Trusts: Legal and Financial Planning

AN EXPERT GUIDE

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Summary

Estate planning is the strategic management of a person's assets to ensure they are distributed according to their wishes, both during their lifetime and after their death. This includes deciding how assets will be passed on to heirs, loved ones, and/or charities. Estate planning also encompasses:

1. Planning for potential incapacity.
2. Reducing uncertainties in the administration of a probate.
3. Maximizing the value of the estate by minimizing taxes and other expenses.

The ultimate goal of estate planning is not set in stone, but rather a flexible concept that can be shaped by the goals of the estate owner. It can be as simple or complex as the owner desires.

Estate planning includes a variety of tasks and legal mechanisms such as preparing a will, establishing trusts, specifying beneficiary designations, and setting up powers of attorney, including durable financial and medical powers of attorney.

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Introduction

A trust is a legal arrangement where one person (the "trustor" or "grantor") gives another person (the "trustee") the right to hold and manage assets for the benefit of another party (the "beneficiary"). The main purpose of a living trust is to provide a flexible and efficient way to manage and distribute assets after the trustor's death. This avoids the costly and time-consuming probate process.

Trusts are commonly used for estate planning, asset protection, tax planning, and charitable giving. They offer a valuable way to protect assets from creditors and legal claims. They can help minimize estate and gift taxes. Additionally, trusts are useful for managing charitable donations while potentially providing tax advantages to the trustor.

How Trusts Work

A living trust can either be revocable or irrevocable, essentially meaning that they can be changed after they are created, or not. A revocable trust is the most common type of trust. It allows the trustor to modify, amend, or revoke the trust during their lifetime. An irrevocable trust, once established, cannot be altered or revoked without the consent of the beneficiaries. This type of trust offers greater protection and may have tax advantages.

1. AVOID PROBATE

Probate is a legal process in which a deceased person's will is validated, and their assets are distributed. Probate can be lengthy, often taking several months to over a year, and it can become expensive with legal fees taking a significant portion of the estate.

Assets placed in a living trust are not subject to probate because the trust itself dictates how the assets will be distributed after the trustor's death. This allows for quicker and more efficient transferring of assets to the beneficiaries without the involvement of the court.

2. PRIVACY

When a will goes through probate, it becomes part of the public record. Meaning anyone can access the details of the will, including the assets involved and the identities of the beneficiaries. A living trust, including the distribution of assets and the identity of beneficiaries are not disclosed to the public.

3. ONGOING ASSET MANAGEMENT

A key advantage of a living trust is the ability to plan for potential incapacity. If the trustor becomes unable to manage their affairs due to illness or disability, then a successor trustee can step in to manage the trust's assets without court intervention. This ensures all financial obligations, such as paying bills, filing taxes, and distributing assets, are met without disruption.

Without a living trust, if a person becomes incapacitated, their family may need to appoint a guardian or conservator to manage their affairs. This can be a time-consuming process that is also costly and emotionally draining. A living trust avoids this by providing a clear plan for the management of the assets.

Setting Up a Trust

Setting up a living trust involves careful planning and consideration. The process typically involves several steps, and working with an estate planning attorney is recommended to ensure the trust is correctly set up and meets the trustor's specific needs.

1. PICK A TRUST THAT FITS YOUR NEEDS

Identify the specific goals of the trust, such as avoiding probate, managing assets for beneficiaries, or planning for incapacity. Select the appropriate trust based on the goals, such as a revocable trust for flexibility or an irrevocable trust for asset protection.

2. IDENTIFY THE BENEFICIARIES

Identify the beneficiaries and the distribution percentages. This could include family members, friends, or charitable organizations. Make sure to consider who will inherit the assets if the primary beneficiaries are unable to accept them.

3. SELECT THE TRUSTEE

Select a trustee who has agreed to administer the living trust after the death of the trustor. The trustor can serve as the initial trustee, allowing them to maintain full control over the trust assets during their lifetime. A successor trustee who will take over management of the trust in case the trustor become incapacitated or dies should also be selected.

4. DRAFT THE TRUST

Drafting the trust document with an experienced estate planning attorney is advisable to ensure that the trust is legally sound, comprehensive, and meets the specific goals. An attorney can also navigate state laws, which can vary significantly and impact how the trust is managed and enforced. Make sure to keep the original living trust document stored safely.

5. FUND THE TRUST

Funding the trust involves changing the title or ownership of the assets to reflect the trust as the owner. If the assets are not properly transferred, they may still be subject to probate. Types of assets include real estate, bank accounts and investments, life insurance policies, and personal property.

