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Revocable Trusts

Advantages, Disadvantages and Myths

One technique for administering assets, both during one's lifetime and after death, is to create a revocable trust. While revocable trusts certainly offer some advantages vis-à-vis wills as a means of managing wealth and transferring it to beneficiaries, there are some disadvantages that should be considered and some popular myths that ought to be dispelled.

FEATURES

A revocable trust is created when an individual (the grantor) signs a trust agreement naming a person(s), a corporation (bank or trust company) or both as trustee to administer the trust. In many jurisdictions the grantor and the trustee can be the same person. In such cases, however, a co-trustee should also be named in order to ensure continuity of management in the event of death or disability. Naming a bank or trust company as trustee rather than an individual ensures that a competent trustee will always be available to act in the grantor's best interest.

A revocable trust typically provides that property be managed for the grantor's benefit. In most cases, the grantor retains certain rights over the trust during his or her lifetime. These generally include the right to instruct the trustee to pay over all or any portion of the trust property, as the grantor desires, and the right to change or revoke the trust at any time. The trustee's powers typically include the right to make discretionary distributions of income and principal to the grantor and, sometimes, to the grantor's family, if the grantor becomes incapable of managing his or her own affairs. When a grantor dies, the trust acts like a will, and the property is distributed to the beneficiaries as directed by the trust agreement.

While a trust may be funded upon the grantor's death, it is generally preferable to fund it while the grantor is living. This ensures continuity of asset management and financial support of the grantor, should he or she become disabled.

Funding a trust during a grantor's lifetime requires reregistering securities, real property and other assets in the name of the trust. Reregistration of property is not required in trusts funded at death where the probate estate is simply "poured over" into the trust. However, funding a trust at death does not avoid the necessity of probate.

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ADVANTAGES OF REVOCABLE TRUSTS VS. WILLS

Continuity of Management During Disability

Creating a revocable trust is probably the best way to ensure that your property remains available to be used for your benefit, should you become physically or mentally incapable of managing your own affairs. While continuity of management is also possible when a durable power of attorney is signed, third parties such as banks, brokers and transfer agents often have more difficulty in dealing with a power of attorney than with a trust agreement. And, if the designated attorney-in-fact is unable to act, the power of attorney may not be usable.

If you become disabled and you have neither a revocable trust nor a power of attorney, an expensive, lengthy, and potentially embarrassing court proceeding is generally required to appoint a conservator or guardian before your property can be used to benefit either you or your family. Even after a guardian has been named, continued court supervision over the management of investments and disbursements is usually required. This can include annual bond fees, annual accounts and additional legal and accounting fees.

Flexibility

Using a funded revocable trust may allow you to name unrelated, out of state individuals and out of state trust companies to act as the primary administrator of your property at death. Without a trust, many jurisdictions limit your flexibility in this regard. Also, it is usually easier to make amendments to a revocable trust than to a will.

Avoidance of Probate

Because probate can be costly and time consuming, the avoidance of probate is often cited as one of the primary benefits of a revocable trust. The extent of this benefit may vary from one place to the next. For example, avoiding probate may be a significant benefit if you own real estate in more than one state, because you avoid multiple probate proceedings. Since each jurisdiction's probate process is different, it is necessary to consult local counsel to determine which, if any, disadvantages of probate apply to you.

Availability of Assets at Death

Assets in a revocable trust at the grantor's death are available to raise cash to pay estate taxes, administration expenses and debts immediately after death, without waiting for a probate decree or issuance of preliminary letters. If the trust is funded prior to death, the property in the trust remains in the trustee's name before and after the death and is immediately available for liquidation should the need arise.

Lost or Destroyed Originals

When offering a will for probate, all original wills must be provided to avoid a presumption that the will was revoked. Typically only one original must be produced at death. Since revocable trusts are not probated, multiple originals may be signed and one original may validate transferred property held in the trust at death. Having a revocable trust, therefore, may simplify the transfer of property at death if the original will cannot be located or has been destroyed.

