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## LIVING TRUSTS: SNAKE OIL OR BETTER THAN SLICED BREAD?

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*"Of comfort no man speak. Let's talk of graves, of worms, and epitaphs, Make dust our paper, and with rainy eyes Write sorrow on the bosom of the earth, Let's choose executors and talk of wills."*<sup>1</sup>

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1. WILLIAM SHAKESPEARE, KING RICHARD II act 3, sc. 2, lines 144-148 (Stanley Wells & Gary Taylor ed., Clarendon Press, 1986).

## I. INTRODUCTION

In 1965, Norman Dacey's book *How to Avoid Probate* was first published, showing people how to set up their own inter vivos will or living trusts without the need for a lawyer.<sup>2</sup> The book featured tear-out pages with fill-in the blank living trust forms that the do-it-yourself estate planner could use to make himself (or herself) the settlor of his own living trust, to name himself the trustee of the trust, and also to be the beneficiary of the trust during his lifetime. At death, the living trust would distribute his or her estate to the chosen beneficiaries, without lawyers or court involvement. In the 1980s, the popularity of living trusts grew. It was not unusual to see weekly advertisements in the business section of the newspaper promoting financial and estate planning seminars that showed how to save taxes, to avoid attorney fees and probate expenses, and how to arrange financial affairs to make the administration of one's estate efficient, inexpensive, and private. Many exaggerated claims were made with respect to the estate planning benefits that could be obtained through the use of a revocable inter vivos or living trust. People (particularly the targeted senior citizen audience) flocked to these seminars for the free refreshments and to learn how to dodge the excessively high fees that would most certainly be charged by probate lawyers for dealing with the probate courts. Fantastic claims were made at these seminars and in popular magazine articles that using a revocable living trust as your estate planning tool would cure estate planning problems that other estate planning tools could not accomplish, such as reducing or eliminating income and estate taxes, and avoiding expensive, complex and time consuming estate procedures.<sup>3</sup> Like some financial snake-oil salesmen, the peddlers making these claims were basically sales people, selling standard, boilerplate, "one size fits all" living trust packages, touted to work in any state, for up to several thousand dollars. Soon the estate planning attorneys saw these "seminars" as good marketing opportunities and hopped on the living trust bandwagon in search of new clients. Everywhere people would look they would see someone showing them that the living trust was the only way to plan their estates.

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2. NORMAN F. DACEY, *HOW TO AVOID PROBATE* (5th ed. 1993).

3. Armond Budish, *The Multipurpose Trust*, MODERN MATURITY, Aug.-Sept. 1991, at 44.

When the client would come in to see the estate planning lawyer, the lawyer could tell that the client had been to such seminars. It was obvious by the client's superficial familiarity with some of the estate planning jargon. The client may even ask for a specific type of document for the estate plan, before even explaining to the lawyer what the client wanted to accomplish. For example, clients at the initial meeting, when asked how the estate planner could help them, would say that they wanted the lawyer to prepare a QTIP trust for them, as if they were ordering off the menu at a drive up legal services center. What the clients were doing was asking the professional to use a certain legal tool, before the clients had even expressed what legal task they were attempting to accomplish. This "tool before task" mentality of the clients necessitates the estate planner to take some time to slow the client down and make certain that their goals and overall situation are understood before choosing the appropriate planning tools for the client.

Recently it appears that there is less living trust hype. One can now see articles in professional journals and in the popular press that question this overselling of living trusts as the panacea of estate planning.<sup>4</sup> Federal and state regulators, concerned about the growth of living trust ownership use among low income seniors who are not as likely to benefit from sophisticated estate planning techniques, like living trusts, warn that some marketers are using living trust planning as a way to obtain the consumer's financial information, in an effort to sell the consumer other financial products.<sup>5</sup> In some parts of the country, regulation regarding the marketing of living trusts to the public is being considered and implemented. In Texas, for example, the state bar association Advertising Review Committee advised that a lawyer may not explicitly or implicitly advertise the following:

1. Living trusts will always save the client money.
2. The use of a living trust, in and of itself, will reduce or eliminate estate taxes otherwise payable as a result of the

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4. Roy Adams, *The Revocable Trust (Darling of the Client's Eye)*, TRUSTS & ESTATES, June 2000, at 57; see also Jeff D. Opdyke, *Living Trusts Can Be a Raw Deal*, MINNEAPOLIS STAR TRIB., June 18, 2000, at D5; Kathy Kristof, *Living Trust A Dead End For Many*, CHI. TRIB., June 25, 2000, § 5 at 3.

5. *FTC Testifies before Senate Special Committee on Aging and Living Trust Scams*, FED. TRADE COMMISSION (July 11, 2000), 2000 WL 950125.

client's death.

