

REVOCABLE LIVING TRUSTS WIN POPULARITY

by

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Reprinted from Wall Street Journal (edited)

When John Tapp's father died four years ago, he left a will and complicated business affairs that went through probate. "It was a mess," Tapp says. Estate taxes and probate fees were hefty.

After that, Tapp and his wife, Linda, both 42-year old accountants in San Gabriel, placed all their assets in a revocable living trust. Says Tapp, "our two children will end up with more money and fewer headaches."

More and more Americans are doing what the Tapps did - putting their assets in revocable living trusts. In such a plan, titles to real estate, securities and other assets are placed in a trust while the owner is still alive. The trust document outlines instructions for managing the assets and distributing them after the individual's death. The people who create the trust can act as their own trustees, so there are no management fees or loss of control. They can change the trust at any time.

The advantages of living trusts over wills are considerable. Under a will, an estate must be settled in probate court. Lawyers' fees and court costs often are substantial; there may be exasperating delays, and the proceedings are a matter of public record. In contrast, a living trust is settled without a court proceeding; a successor trustee simply distributes assets according to the trust's instructions, with an accountant, notary public or lawyer certifying any transfer of titles. The process is much quicker, cheaper and more private than settling a will, and it may save on estate taxes.

Trusts can be contested, but not as easily as contesting a will. When an estate goes to probate in California, the court freezes its assets for four months and asks anyone to come forward and contest the will if they please. Someone contesting a will does not even need to hire a lawyer.

But to contest a trust, a disgruntled heir needs to hire a lawyer and file a civil suit. The assets of a living trust aren't frozen, however, and the trustee can distribute them to the beneficiaries immediately. The disgruntled heir then would have to sue each beneficiary.

Many other kinds of trusts are used for estate planning, but the revocable living trust is most popular. An irrevocable living trust offers the same advantage of avoiding probate and perhaps saving on estate taxes, but causes problems because it cannot be changed and the grantors lose control of their assets, lawyers say. A testamentary trust, created after death, must go through probate.

"(Revocable) living trusts have become the preeminent modern estate-planning tool," says Lynn Hopewell a Falls Church, Va., financial planner.

Disadvantages of revocable living trusts are relatively few, estate planners say. But there are some, including the hassles of transferring the titles to homes and other property, bank accounts, securities, businesses and other investments into the name of the trust.

For a home refinancing, some lenders demand that the house title be taken out of a living trust. Lawyers say some institutions that buy mortgages in the secondary market from thrifts and banks will not buy mortgages in the name of a trust, because they fear that some trusts may have stipulations preventing a trustee from selling the property. After the refinancing is completed, the home can be transferred back to the trust.

Rather Write Wills

Many lawyers do not go out of their way to tell clients about living trusts. Lawyers would rather write wills for a small fee and then make a bundle when the will is probated.

Lawyers' and Executors' probate fees, as mandated by California law, average 4 percent to 8 percent of the gross value of an estate - \$8,000.00 for a \$100,000.00 estate and \$46,000.00 for a \$1,000,000.00 estate. (Average fees in other states range from 3.8 percent in Utah to 11 percent in Alaska.) In addition, special fees are granted by a court for sales of assets during probate, preparation of estate-tax returns and litigation costs. There are generally approximately \$2,000.00 in additional out-of-pocket court and publication fees.

In contrast, the Law Office of HARALD WESTENDORF charges hourly for terminating a living trust usually not more than \$3,000.00. People willing to settle a simple trust with a notary or accountant need not pay even that much, and the process can be completed in a matter of days.

Joint Tenants

Most married couples hold title to their house as joint tenants. Upon the death of the first spouse, the house does not have to pass through probate. But when the second spouse dies, unless he or she has placed the home in joint tenancy with another person, the property will be probated. The same is true of bank accounts, stocks and other assets. A living trust is one way to avoid that problem.

Federal Estate Tax.

The estate of a deceased person receives a \$5.49 million exemption in 2017. This means that the first \$5.49 million net, after expenses and liquidation costs, of an individual's estate passes tax-free. The estate tax rate is 40 percent on the amount above \$5.49 million.

Gift Tax.

The exclusion amount for gifts is unified with the estate tax exemption, which means that an individual can gift up to \$5.49 million without paying taxes on it. But if that individual were also to die after giving away that amount in lifetime gifts, then his estate would be taxed. If the individual were to die after giving away \$4 million in lifetime gifts, then \$1.49 million of his/her estate would be tax-free, utilizing the remainder of his/her remaining exemption. The tax rate for any lifetime gifts over the exemption amount is forty percent (40%).

