The court is merely trying to protect you in case someone does not have your best interests at heart. What are the chances that you will need a conservatorship someday? Actually, the chances are quite high. Legal care for the elderly is one of the fastest growing areas of the law. Each year, those over 65 years of age make up an increasingly larger portion of the American population.

Medical technology has greatly helped in extending our average life-expectancy, but unfortunately, many of the later years are spent in a condition in which we are unable to manage our financial affairs. The percentage of the population subject to conservatorship is growing rapidly.

Does a simple Will protect you and your family from a conservatorship? No. The simple Will, or any Will for that matter, offers absolutely no protection from the legal proceedings arising out of disability.

Nursing Home Costs

The average nursing home in the Denver Metro Area currently costs over $90,000 per year, and is increasing rapidly. With proper advanced planning you may be able to protect much of your estate. But if a conservatorship is required to be opened, the court will require that all of your assets be spent on your care.

The court will not allow your family to make legally-available transfers and take other planning steps to protect the at-home spouse from impoverishment or protect assets for children.

Your Will won't help at all, simply because a Will has no legal significance until you die. We hope by now you realize that, despite what you have been led to believe, a simple will provides very few estate planning advantages.

Revocable Living Trust

What is the solution? Must you surrender to the Internal Revenue Service, the probate lawyers, and the nursing homes? Fortunately, no.

There is a document called a Revocable Living Trust, which can totally eliminate both probate and conservatorship, and, for married couples, may help reduce your family's potential federal estate tax liabilities.

Broken down into its simplest terms, a Living Trust is nothing more than another way of holding record title to your hard earned assets.

The primary reason that your family must go through the probate process on your death is to transfer record title of your assets, which are just in your name, to your family or other heirs.

If you want to avoid the costs of probate at death and conservatorship if you become disabled, you must get the title of your assets out of your name. You would probably be reluctant to transfer your assets if you had to give up the right to control, manage, or use the assets for your own benefit.

Change Title of Assets and Still Maintain Control

The good news is that you can change the title of your assets and still keep control. This is accomplished by the creation of your own Revocable Living Trust.

A Living Trust is a document created by you while you are alive. Picture the Living Trust as nothing more than a huge legal box which contains title to all of your assets which might be subject to probate.

In every trust, there are three principal positions. First, there are the Trustmakers. These are the people who created the trust, and then transferred their assets into the trust.

The second position is the Trustee. The Trustee is the person or persons charged with the task of managing the assets in the trust. The Trustee makes all the financial and business decisions concerning the trust assets.

The Trustee has the right to buy, sell, trade, exchange, mortgage and encumber. In fact, the Trustee is generally permitted to do virtually anything with the assets except spend the money on himself or use the trust assets for his own benefit. These rights are reserved for the third position in the trust, the Beneficiary. A Beneficiary has only one job; to benefit from the assets held by the trust.

You are the Trustmaker, Trustee, and Beneficiary

When you create your trust, you lawfully can occupy all three positions. You will be the Trustmaker, the Trustee and the Beneficiary of your own Living Trust! No, this is not a fraud or a sham. It is not "one step ahead" of the Internal Revenue Service. It is the way most Living Trusts are created.

What you have really done is transferred title of your assets from yourself, as an individual, to yourself, as a Trustee, to manage for the benefit of yourself, as the Beneficiary.

When you occupy all three positions, what can you do with the assets in the trust? Anything you want. There are no restrictions. You can add new property to the trust. You can sell assets from the trust. You can spend assets in the trust if you want. If you don't like the terms of the trust, you can amend them. Moreover, you can terminate or revoke the trust at any time. If you are married, both you and your spouse can occupy all three positions.

For income tax purposes, you are taxed in exactly the same way as you would have been without the trust. The trust is actually required to use your Social Security number as its tax Identification number.

Living Trust Eliminates Conservatorship and Probate

With your assets in a Living Trust, if you become disabled, there will be no need for a conservatorship proceeding. This is because, in the trust document, you have already named a successor to take over.

A properly-drafted living trust, when combined with the proper durable power of attorney, can allow your family to do nursing home planning to protect as much of your assets as they are legally allowed to protect. When you die, all assets in the trust will avoid probate because the trust already has title to the assets. The successor Trustee you named will follow your instructions regarding the management and distribution of the assets.

What this means is that when you die with title to your assets in a Living Trust, there will be no attorney's fees or court hearings. There will be no legal delays in distributing the assets. The next Trustee will be able to immediately distribute your property according to the terms of the trust. There will be no public record. No one other than the people you have named in your trust will ever know the details of your financial or estate planning.

Living Trusts with Bypass Trust Provisions: Exceed Exemption Limit and Remain Free of Estate Tax

In addition to completely avoiding probate and conservatorship proceedings, the Living Trust can help minimize federal estate taxes for married couples. As we discussed earlier, every person is given an $11.58 million estate tax exemption (2020). Furthermore, if you are married, you can pass an unlimited amount to your surviving spouse estate tax free.