3. Estate tax savings can be achieved only by the use of a living trust.
4. The use of a living trust will achieve estate tax savings that cannot be achieved using a will.
5. The probate process is always lengthy and complicated.
6. The probate process should always be avoided.
7. The use of a living trust will reduce the total expenses incurred compared to expenses incurred using other estate planning devices intended to address the same basic function.
8. The use of a living trust avoids lengthy delays experienced in the use of other estate planning devices intended to address the same basic function.
9. Lawyers use will-writing as a loss leader.<sup>6</sup>

So, is the living trust a form of estate planning snake oil, over-hyped and over-sold to gullible senior citizens, or is it estate planning's version of the greatest invention since sliced bread, the only tool required for the client's estate planning needs? To answer this question we will need to know what estate planning options are available for the client and what the client expects to accomplish from estate planning.

## II. THE CLIENT'S ESTATE PLANNING GOALS

Most estate planning lawyers know that usually there are many planning options available to accomplish a particular client's estate planning goals. It is the estate planner's job to determine exactly what the client is trying to accomplish and then to educate the client so that the client is able to make (with the lawyer's help and advice) an informed and intelligent decision with respect to the client's estate planning. There are some basic estate planning goals that are common to most, if not all, clients. These goals generally involve passing as much of the client's estate as possible to the chosen beneficiaries, in the most appropriate manner and at the appropriate time.

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6. *Internal Interpretive Comment No. 22*, [www.obeliskcom.com/arc/comments-.html](http://www.obeliskcom.com/arc/comments-.html) (visited 10/27/2000).

To accomplish the client's basic goals, the estate planner and the client may choose from four different planning approaches: 1) pass through the estate without using a will or a trust; 2) a will without trust provisions; 3) a testamentary trust; or 4) a living trust as the main dispositive document of the estate plan. How do these different approaches compare? What are their relative advantages and disadvantages, in light of the general goals that a client may have in mind? The answers to these questions will hopefully provide the estate planner and the client with some basis for deciding whether a living trust, or some other estate planning tool, is the appropriate tool for the particular client's estate plan.

#### *A. Passing The Largest Estate Possible*

Passing the largest estate possible to the beneficiaries involves several things. First, the client must properly manage the estate during his or her lifetime. Proper lifetime management involves investment planning and discipline, asset management, and income tax planning, all of which require the periodic maintenance or attention of the client. Improper investment management and lack of investment discipline can result in missed opportunities for assets to fully appreciate in the client's estate, and may even depreciate the value of the estate when the effects of inflation are considered. A lack of a savings discipline, or allowing assets to remain under-invested in low return investments, can have an enormous adverse effect on the ultimate estate that the client will have to pass on to beneficiaries.<sup>7</sup> Poor tax planning can allow income taxes to greatly reduce the real investment returns and cost the client significant dollars.<sup>8</sup>

As the client ages, there is an increased chance of the client suffering a physical and mental infirmity. If the financially capable client becomes incapacitated, proper management of his or her estate is jeopardized. Someone will be needed to continue the man-

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7. The client who invests \$10,000 in a passbook-type savings account paying 1.25% interest, compounded annually, will accumulate \$12,820.37 after twenty years. If the client invests the same \$10,000 in a money market-type account paying 5.0% interest, compounded annually, the client will have \$26,532.37 after twenty years.

8. Federal income tax rates for single individuals in the year ending December 31, 1999, range from 15% on taxable income up to \$25,750 to 39.6% on taxable incomes over \$283,150. INTERNAL REVENUE SERVICE, U.S. DEPT OF TREASURY, 1040 FORMS AND INSTRUCTIONS (1999).

agement of the client's assets. The interruption or cessation of proper asset management can result in dissipation of assets due to spend-thrifty habits of the client, who may become more susceptible to the influence of others, or the victim of scams targeted at senior citizens. A lack of planning could cause the client to consume the estate by failing to qualify for, or take advantage of, available beneficial government programs, such as Medicaid. The incapacitated client may inadequately insure, inadvertently let insurance lapse, or be forced to incur other expenditures, such as unnecessarily high interest rates.

Without some prior planning, it will be necessary to go to the court and have a guardian or conservator appointed to obtain the necessary asset management. The client may wish to avoid the guardianship process because of the attorney's fees incurred in setting up the guardianship, the cost of court ordered bond on the guardian, as well as the embarrassment of having the client's frailties proved up in court. A guardianship can go on for many years, as long as the incapacitated client is alive. Annual accounts need to be prepared and periodic court hearings are required to obtain court approval of the accountings.<sup>9</sup> Since the management of the assets of the guardianship estate will be under the supervision of the probate court, dealing with the assets under guardianship can be quite cumbersome for the guardian. Sales of guardianship assets require the approval of the court and may also require an appraisal of the property to be sold.<sup>10</sup> The court may restrict allowable investments, such as investment only in FDIC insured investments. This would greatly lower the return and growth on assets in the guardianship estate. If the client under guardianship did not already have a pattern of gift making, the court may also restrict the guardian's ability to make gifts for tax purposes, subjecting the assets to estate taxes. All of these situations can greatly diminish the client's estate.

In order to pass on most of what the client has managed to accumulate during life, the client must also provide for the assets of the estate to be easily collected, properly managed and administered after the client's demise. Efficient collection, management, and administration of the client's estate requires the client to organize information about the assets included in the estate, provide

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9. MINN. STAT. § 525.58 (1999).

