Kinds of Trusts

Trusts fall into two basic categories: testamentary and inter vivos.

A testamentary trust is one created by your will, and it does not come into existence until you die. In contrast, an inter vivos trust, starts during your lifetime. You create it now and it exists during your life.

There are two kinds of inter vivos trusts: revocable and irrevocable.

Revocable Trusts

Revocable trusts are often referred to as “living” trusts. With a revocable trust, the person who created the trust, called the “grantor” or “donor,” maintains complete control over the trust and may amend, revoke or terminate the trust at any time. This means that you, the donor, can take back the funds you put in the trust or change the trust’s terms. Thus, the donor is able to reap the benefits of the trust arrangement while maintaining the ability to change the trust at any time prior to death. **need to give some real-world examples of trusts*

Revocable trusts are generally used for the following purposes:

1. *Asset management.* They permit the named trustee to administer and invest the trust property for the benefit of one or more beneficiaries.
2. *Probate avoidance.* At the death of the trust grantor, the trust property passes to whoever is named in the trust. It does not come under the jurisdiction of the probate court and its distribution need not be held up by the probate process. However, the property of a revocable trust will be included in the grantor’s estate

for tax purposes.

3. *Tax planning.* While the assets of a revocable trust will be included in the grantor's taxable estate, the trust can be drafted so that the assets will not be included in the estates of the beneficiaries, thus avoiding taxes when the beneficiaries die.

Irrevocable Trusts

An irrevocable trust cannot be changed or amended by the grantor. Any property placed into the trust may only be distributed by the trustee as provided for in the trust document itself. For instance, the grantor may set up a trust under which he or she will receive income earned on the trust property, but that bars access to the trust principal. This type of irrevocable trust is a popular tool for Medicaid planning.

Testamentary Trusts

As noted above, a testamentary trust is a trust created by a will. Such a trust has no power or effect until the will of the grantor is probated. Although a testamentary trust will not avoid the need for probate and will become a public document as it is a part of the will, it can be useful in accomplishing other estate planning goals. For instance, the testamentary trust can be used to reduce estate taxes on the death of a spouse or to provide for the care of a disabled child.

Supplemental Needs Trusts

The purpose of a supplemental needs trust is to enable the donor to provide for the continuing care of a disabled spouse, child, relative or friend. The beneficiary of a well-drafted supplemental needs trust will have access to the trust assets for purposes other than those provided by public benefits programs. In this way, the beneficiary will not lose eligibility for benefits such as Supplemental Security Income,

Medicaid and low-income housing. A supplemental needs trust can be created by the grantor during life or be part of a will.

Credit Shelter Trusts

Credit shelter trusts are a way to take full advantage of state and federal estate tax exemptions.

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Redo Your Estate Plan Before You Remarry

If you are getting remarried, you obviously want to celebrate, but it is also important to focus on less exciting matters like redoing your estate plan. You may have created an estate plan during your first marriage, but this time it will probably be more complicated—especially if you have children from your first marriage or more assets. The following are some pointers for ensuring your interests are taken care of when you remarry:

- **Take an inventory**. The first thing you and your partner should do is each take an inventory of your assets and debts and share it with the other person. Don’t forget to include life insurance policies and retirement plans in your inventories. It is important to be open and honest about money if you want to prevent bad feelings in the future.

- **Decide how you want to handle finances**. Once you know what you are dealing with, then you need to decide if you want to combine (or not combine) assets when you are married. For example, if one partner is selling a house and moving in with the other partner, will he or she contribute to the cost of the house? If one partner has significant debt, you may not want to combine finances or make any joint purchases. These decisions need to be made upfront so everyone is clear on what to expect.
- **Decide what you want to happen when you die**. You and your future spouse need to figure out where each of you wants your assets to go when you die. If you have children from a previous marriage, this can be a complicated discussion. There is no guarantee that if you leave your assets to your new spouse, he or she will provide for your children after you are gone. There are a number of options to ensure your children are provided for, including creating a trust for your children, making your children beneficiaries of life insurance policies, or giving your children joint ownership of property. Even if you don't have children, there may be family heirlooms or mementos that you want to keep in your family. Again, open discussions can prevent problems in the future.
- **Consult an elder law or estate planning attorney**. Even if you don't have a lot of assets, you should consult an attorney, especially if you have children. You will definitely need to update your will. You may also need to update or create other estate planning documents such as a durable power of attorney and a health care proxy. If you have significant assets, a prenuptial agreement may be appropriate. In addition, the attorney can help you decide if a trust is necessary to protect your children's interests.
- **Change your beneficiaries**. You may want to change the

beneficiaries on your life insurance policy, annuity, and/or retirement plan. If you are divorced, however, you may not be able to change some of the beneficiaries. Bring your divorce decree with you to the attorney so he or she can make sure you do not violate the decree. If you can't change your beneficiaries, you may want to buy additional life insurance or retirement plans that will include your new spouse.

- **Consider a prenuptial agreement**. While you are intending to stay married, things happen. Unlike a first marriage, you may be bringing property to this marriage that you spent decades accumulating and you may be merging two families. You need to decide together what your intentions are for the use of funds while you are living together, if you get divorced and when one of you dies before the other. Failure to think and plan ahead can mean severe heartache and financial costs for you and your family.
- **Consider purchasing long-term care insurance**.The physical, emotional and financial cost of long-term care can deplete the savings of all but the most wealthy. While you may be willing to spend your lifetime of savings on the care of a spouse with whom you raised a family and accumulated the funds, you may not want to lose this to the care of a relatively new spouse. Long-term care insurance, while expensive, can permit you and your new spouse to get the care you need without impoverishing the other.