If no estate tax return is timely-filed after your death, upon the death of the surviving spouse, your family will be assessed taxes on every dollar in the surviving spouse's estate in excess of the exemption amount.

Example: Let's say a married couple had an estate valued at $20 Million. With the creation of a simple Will, they plan to pass everything to the surviving spouse when the first spouse dies.

This results in no federal estate tax at the first death because of the unlimited marital deduction. However, when the surviving spouse dies, he or she will only have an $11.58 million exemption and the estate tax on the remaining $8.42 million ($20M - $11.58M exempt) will be $3,368,000 million. These overwhelming estate taxes can be avoided with the use of a Living Trust.

In our example, after the first spouse died, the Living Trust would divide up into two other sub-trusts, often referred to as a Marital Trust and Family Trust. The Family Trust would hold up to $11.58 million of the deceased spouse's assets, and the Marital Trust would hold the surviving spouse's assets and any excess assets of the decedent. Upon the death of the surviving spouse, only the Marital Trust would be subject to estate taxes.

This trust planning method allows the use of the estate tax exemption for both the husband and the wife, thereby completely eliminating all federal estate taxes for estates up to $11,580,000 million or more if the estate grows after the first death All while keeping the family wealth under the control of, and for the benefit of, the surviving spouse.

It is important to note that the estate tax exemption is a "use it or lose it" benefit, but can also be taken advantage of if an estate tax return is timely-filed after the first death.

The Living Trust allows you to maximize the usage of the first spouse to die's exemption by keeping the asset growth in the family trust exemption from estate tax on the second death. Not only are taxes avoided, but the surviving spouse has the right to use the assets of both trusts while he or she is alive.

Upon the survivor's death, the trust assets in this example can be distributed to the children or any other beneficiary named in the trust completely free of probate fees and estate taxes.

What a Living Trust Can Do for You:

Avoid Probate

With a Living Trust, your assets will go directly to your beneficiaries after your death. There will be no attorney's fees or court costs. There will be no delay in distributing your assets, and all your estate planning goals will be completely private.

Reduce or Eliminate Federal Estate Taxes

A Living Trust with Family Trust Provisions can allow a married couple to pass $22 million, and sometimes even more, absolutely estate tax free to their heirs. Of course, a single person can still pass $11 million estate tax free.

Eliminate the Conservatorship Proceedings and Protect Assets from Nursing Home Expenses

If you become disabled or are unable to manage your estate, the Living Trust avoids the need for a conservatorship. The successor Trustee you have named will step in and manage your trust assets without government interference and expense. Your Trustee can be empowered to transfer assets to legally protect your assets from nursing home costs.

Determine the Way Your Estate is Managed and Distributed

It can provide the care, support and education for your beneficiaries by turning over assets to them at an age chosen by you.

Ensure That Your Wishes Are Carried Out and Are Not Subject to Attack

Most Living Trusts contain a "no contest clause" which discourages greedy heirs and their lawyers from successfully attacking your estate.

Give You Peace of Mind

When your Living Trust is completed, you and your family will relax, knowing that your estate will be managed and distributed by someone you have selected, and will be distributed with the least amount of expenses, taxes and delays.

Estate Planning Portfolio

The highest quality, most comprehensive, Living Trust documentation – included in your Estate Planning Portfolio that we prepare for you – is a combination of documents that makes this package genuinely unique. Here's what you get:

Personalized Living Trust

Your Living Trust will protect you and your family from probate, conservatorship and (for married couples) death taxes.

Statement of Authority

This is a document that states the name of your trust and that it is revocable, who the trustees are, and what are their powers.

Pour-Over Will

Transfers any remaining assets still in your name on your death into your trust. Appoints your executor.

Asset Transfer Instructions

Explains how to transfer all of your important properties into the Living Trust, and may include deeds to transfer record title to your real estate to your trust.

Durable & Statutory Power of Attorney

These documents allow another to act on your behalf, even after you have become incapacitated.

Health Care Power of Attorney

These documents empower the person you name to make certain medical decisions on your behalf in the event that you are unable to do so.

Living Will

Authorizes your physician to remove life support devices if you are terminally ill with no chance of recovery.

Nursing Home Declaration

A statement regarding your desire to remain in your home and not be placed in a nursing home unless absolutely necessary for your safety. Also, your intention and desire to return to your home should you end up in a nursing home.

Personal Property Memorandum

Outlines distribution of your household items, such as furniture, jewelry, tools, and cars.

Memorial Instructions

States your desires as to burial and funeral instructions, even if nothing more than a request to keep the expenses to a minimum if that is your desire.

Location Lists

Summarizes the location of your important documents, including who to contact in case of death or disability.