10. *Id.* § 525.562.

for an orderly disposition of the assets, and make appropriate plans to deal with estate taxes. An orderly disposition of the estate can maximize the size of the estate by preventing unnecessary estate dissipation and reducing estate transmission or transfer costs. Estate transmission costs are the expenses of administration of the estate, and include the cost of transferring the estate assets to the beneficiaries, filing and recording fees, fiduciary and attorney fees, probate court costs, appraisal fees, and tax return preparation fees. If the heirs or representatives of the client are unaware of the existence of certain assets, the transfer of the estate will likely be more costly and take longer to accomplish, since the estate representatives will need to search for assets. In the worst case, assets may never be discovered and unknowingly go unclaimed. Simply providing organized asset information to the beneficiaries or the estate representatives can eliminate the risk of losing assets and allow for a more efficient and less costly transfer of the estate to the beneficiaries.

The client also needs to make certain that an appropriate estate and gift tax plan has been established. The client's plan should consider taking advantage of the available annual gift tax exclusions, estate and gift tax unified credit, generation-skipping transfer tax exemption, and the ability to use whatever valuation discounts are available to the client's estate, in order to minimize estate and inheritance taxes. Failure to make use of the annual gift tax exclusion may subject the estate assets to marginal estate tax rates ranging from thirty-seven percent to as high as fifty-five percent.<sup>11</sup> Unused unified credit means that, at the death of one spouse, the estate left for the benefit of the heirs after the death of the surviving spouse, who dies in the year 2001, will be decreased by up to \$220,550 of otherwise avoidable estate tax.<sup>12</sup> The client must also consider the liquidity of the estate. An illiquid estate may result in dissipation of the estate due to the smaller value that estate assets realize when untimely sales are required to raise the cash

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11. When the increasing unified credit is fully phased in under current law on January 1, 2006, the range of marginal rates will be 41% to 55%. I.R.C. §§ 2001, 2010 (CCH 1999). It is also possible to reach a real marginal rate of 60% on estate over \$10,000,000 due to the phase out of the benefit of the lower estate tax brackets and the unified credit. I.R.C. § 2001(c)(2) (CCH 1999).

12. For decedents dying after December 31, 2005, when the increasing unified credit is fully phased in, unused unified credit would cause otherwise avoidable estate tax of up to \$345,800. I.R.C. § 2010 (CCH 1999).

needed to pay estate taxes, debts, and administration expenses, as well as the actual cost of borrowing funds to obtain the necessary cash.

### *B. To The Right Beneficiaries*

The goal of passing the estate to the client's chosen beneficiaries generally means avoiding statutory intestate distribution and ensuring, as much as legally possible, that the documents which contain the client's dispositive provisions will withstand a contest of their validity. Without any planning, the client's probate estate will pass by intestacy and basically go outright to next of kin. Most clients would consider this an unacceptable result. Under intestate succession law, persons not related to the decedent by blood, such as foster children, life partners, in-laws, friends, or charities, are not included as possible beneficiaries of the intestate estate.<sup>13</sup> The client would need to take affirmative steps to provide for such beneficiaries to share in the client's estate. In second marriage situations, the client may think that intestacy provides too much of the estate to the surviving spouse, and not leave enough for the children of a prior relationship. On the other hand, intestacy may also reduce the amount passing to a spouse in favor of children, rather than making the children wait until both the decedent and the surviving spouse/parent are deceased.<sup>14</sup>

The client can easily name the beneficiaries of the client's nonprobate assets such as retirement plan proceeds, life insurance, or multi-party accounts, simply by filling out the applicable beneficiary designation form. However, beneficiary designation may be somewhat cumbersome, if not impossible, for naming contingent beneficiaries, or for specifying certain conditions under which the funds will be paid.

If the client's intention is to exclude certain persons from the estate, then intestate succession may not work as the dispositive mechanism of the estate plan.<sup>15</sup> The estate planning documents

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13. UNIF. PROBATE CODE §§ 2-102, 2-102A, 2-103, and 2-105 (amended 1991), 8, Pt. I U.L.A. 81, 82, 83, 84 (1998); *see also* MINN. STAT. §§ 524.2-102, 524.2-103, 524.2-105 (1999).

14. UNIF. PROBATE CODE § 2-102 (amended 1991), 8, Pt. I U.L.A. 81 (1998); *see also* MINN. STAT. § 524.2-102 (1999).

15. UNIF. PROBATE CODE § 2-302 (amended 1993), 8, Pt. I U.L.A. 136 (1998); *see also* MINN. STAT. § 524.2-302 (1999) (regarding omitted children).

used to dispose of the estate must not be so easily challenged that the reliability of the client's distribution scheme becomes uncertain, and costs the estate time and money to defend.

### *C. Appropriate Distribution To Beneficiaries*

Appropriate distribution to the client's beneficiaries requires that the assets be cost-effectively managed for the beneficiary, and provide for access to the assets for the benefit of the beneficiary, until such time as the client has determined that an outright distribution of the assets is appropriate, given the age and abilities of the beneficiary.