6. REVIEW AND UPDATE THE TRUST

Review and update the trust every few years or after significant life events such as marriage, divorce, the birth of a child, the death of a beneficiary, or a major change to the trustor's financial situation. If opting for a revocable trust, changes can be made to the document with the help of an attorney.

Examples

1. PLANNING FOR INCAPACITY

Sarah is a single mother with two young children. She is concerned about what would happen if she became incapacitated due to illness or injury.

Details: Sarah wants to ensure her financial assets are managed properly and that her children will be supported if she is unable to manage her affairs. Her primary focus is to avoid the court appointing a guardian to manage her finances.

Plan: Sarah will create a revocable trust that has clear instructions for managing her assets if she is incapacitated. She names her brother as the successor trustee. The trust includes provisions for the care and financial support of her children, such as allocating funds for their education and living expenses. Sarah also established a durable power of attorney to give her brother legal authority over any assets not included in the trust.

2. AVOIDING PROBATE

John and Mary, a retired couple, want to protect their real estate assets, ensuring these properties are passed on to their children without the complications associated with probate, such as delays, costs, or the lack of privacy.

Details: The couple owns properties in two different states. They are worried about potential extending legal proceedings in different states.

Plans: To avoid probate, John and Mary will establish a revocable living trust and will transfer the deeds of their homes into the trust, making the trust the legal owner of these properties. They will also designate one of their children as the successor trustee to manage and distribute the properties according to their wishes after they pass away. Regular reviews and updates to the trust will be important if they acquire new properties or if there are changes in state laws affecting estate planning.

3. COMPLEX ESTATE PLANNING

Linda is a wealthy individual with a diversified portfolio. She is worried about the potential impact of estate taxes on her heirs and wants to ensure a smooth transition of her business.

Details: Her assets include real estate, investments, and a family business. She is focused on ensuring her family business continues to operate smoothly after her death, without being impacted by the estate settlement process.

Plans: Linda will work with her attorney to establish a living trust that includes tax-saving strategies, such as a credit shelter trust (reduces or completely avoids estate taxes when passing assets on to heirs) to minimize the impact of estate taxes. The trust will include instructions for the transition of the business, such as who will take over management and how ownership will be transferred.

4. BLENDED FAMILIES

James is remarried and has two children from both his current and previous marriage. He wants to ensure that all his children are treated fairly and that his estate plan reflects his intentions for both his spouse and children.

Details: James has a home and investments. He wants to ensure his estate is divided in a way that honors his commitment to his children and spouse and avoids potential conflicts.

Plans: James will establish a living trust that outlines how he wants his assets to be divided among his current spouse and children from both marriages. His attorney said he should consider creating separate trusts or sub trusts within the primary trust, specifying different terms for each group. To avoid conflicts, he will appoint a neutral third-party trustee to manage the trust according to his instructions.

5. PLANNING FOR IN-HOME CARE

Kate is an elderly widow with substantial assets. She wants to age in place and receive in-home care without depleting her estate, which she plans to pass on to her children.

Details: Kate owns a home, a diversified investment portfolio, and significant savings. She wants to secure her ability to pay for in-home care while preserving her assets for her children.

Plans: Kate will establish an irrevocable trust and transfer ownership of her home, investments, and savings into the trust. The trust will be managed by a trustee who will use the funds to cover the costs of in-home care, such as hiring caregivers, nurses, or making modifications to her home to accommodate her needs as she ages. This will also protect her assets for her children.

Terms to Know

Trustor/Grantor: The person who creates the trust by transferring assets into it.

Trustee: The individual or institution responsible for managing the trust's assets according to the trustor's instructions.

Beneficiary: The person or entity entitled to receive benefits or assets from the trust.

Revocable trust: A trust that can be altered or revoked by the trustor at any time during their lifetime.

Irrevocable trust: A trust that cannot be changed or revoked once it is established, providing greater asset protection.

Probate: The legal process of validating a will and distributing a deceased person's estate, which a trust can help avoid.

Incapacity: A state where a person is unable to manage their affairs due to mental or physical impairment.

Successor trustee: The person or entity appointed to take over as trustee if the original trustee is unable or unwilling to continue.

Guardian or conservator: A court-appointed individual responsible for managing the personal and financial affairs of someone unable to do so themselves.

Durable power of attorney: A legal document that grants someone the authority to act on another person's behalf in financial or legal matters, even if they become incapacitated.

Additional Resources

At LifeWorx, we are committed to supporting you through every stage of planning for future healthcare needs. We offer a range of resources to help you understand options for long-term care and ensure peace of mind. Here are some additional topics that may be helpful:

- Long-Term Care Insurance White Papers
- Guides
- FAQ