Federal Estate and Gift Taxes' Implications for Couples

One of the major changes under the Tax Relief Act provides a tax benefit for widowed individuals whose spouse dies. These benefits called "portability" have been made permanent under the 2012 Act.

Without proper tax planning, what typically happens when one spouse dies is that the entire estate is passed on to the other spouse tax-free, without applying the first spouse's exemption. The problem was that when the second spouse died, because anything above the second spouse's exemption amount was taxed. Essentially, the first spouse's exemption was lost. For example, Bob dies leaving his estate to his wife, Sally. Sally gets everything without paying taxes, but when Sally dies only the first \$5 million (or applicable exemption rate at the time of death) would pass tax-free. Bypass, or family trusts, helped work around this and allowed for exemptions for both spouses to be utilized.

Portability means is that bypass trusts are no longer needed to enable use of both spouses' federal exemptions. Widows and widowers can add any unused tax exemption of their recently deceased spouse to their own – allowing almost \$11 million net to be transferred tax free.

Under current law, Bob dies leaving his estate to Sally. Sally still gets everything without paying taxes, and now when she dies her exemption plus Bob's previously used exemption allows Sally's estate to pass almost \$11 million to her heirs without being taxed.

This portability of exemption also applies to the gift tax since it is unified with the estate tax, meaning that Sally could use part of Bob's unused \$5 million exemption to give tax-free gifts if she so chooses.

A reporting gift or estate tax return is required at the time of the gift or the death of the first spouse.

Importance of Continued Estate Planning

There are many non-tax reasons to create a bypass trust. For example with a bypass trust you can protect the deceased spouse's assets from being spent down so the surviving spouse can qualify for long-term assistance. The bypass trust assets can also be protected from the surviving spouse's creditors, or from the new spouse if the surviving spouse remarries.

Living Trusts are Cheaper than Wills

A growing number of older Americans are putting their assets into living trusts because they want to avoid being placed under a court-appointed conservator if they become unable to manage their affairs. If a home or stock is in joint tenancy, a wife cannot sell it if her husband has a stroke and is not competent. So she must get the court to appoint her as conservator and then must keep scrupulous records and return to court periodically with formal accountings.

A living trust "avoids the Groucho Marx problem," says W. Bailey Smith a Newport Beach, California lawyer who specializes in estate-tax planning. In his 80's, contrary to his desire, Marx was declared incompetent by a Los Angeles court. At the time, he was living with a woman named Erin Fleming, who said he preferred her as his conservator.

After a messy court battle, though, a relative was appointed as his conservator. "With a living trust, he could have specified in advance whom he wanted to manage his affairs if he ever became incompetent," Smith says. A will cannot be used for this kind of contingency.

Privacy is another argument for a living trust. "Anyone can go down to Los Angeles probate court and find out that Natalie Wood had a \$6,000,000.00 estate that included 29 fur coats," Smith says.

If a living trust is contested, the barrier of privacy may be breached; otherwise, no details about beneficiaries or the estate enter the public record. Bing Crosby, for example, set up a living trust before he died in 1977, and "you cannot find any public details about his estate," Smith says.

PROBATE COSTS

California's probate fees are set by law. These fees do not include special fees for the sale of assets, tax preparation and litigation, or court filing fees which generally add about \$2,000.

<u>Gross Assets</u>	<u>Minimum Fees Attorney & Executor</u>
\$ 200,000.00	\$ 14,000.00
\$ 300,000.00	\$ 18,000.00
\$ 400,000.00	\$ 22,000.00
\$ 500,000.00	\$ 26,000.00
\$ 700,000.00	\$ 34,000.00
\$1,000,000.00	\$ 46,000.00
\$2,000,000.00	\$ 66,000.00
\$3,000,000.00	\$ 85,000.00
\$5,000,000.00	\$126,000.00

Estate Tax Rates and Exemption Amount

Thanks to the American Tax Payer Relief Act of 2012, signed into law on January 2, 2013, the following exemptions are now permanent and inflation adjusted annually:

<u>Year</u>	<u>Exempt amount</u>	<u>Estate tax rate</u>	<u>Tax on \$5 million net estate</u>	<u>Tax on \$10 million net estate (no spouse)</u>
2017	\$5.49 million	40%	No tax	\$1,804,000

Annual Gift Exemption

The taxpayer may gift up to \$14,000 to any individual in a calendar year without having to file a gift tax return.