Without special planning, a devise under a will passes to the beneficiary immediately, or if the beneficiary is a minor, then upon the devisee's attaining the age of majority. If the devise passes immediately, there is no management of the assets prior to the time at which the beneficiary attains financial maturity. This could result in a young beneficiary's decision to postpone education plans until after he or she takes a few years off to enjoy spending the unexpected windfall. If the devisee under the client's will is a minor, any assets passing to the minor devisee may make an informal probate administration unavailable and subject the estate to a more costly and cumbersome formal court supervised probate administration.<sup>16</sup> A devise to a minor will generally require the appointment of a guardian or conservator to manage the estate and to get immediate access to the assets for the benefit of the minor, prior to becoming an adult. Being forced to go through these court supervised guardianship procedures will add to the cost of transferring the estate and may still allow the assets into fall into the hands of the devisee at an age where the inheritance could be squandered due to financial inexperience.

At the other end of the age spectrum, an inheritance to an older beneficiary could reduce the estate by adversely affecting the beneficiary's eligibility for Medicaid programs causing the beneficiary to spend down the assets, rather than preserving them. If the beneficiary is well off financially, then adding the inherited assets

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16. For example, in some counties in Minnesota, the probate registrar will not accept an application for informal probate if a minor is a devisee. The estate is required to be formally administered and be supervised by the court. There may be some short cut procedures for small devises to minors, but a court order will probably be required. MINN. STAT. § 524.3-915 (1999).

to the beneficiary's estate could increase estate tax in the beneficiary's estate.

### III. WHY USE A LIVING TRUST?

If the estate planner takes an ethical, balanced, and reasonable look at the basic client goals and reviews all the options available with the client, how does the living trust fare when compared with the other tools in the estate planner's toolbox?

The common benefits of using the living trust are fairly well known:

- Probate Avoidance
- Administrative Cost Savings
- Privacy
- Protection Against Settlor's Incapacity
- Professional Management
- Protection Against Will Contests
- Opportunity to Test the Trustee
- Tax Benefits

The most popular reason given for using the living trust in one's estate plan is the avoidance of probate. Probate is the court process that chooses the person to administer the estate. The executor or personal representative of the estate collects or marshals the assets, satisfies the decedent's debts, and distributes what is left in accordance with the decedent's will, or by following the state's intestacy law. The advantage of avoiding probate is based upon the premise that probate is both time consuming and expensive, and thus avoiding the process should reduce the expenses of administering the estate, cause less interruption in the management of the assets, and get more assets to the beneficiaries in less time.

The living trust also affords the decedent and the decedent's heir's financial privacy. Since the use of the living trust avoids the probate process, the family avoids having to make the dispositive provisions of the will, and the inventory of estate assets, public information.

When a client becomes incapacitated or incompetent during the client's lifetime, a guardian or conservator may be required to be appointed to manage the client's estate.<sup>17</sup> If the client has a living trust in place, then the trustee or successor trustee could continue to manage the trust assets, thus making the guardianship or conservatorship unnecessary. If the client simply has poor investment or management skills, then the client, as the settlor of the living trust, can appoint someone else, i.e. a professional fiduciary, as the trustee and get the benefit of professional investment and management of the trust assets.

When the settlor of a living trust appoints a professional fiduciary to manage the trust assets during the settlor's life, the settlor is then able to monitor the trustee's management of the trust. The settlor may test one trustee against other trustees, to see how the trustees perform with respect to investments and how the trustees handle discretionary distributions to the beneficiaries. The settlor may get a better idea of which trustee would best handle the administration of a trust that is intended to continue for a long time after the settlor is deceased.

The living trust may also be used to save income estate and gift taxes. While a revocable living trust provides no income tax benefits to the settlor,<sup>18</sup> an irrevocable living trust can be used to shift income from high tax bracket taxpayers to lower bracket taxpayers, if the grantor trust rules are avoided.<sup>19</sup> The irrevocable living trust can also be used as a vehicle for making gifts that qualify for the gift tax annual exclusion and reduce the taxable estate for estate tax purposes.<sup>20</sup>

#### A. *Probate Avoidance*

Contrary to what many clients think, it is not the use or nonuse

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17. MINN. STAT. §§ 525.539-525.6199 (1999).

18. A revocable living trust may require the settlor to prepare and file an additional income tax return (the fiduciary income tax return).

19. The grantor trust rules under the Internal Revenue Code of 1986 set forth the circumstances that will cause the grantor (settlor) of a trust to be taxed on the income of the trust. I.R.C. §§ 671-678 (CCH 1999). Avoiding grantor trust status allows the trust or other income beneficiaries to bear the income tax consequences of trust taxable income. *Id.* §§ 641-668.

20. *Id.* § 2503 (making the so-called minor's trust an exception to the requirement under § 2503 that the gift tax annual exclusion is available only for gifts of a present interest in property).

of a will that causes the estate to go through probate. Rather, probate is caused when there are probate assets in the estate. Probate assets are those assets that are basically in the decedent's name alone, with no beneficiary designation or co-ownership attached to the asset. Those assets must go through probate because they pass in accordance with the decedent's will (or intestacy law). So, it is clear that a client will not be able to avoid probate and still get the estate to the chosen beneficiaries and in the appropriate manner by using a will as the main dispositive instrument of the estate plan, since the will only controls probate assets. If the client owns certain property, particularly real property, in several different states, the estate will have ancillary probate administration in each of those states. Ancillary probates tend to be more expensive relative to the size of the ancillary estate. If the client can avoid multiple ancillary probates, the overall estate can save significant expense.