No Interruption in Investment Management

One of the primary benefits of creating a revocable trust is the ability to provide uninterrupted investment management should the grantor become disabled, as well as after the grantor's death. Assuming the assets were previously transferred into the trust's name, there is no need to reregister securities after death. In addition, depending on the cash needs and investment objectives of the grantor's estate, there may be no need to develop a new investment strategy.

DISADVANTAGES OF REVOCABLE TRUSTS VS. WILLS

There are a few disadvantages that may apply to using a revocable trust instead of a will. These arise from the different treatment of trusts and wills under certain property laws.

Reregistration of Property

As noted above, in order to be included in a revocable trust, property must be reregistered in the name of the trust. This may be cumbersome and may involve other costs such as filing fees.

May Not Automatically Adapt to Changed Circumstances

In many jurisdictions, wills change automatically upon divorce, marriage or the birth of a child. Most jurisdictions do not provide similar flexibility for revocable trusts. Therefore, when circumstances change, the grantor must be sure to make the necessary amendments to the provisions of a revocable trust.

MYTHS ABOUT REVOCABLE TRUSTS

Myth: Revocable Trusts Save Taxes.

No, revocable trusts do not save income taxes, nor do they save estate taxes. In fact, during a grantor's lifetime, the IRS may actually discriminate against revocable trusts in certain specific income tax situations. In most cases, however, the property in a revocable trust is treated as if it were the grantor's own property for both income tax and estate tax purposes.

Myth: Heirs Cannot Challenge a Revocable Trust. Revocable trusts, like wills, can be attacked by dissatisfied heirs. In fact, in those jurisdictions where it is easier to create a will than a revocable trust, a trust agreement may be more vulnerable to objections than a will.

Myth: Revocable Trusts Protect Assets from Creditors. This is incorrect. Creditors may reach the assets during the grantor's lifetime.

Myth: Property Is Distributed More Quickly from a Revocable Trust. Upon death, beneficiaries do not receive property more rapidly from a revocable trust than from a will. And, in some jurisdictions, the rule requiring a notice period for creditors applies to revocable trusts as well as estates.

Myth: Revocable Trusts Lower Administrative Costs. Generally revocable trusts do not lower commissions or legal fees. Both an estate's personal representative and the trustee of a revocable trust are entitled to receive commissions. And, because the trust is often administered for many years before being distributed, it is likely that the trustee's annual commissions, even when calculated at a lower rate, will actually, in aggregate, be higher than the personal representative's.

Most legal fees are incurred in connection with postmortem estate and income tax planning and the distribution of assets—

fees that apply to both revocable trusts and estates. If a lawyer computes a fee on a percentage basis, as is often the case, that percentage is usually based on the estate tax value of a decedent's property, not on the value of the probate estate.

Revocable trusts normally do not incur court filing fees. However, such fees are relatively modest, are tax deductible and, in themselves, do not constitute a sufficient reason to create a revocable trust.

CONCLUSION

The primary benefit of creating a revocable trust is that it provides a prearranged mechanism that will ensure the continued management and preservation of your assets, should you become disabled. It can also set forth all of the dispositive provisions of your estate plan. Due to recent changes in the tax laws, most revocable trusts can now be treated as part of a decedent's estate for federal income tax purposes. Consequently, a revocable trust is now afforded certain postmortem tax advantages that are enjoyed by an estate, including the ability to report its income on a fiscal year basis, rather than a calendar year basis.

Revocable trusts are not for everyone. Whether a revocable trust is appropriate for you and your beneficiaries depends greatly on your specific needs and circumstances. Although the advantages of creating a revocable trust usually outweigh the disadvantages, the decision to create a revocable trust is complicated and requires a thorough legal analysis considering all of the above factors as they affect each individual and family.

Attribute	Revocable Trusts vs. Wills		
	Revocable Trusts	Will	No Difference
Protects assets in case of disability	✓		
Avoids probate	✓		
Affords greatest flexibility	✓		
Availability of assets at death	✓		
No need to reregister property after death	✓		
No need to reregister property during lifetime		✓	
May automatically adjust to changing circumstances		✓	
Saves income taxes during lifetime			✓
Saves estate taxes during lifetime			✓
Saves estate taxes after death			✓
Protects assets from creditors			✓
Lowers administration expenses			✓
All original documents required	✓		

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