The most important thing to remember is to be open and honest with your future spouse and your family members about your wishes.

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When Should You Update Your Estate Plan?

Once you've created an estate plan, it is important to keep it up to date. You will need to revisit your plan after certain key life events.

Marriage

Whether it is your first or a later marriage, you will need to update your estate plan after you get married. A spouse does not automatically become your heir once you get married. Depending on state law, your spouse may get one-third to one-half of your estate, and the rest will go to other relatives. You need a will to spell out how much you wish your spouse to get.

Your estate plan will get more complicated if your marriage is not your first. You and your new spouse need to figure out where each of you wants your assets to go when you die. If you have children from a previous marriage, this can be a difficult discussion. There is no guarantee that if you leave your assets to your new spouse, he or she will provide for your children after you are gone. There are a number of options to ensure your children are provided for, including creating a trust for your children, making your children beneficiaries of life insurance policies, or giving your children joint ownership of property.

Even if you don't have children, there may be family heirlooms or mementos that you want to keep in your family. For more information on estate planning before remarrying, click here.

Children

Once you have children, it is important to name a guardian for your children in your will. If you don’t name someone to act as guardian, the court will choose the guardian. Because the court doesn’t know your kids like you do, the person they choose may not be ideal. In addition to naming a guardian, you may also want to set up a trust for your children so that your assets are set aside for your children when they get older.

Similarly, when your children reach adulthood, you will want to update your plan to reflect the changes. They will no longer need a guardian, and they may not need a trust. You may even want your children to act as executors or hold a power of attorney.

Divorce or Death of a Spouse

If you get divorced or your spouse dies, you will need to revisit your entire estate plan. It is likely that your spouse is named in some capacity in your estate plan – for example, as beneficiary, executor, or power of attorney. If you have a trust, you will need to make sure your spouse is no longer a trustee or beneficiary of the trust. You will also need to change the beneficiary on your retirement plans and insurance policies.

Increase or Decrease in Assets

One part of estate planning is estate tax planning. When your estate is small, you don’t usually have to worry about estate taxes because only estates over a certain amount, depending on current state and federal law, are subject to estate taxes. As your estate grows, you may want to create a plan that minimizes your estate taxes. If you have a plan that focuses on tax planning, but you experience a decrease in assets, you may want to change your plan to focus on other things.

Other

Other reasons to have your estate plan updated could include:

You move to another state

- Federal or state estate tax laws have changed
- A guardian, executor, or trustee is no longer able to serve
- You wish to change your beneficiaries
- It has been more than 5 years since the plan has been reviewed by an attorney

Contact your attorney to update your plan.

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How to Make Changes to Your Will

As life circumstances change (births, marriages, divorces, and deaths), it may become necessary to make changes to your will. If an estate plan is not kept up-to-date, it can become useless. The best way to make changes is either through a codicil – an amendment to the will – or by creating a new will.

While it may be tempting to just take out a pen and make changes by hand, this is not recommended. Changes will not be effective unless you use the same formalities as you did when drafting the will. And depending on state law, changes made by hand on the will may void the will altogether. If you sign your name to handwritten changes and have the changes witnessed, it is possible a court will find that the changes

are valid, but there is no guarantee and there are likely to be delays with the court while your final wishes are sorted out.

If you have small changes to make to your will (i.e., changing your executor or updating a name that has changed), a codicil may be appropriate. The benefit of a codicil is that it is usually cheaper than redoing the entire will. The same rules for wills apply to codicils, which means the codicil should be dated, signed, and witnessed. Always keep a codicil with the will so your personal representative can find it easily.

If you have significant changes to make to your will (i.e., adding a spouse or removing a beneficiary) or have more than one change, it is generally better to update your will rather than write one or more codicils. The updated will should include a date and a clear statement that all other previous wills and codicils are revoked.

Before you make any changes to your will, you should consult with your attorney.

For more information on when you should update an estate plan, click here.

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Using a No-Contest Clause in

Wills and Trusts

If you are worried that disappointed heirs could contest your will or trust after you die, one option is to include a “no-contest clause” in your estate planning documents. A no-contest clause provides that if an heir challenges the will or trust and loses, then he or she will get nothing.

A no-contest clause may be a good idea if you have a beneficiary who may be upset by the property distributed to him or her. However, no-contest clauses (also called in terrorem clauses) only work if you are willing to leave something of value to the potentially disgruntled heir. You must leave the individual enough so that a challenge is not worth the risk of losing the inheritance.

Most states allow no-contest clauses, but there may be restrictions. In many states, if the contest is based on probable cause or good faith, then the no-contest clause is unenforceable. That means that if the court determines there is a good reason for the contest, the clause won’t prevent the challenging heir from inheriting. In addition, a no-contest clause may apply to some portions of your estate plan, but not others. For example, your heirs may be able to challenge your executors without violating a no-contest clause.

Two states –Florida and Indiana – will not enforce no-contest clauses no matter what. If you write your will in a state that enforces no-contest clauses and then move to Florida or Indiana, the no-contest clause will be void.

If you include a no-contest clause in your estate plan, you need to be sure there are no mistakes. If you leave out important property or aren’t clear about property in your possession, your heirs could be completely disinherited if they try to fix any mistakes.

While a no-contest clause can be a good tool, there are other

ways to discourage a will contest. To learn more, click here. Talk to your elder law attorney to determine the best method to protect your wishes.

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