The client can certainly avoid the probate process by using the living trust. However, the living trust is not fool proof. Care must be taken to make certain that the trust is fully funded prior to the death of the settlor. If the client (or the estate planner) fails to transfer all of the settlor's property into the trust before the settlor's death, the client's effort to avoid probate will have failed, at least with respect to the probate assets left outside of the trust.

Living trusts however, are not the only way to avoid probate. The client may use other nonprobate means, such as multi-party accounts,<sup>21</sup> transfer on death accounts,<sup>22</sup> life estates with remainder interests, beneficiary designated assets like life insurance or retirement accounts, and inter-vivos gifting of assets to avoid probate.<sup>23</sup>

Perhaps then the real question is whether probate needs to be avoided in the first place. Why do clients want to avoid probate? The impression some people seem to have is that probate is an archaic, rigid, time consuming, and very expensive procedure, requiring unending paperwork, that seems to serve no useful purpose.<sup>24</sup> People may mistakenly think that avoiding probate reduces

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21. MINN. STAT. §§ 524.6-201-524.6-213 (1999).

22. *Id.* §§ 524.6-301-524.6-311.

23. Probate avoidance of beneficiary designated assets assumes that the client has not named the estate as the beneficiary.

24. It is not uncommon for new clients to believe that attorney's fees for probate would be ten percent of the value of the estate. Uniform Probate Code states allow the attorney reasonable compensation determined by the personal representative. UNIF. PROBATE CODE § 3-715(18), (21), 8, Pt. II U.L.A. 170 (1998).

estate taxes in ways that cannot be accomplished by a will. Perhaps some of the criticisms of the probate process are justified, at least in some states. It is certainly possible for a probate administration to take a long time, maybe even several years, and cost many thousands of dollars. However, in states that have adopted the Uniform Probate Code, an informal and independent probate administration is available.<sup>25</sup> This informal probate process permits a probate administration to proceed unsupervised by any court. The executor, or personal representative, simply files the will and an application for appointment of the personal representative with the registrar of probate, and then does not need to go back to the courthouse. Personal representatives may be allowed to proceed *pro se*, saving the cost of an attorney, and in some jurisdictions the filing of the application for informal probate may be done by mail without even an appearance before the probate registrar.<sup>26</sup> Once the personal representative is appointed, an inventory of probate assets, receipts from beneficiaries, and a closing statement telling the court that administration has been completed, are the only documents required to be filed with the probate court.<sup>27</sup> These documents are not terribly difficult to prepare and a prudent fiduciary may want to prepare them, for trust accounting or estate tax purposes, even if there is no probate proceeding.

It is prudent, for the protection of the estate's fiduciary, be it the personal representative of a probate estate or the trustee of a trust, to inventory the assets that are under the fiduciary's control. It is also a good idea for the fiduciary to obtain a receipt from each beneficiary upon final distribution of the assets. The application

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Many states prohibit estate attorneys from charging fees based upon the size of the estate and look at factors such as time and labor required, the experience and knowledge of the attorney and the complexity and novelty of the problems presented. MINN. STAT. § 525.515(b) (1999).

25. UNIF. PROBATE CODE §§ 3-301, 3-706, 3-1003 (amended 1987), 8, Pt. II U.L.A. 55-56, 152, 294-95 (1998); *see also* MINN. STAT. §§ 524.3-301-524.3-311 (1999).

26. In Minnesota, many counties will accept filing of applications for informal probate by mail with no required appearance. The larger urban counties may still require personal appearance of the attorney or personal representative before the probate registrar. These larger counties have a greater volume of *pro se* cases that the registrars think would cause an administrative burden on court personnel in having to deal with improperly prepared or inaccurate informal applications.

27. UNIF. PROBATE CODE §§ 3-301, 3-706, 3-1003 (amended 1987), 8, Pt. II U.L.A. 55-56, 152, 294-95 (1998); *see also* MINN. STAT. §§ 524.3-706, 524.3-906, 524.3-1003 (1999).

for probate and the closing statement appear to be the only probate documentation that is required solely because of the probate process. It would then seem that in Uniform Probate Code jurisdictions, the court process does not significantly add to the paperwork of the administration process, and should not be a compelling reason to go to any extraordinary lengths to avoid the probate administration.

Usually the extended time to complete estate administration is not caused by the probate process itself, but rather it is indicative of problems with people, or the property in the estate. Will contests and other disagreements among estate beneficiaries can significantly prolong estate administration. Similarly, a decedent who leaves assets in disarray can greatly hinder the estate representative's ability to effectively marshal the assets and satisfy estate obligations so that distribution can take place efficiently.

