

A Word about Living Trusts

First let's define the phrase "living trust," the subject of this short article. The "living" part of "living trust" indicates that the trust is created and operable during the life of the creator. Then, of course, a "trust" is created. In its broadest sense, the word "trust" signifies a confidence that one person reposes in another. A "trust" has been defined as an arrangement whereby property is transferred with an intention that it be held and administered by the transferee for the benefit of another. In this sense, a trust can be properly understood as a legal and fiduciary relationship between parties with respect to the trust property. However, before delving further into a trust, let's take a look at the parts of a "living trust."

A trust starts with a "settlor," the person who creates the trust. This is you.

The settlor then asks a person who will hold the property to act as "trustee." With a "living trust" the initial trustee is you. You then select other persons, preferably one at a time, to be your alternate trustees. I favor that you name as a last alternative trustee a trust department at a banking institution, as that bank trust department will outlive any of the individuals you may name as alternate trustees.

The trust also has a "beneficiary," a person for whose benefit the trustee holds the trust property. You are the first beneficiary. The trust will benefit you during your lifetime. Then the trust specifies a distribution at your death to the beneficiaries you name.

The next thing a "living trust" needs is a "trust instrument." A "trust instrument" is a formal document that creates a trust and sets forth the powers of the trustee and the rights of the beneficiaries. Your trust instrument will probably be what is termed a "declaration of trust," but you may also have a "trust agreement" in which you name a third party to act as the trustee for you.

Finally, a "living trust" must have "trust property" in order to function. "Trust property" is the property that is the subject matter of the trust. In order to create "trust property," you will transfer title of all of your assets to yourself as trustee of your trust. You will also ensure that the beneficiary designations of your life insurance policies, individual retirement accounts, 401(k)'s, and the like are coordinated with the distribution set forth in your declaration of trust. This process of changing title and beneficiary designations is known as "funding" the trust.

Now let's look at several reasons for creating a "living trust." A "living trust" is generally suitable if you wish (1) to avoid probate administration of your assets after death, (2) to establish a mechanism so that your property can be managed by another in case of your disability, and (3) to reduce the "costs of dying"—specifically the cost of probate administration, and federal estate taxes at the second death of married persons or domestic partners.

If the settlor should become disabled while still living, the alternate trustee is empowered to manage the trust property for the benefit of the settlor without the appointment of a conservator. On the settlor's death, the trust will operate in much the same way as a will. The trust instrument will either require the trustee to distribute the trust property to designated beneficiaries or to hold it in trust for the benefit of those beneficiaries.

A "living trust" does not save any federal income, estate, or gift tax during the settlor's lifetime or on the settlor's death. However, a "living trust" may be used to achieve some tax-saving goals after the settlor's death, especially if one of the purposes of the trust when the declaration of trust is written is to limit estate taxation in the estate of the surviving spouse or partner.