Living trusts, on the other hand, do not require any court involvement to be administered in the usual case. The trust document can simply state, as part of the trust terms, that any court supervision of the trust is waived. Court supervision of the trust administration is necessary only when there is a problem, such as the need for judicial construction of a poorly drafted trust document. The trustee is free to proceed with the trust administration without any notice, publication, or filing with the court system. In a fully funded living trust, the assets would already be in the trust making asset collection simple.

The administration of other nonprobate assets may also be administered without any court involvement and may have even fewer documentation requirements than the living trust administration. If the client uses joint tenancy with right of survivorship, transfer on death accounts, or other multi-party account ownership of property, only a death certificate should be needed for the beneficiary to collect the assets. Real property owned as joint tenants may only need a title clearing document, such as an affidavit of survivorship, and a certified copy of the death certificate, to place title in the surviving joint tenant's name. Life insurance and retirement benefits should only require a certified copy of the death certificate to claim the proceeds, unless the estate is the named beneficiary. Marshaling these assets may be more difficult if the client does not keep proper records.

One advantage of the probate process is the availability of a

shortened statute of limitations on creditor claims, the so-called nonclaim statute. A decedent's creditors have a short time after a personal representative's appointment to make claims against the estate. After the claims period, creditors are barred from making further claims against the decedent's estate.<sup>28</sup> If probate is avoided by the use of a living trust, or other nonprobate means, the client gives up the benefit of the nonclaim statute and the trustee would have to publish notice and wait an extended period of time to effectively close the estate to creditors. It is conceivable that a client may purposely create a probate in order to avail the estate of the statutory cut off of creditors claims.<sup>29</sup>

### *B. Administration Costs*

The administration costs of an informal probate estate typically fall into three categories: pure probate costs, transfer costs, and tax costs. The pure probate costs are those costs that are due to the probate process itself, and include the court filing fee, publication costs, the fees for court documents such as letters testamentary, and the cost of preparing the inventory, the receipts, and the closing statement. These costs may range from several hundred dollars to several thousand dollars. Of course, if there are probate assets in more than one state, the cost of an ancillary probate administrations easily can add to the probate costs.

Transfer costs are the costs involved in the transfer of assets to the ultimate beneficiary. These costs typically include the cost of gathering and identifying the assets, and then preparing and filing deeds, or other transfer documentation. These transfer costs are not necessarily saved when the probate is avoided. A trustee will still have the costs of distributing trust assets to trust beneficiaries. Similarly, the recipients of other nonprobate assets, like a remainder interest or joint tenancy property, would incur the cost of filing a death certificate and survivorship documentation. Transfer costs may even be increased if the client avoids probate by using a living trust. The client must incur the transfer cost of transferring the assets into the trust in order to avoid the probate, and then the fidu-

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28. UNIF. PROBATE CODE § 3-803 (amended 1997), 8, Pt. II U.L.A. 215 (1998); *see also* MINN. STAT. § 524.3-803 (1999) (stating that the claim of a known creditor who is served proper notice is barred four months after the first publication of notice to creditors, or one month after service of the notice, whichever is later).

29. MINN. STAT. § 3-803(a)(3) (1999).

ciary must incur transfer costs again when the assets are transferred out of the trust to the trust beneficiaries. In a probate estate, only one transfer cost is incurred, that of the transfer from the estate to the estate beneficiary.<sup>30</sup>

Tax costs include the fees paid for the calculation or determination of tax, the preparation and filing of returns, and ancillary expenses such as valuation appraisals. Again, these tax expenses are not saved, even if the probate is avoided. If the decedent has a large enough estate, the tax costs are incurred regardless of what procedure is used to administer the assets.

It is only the pure probate costs that are actually saved by avoiding probate. When the client compares the typical pure probate costs saved by probate avoidance with the typically more expensive setup costs and extra transfer costs of the living trust, the client may determine that avoiding probate is not cost effective, particularly for smaller estates. The cost-conscious client may wish to avoid probate and ancillary probates by using nonprobate ownership of assets like joint tenancy or life estate/remainder interests, rather than living trust ownership, to avoid the cost of setting up the trust arrangement and the asset transfers.

### *C. Privacy*

Keeping the administration of the estate private with respect to the size of the estate, the nature of the estate assets, and disposition of the assets is also an advantage of the living trust. Of course, if the client avoids probate, the client will also avoid the publicity that goes along with the public probate process. The publicity issue seems largely a matter of degree. Only the probate assets need be reported on a probate inventory, which is filed with the court. If most of the decedent's assets are nonprobate assets, then most of the estate will remain out of the public view. This is the usual result when the client uses a living trust with a pour-over will, but does not transfer all of the client's assets to the living trust during the client's lifetime. On death, only the probate assets (the assets that did not get transferred into the trust prior to death) will be re-

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30. Sometimes a rearrangement of asset ownership is necessary for estate tax planning in order to make sure each spouse has sufficient assets to fund a credit shelter trust, and some costs may be incurred for transferring assets between spouses.

ported on the probate inventory. The will itself would contain only the pour-over provisions, so the main dispositive provisions, which are in the trust document, would not become public record. In many states, the client does not have to file a copy of the living trust with any public body. However, particularly when real property is sold, it may be necessary to file a copy of the trust agreement in order to document who the trustees are and that they have the requisite powers to transfer the real estate. This would destroy the privacy otherwise afforded the settlor of the living trust. Fortunately, a synopsis or abbreviated trust document is allowed to be filed in some states, so that the more private dispositive provisions of the trust agreement may remain private.<sup>31</sup>

Other methods of probate avoidance such as multi-party accounts and transfer on death accounts, will also avoid court filing and thus avoid the publicity. The beneficiaries of retirement benefits and life insurance are able to claim the benefits without filing any thing in the public domain, as long as the estate is not named as the beneficiary.

#### *D. Protection Against Settlor's Incapacity*

The publicity and cost of setting up the guardianship and the burdensome reporting to the court is avoided by using the living trust. The details of the settlor's incapacity can remain between the settlor, the trustee, and the settlor's physician.<sup>32</sup> All assets in the trust would continue to be managed with little interruption, by the trustee or successor trustee, without court intervention. The trustee's investment possibilities would only be restricted by the fiduciary's duty to prudently invest trust assets<sup>33</sup> and the provisions of the trust instrument itself.

Similar, albeit less formal, protections are available to the client without using a living trust. The durable power of attorney (the so-called poor man's trust) may be used to provide another person with legal authority to act on behalf of the client, presumably at the time the client is no longer capable of handling the client's own fi-

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31. MINN. STAT. § 501B.56.

32. The trust agreement could state that court adjudication of incapacity is not required, but instead could provide for a more informal determination of incapacity, such as the opinion of the personal physician of the incapacitated person.

33. MINN. STAT. § 501B.151.

nancial matters. Powers of attorney would cost the client only a fraction of the cost of preparing the living trust. However, an attorney-in-fact under a power of attorney generally has no affirmative duty to act as does the trustee of a trust.<sup>34</sup> This situation could leave an incapacitated client with an attorney-in-fact that has the authority to act, but no desire to actually do anything for the client.

#### *E. Professional Management*

When the client simply has poor financial or management skills, the ability to obtain assistance is critical. The living trust allows the settlor to obtain professional investment and management assistance and still maintain control over the trust assets. The trustee of a trust has an affirmative duty to act, and the trust document can set forth instructions as to how the settlor would like the trust to be administered. The less formal power of attorney must rely on statutory instruction and the good conscience and common sense of the attorney-in-fact. The power of attorney relationship is also not as widely recognized as the trust relationship and so the attorney-in-fact may encounter problems with the power being accepted by third parties. If the attorney-in-fact finds that a quick transaction is necessary on behalf of the principal, being told that the attorney-in-fact must first obtain a lawyer's opinion stating that the power is valid, or that the legal department must review the power, can be very frustrating and may cause some extra cost, delay, and even financial loss.<sup>35</sup>

Without planning, the only management that the minor beneficiary will get will be the court appointed guardian or conservator. The guardianship will only last until the ward has attained the age of adulthood, typically age eighteen, then the assets are distributed to the beneficiary. Many clients would say that age eighteen is still too young. A uniform transfer to minors act account can hold assets to age twenty-one, provide for easy access to custodial funds to be used for the benefit of the minor, and allows for more diverse investments such as equity securities,<sup>36</sup> but the clients still may want

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34. *Id.* § 523.21.

35. Some statutory power of attorney laws attempt to put some teeth in the power of attorney statutes by holding third parties harmless and even imposing liability for damages caused by refusing to accept the power of attorney when presented. MINN. STAT. §§ 523.19, 523.20 (1999).

36. *Id.* §§ 527.32, 527.34, 527.40.

various trustees, only the living trust will allow the settlor to observe how the various trustees will deal with the trust beneficiaries.

#### *H. Tax Benefits And Consequences*

The income tax benefits with respect to the living trust are obtained mainly by using irrevocable living trusts. If the grantor trust rules are avoided, the settlor is able to shift the income tax consequences from the settlor, who is in a high income tax bracket, to other beneficiaries, who are presumably in lower income tax brackets. However, since the tax brackets for trusts were greatly compressed, using the trust entity as another taxpayer is usually not beneficial because the trust's income reaches the highest marginal tax rate much sooner.<sup>39</sup>

The living trust can also be used to obtain estate tax benefits. The traditional credit shelter trust can provide the surviving spouse with an income interest and limited rights to trust principal, while keeping the trust out of the surviving spouse's taxable estate at death. The testamentary trust can do that as well, but it would be extremely difficult to obtain the same estate tax benefits without using some form of trust. Without a marital formula, the client would be required to constantly monitor the asset values and rearrange them to get the optimal split between marital and credit assets.

There are some income tax benefits to having a probate estate. Individuals and trusts generally must choose a calendar year for the taxable year.<sup>40</sup> The individual or trust must recognize income for tax purposes in the tax year in which it was earned. An estate, on the other hand, is able to pick a fiscal year as long as the fiscal year ends on the last day of calendar month and does not exceed twelve months in length.<sup>41</sup> This allows the estate to possibly defer the payment of income tax on estate distributions up to twenty-six months. If the taxpayer cannot eliminate or reduce the tax, this deferral of the tax is the next best option. Without a probate estate, no income tax deferral is possible.

In addition to the fiscal year differences, estates have a per-

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39. For taxable year 1999, a single individual hits the highest federal income tax bracket of 39.6% at \$283,150 of taxable income, but a trust hits the highest bracket at only \$8,450 of taxable income. INTERNAL REVENUE SERVICE, U.S. DEPT OF TREASURY, 1999 1040 FORMS AND INSTRUCTIONS (1999).

40. I.R.C. § 644(a) (CCH 1999).

41. *Id.* § 441; Treas. Reg. § 441-1T(b) (2) (CCH 1999).

sonal exemption of \$600 for fiduciary income tax purposes, while trusts only get a \$300 exemption for complex trusts and a \$100 exemption for simple trusts.<sup>42</sup> A small difference to be sure, but a slight advantage to the probate estate.

Estates do not have to make estimated income tax payments for two years after the death of the decedent.<sup>43</sup> Trusts, on the other hand, are generally required to pay estimated taxes in the same manner as individuals, unless the trust is a grantor trust into which the residue of the decedent's estate will pass under the will. In that case, the trust receives the same two year reprieve from paying estimated taxes that a probate estate receives. If no will is admitted to probate, then this rule will apply to the trust which is primarily responsible for paying taxes, debts, and administration expenses.

With respect to the taxation of IRAs or other qualified retirement plans, the general rule is that when an employee dies before the required beginning date for distributions from his IRA or other qualified retirement plan (age seventy and one-half) the employee's entire interest remaining in such retirement plan must be distributed to the beneficiary, and therefore treated as taxable income, within five years of the employee's death.<sup>44</sup> There is an exception to this five-year distribution rule if the employee's interest is payable to a designated beneficiary. Estates and trusts generally do not qualify as designated beneficiaries. Only individuals may be designated beneficiaries.<sup>45</sup> Naming multiple beneficiaries that include a charity (which cannot be a designated beneficiary) will cause the distributions to all the beneficiaries to be subject to the five-year rule and result in an acceleration of the income tax consequences. In the event that the employee's interest in the retirement plan is payable to a designated beneficiary the distribution is allowed to be spread out over the designated beneficiary's life expectancy.<sup>46</sup> If the designated beneficiary is the employee's spouse, the spouse also has the added benefit of being able to rollover the plan proceeds to the spouse's own IRA and postpone taking taxable distributions until reaching age seventy and one-half.<sup>47</sup>

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42. *Supra* note 40, at § 642(b).

43. *Id.* § 6654(1)(2).

44. *Supra* note 40, at § 401(a)(9)(B).

45. Treas. Reg. § 1.401(a)(9)-1(D-2) (CCH 1999).

46. *Id.* § 1.401(a)(9)-1(C-1).

47. *Supra* note 40, at 408(d)(3).

There are obvious advantages of deferral of income tax and simplicity obtained when the client simply names individuals, who qualify as designated beneficiaries. However, if the client names the estate as the beneficiary of the retirement plan benefits, the five-year rule applies. A testamentary trust or a living trust may be able to avoid the five-year rule and be treated as a designated beneficiary, but the trust must meet the following requirements: 1) the trust must be a valid trust under state law; 2) the trust must be irrevocable; 3) the beneficiaries of the trust must be identifiable; 4) all beneficiaries must be individuals; and 5) a copy of the trust must have been provided to the plan or IRA administrator by the required beginning date.<sup>48</sup>

#### IV. CONCLUSION

The living trust is a legal tool no better or worse than other legal tools. Our legal tools only need to be matched up with the appropriate legal task. There are a number of estate planning options available to a given client, each having some advantages and some disadvantages. The living trust is a valuable estate planning tool for clients with larger estates and property in many different states or clients that live in states that have complicated probate procedures. A living trust may not be appropriate for clients with simple or smaller estates, due to its cost and complexity. Clients will not always save money by using the living trust, and estate taxes can be reduced or eliminated without using the living trust. The probate process is not always lengthy, complicated and expensive, and need not always be avoided. Lawyers do a disservice to their clients by perpetuating these myths. In 1858, Oliver Wendell Homes said, "Put not your trust in money, but put your money in trust."<sup>49</sup> Good advice, but maybe not for every client.

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48. Treas. Reg. § 1.401(a)(9)-1(D5)(CCH 1999). If amendments to the proposed regulations which are pending are finally approved, the trust or the will, by its terms, must become irrevocable upon the death of the retirement plan owner, and a copy of the trust, and all amendments, as well as a list of trust beneficiaries must be sent to the plan administrator. *Id.* § 1.401(a)(9)-1(D7).

49. JOHN BARTLETT, FAMILIAR QUOTATIONS (Justin Kaplan ed., 16th ed., Little Brown and Company 1992) (quoting OLIVER WENDELL HOMES, THE AUTOCRAT OF THE BREAKFAST TABLE, Ch. 1 (1858)).