Revocable Trust Myths

Articles constantly appear and seminars proliferate lauding the benefits of "revocable" or "living" trusts and urging all people of sound mind to create them. These articles or seminars **invariably prompt clients to ask me why their estate plan fails to include one of these miraculous devices**. This Memorandum will highlight some of the advantages and disadvantages of Revocable Trusts vis-à-vis Wills in Maryland and the District of Columbia

Revocable (living) trusts are basically plain vanilla revocable trusts established during a person's lifetime. The person retains the right to income and principal and the right to amend or revoke the trust prior to death. The trust becomes irrevocable when the person dies and the trust assets are disposed of according to the trust instrument. The trust instrument at death acts essentially as a **will substitute**.

The claims made for a revocable trust as a will substitute are that it saves taxes, avoids the expenses associated with probate, and avoids delays in distributing assets after death. There is also the claim that it ensures a greater degree of privacy than probating a will. Let's briefly dispel some myths and then highlight situations when a revocable trust may make sense.

***Estate, inheritance, and income taxes*.** The first myth to be dispelled is that a revocable trust is a tax-savings device. The assets in the trust at death are included in the person's estate and subject to estate tax. **There simply are no inheritance or estate tax savings**.

As far as income tax, an estate offers several advantages over the revocable trust, the most important of which is the ability of the estate to elect a fiscal year. While a trust must report on a calendar year basis, the ability of the

estate to choose a fiscal year may enable the beneficiaries to postpone payment of tax for a year on post-death income.

Avoiding probate costs and delays. The other major claim made for revocable trusts is that they save probate costs. This is literally true, except that there are important counterbalancing expenses involving revocable trusts. Probate fees themselves tend to be rather reasonable in Maryland, for example. In fact, revocable trusts can involve probate fees because it is frequently necessary to have a "Pour-over" Will for assets not in the trust, in which case there are probate fees.

Of more importance, however, is the fact that the cost of preparing the trust agreement and related documents, such as a pour-over will, and the costs of transferring property to the trust, can be significant. Moreover, transferring assets to the trust can be more than a documentary formality. Permission may be necessary to transfer interest in partnerships, closely held businesses, and cooperative apartments. With respect to real estate, deeds must be prepared.

It is true that there is no interruption in trust administration when the person establishing the revocable trust dies, but there are usually only minimal delays in having a will admitted to probate and special procedures are available to expedite the process. As a practical matter, distributions by both trustees and executors are generally delayed until assets are valued, federal and state inheritance taxes are paid, and the appropriate releases secured. The legal fees would be fairly constant whether or not a revocable trust is issued, provided that you retain an attorney who is compensated based upon professional services rendered rather than getting a "cut" or percentage of the size of the probate estate. Although a revocable trust does not have to be filed for probate like a traditional will and has "privacy" advantages, its privacy may be compromised by the requirement of banks and brokerage firms that they review the trust

agreement before they will open an account. In addition, the assets in a revocable trust must be reported on an information report in Maryland which needs to be filed.

Avoiding contested wills. Because a "trust" and a "will" are separate legal concepts, a trust is not subject to a will contest. However, trusts are subject to attack on the basis of lack of capacity, undue influence, and fraud. These same grounds can be used to contest a transfer by will.

BUT – there is an additional problem with trusts. When a will is probated, the disposition of the assets come under the supervision of the Court through the Register of Wills, an administrative agency of the court. This includes the auditing of accounts and distributions by the Register of Wills auditor's office. **Contrary to popular belief, this is a good thing that is – unfortunately – avoided by having a trust.** Recently I spent two years representing – and litigating – a revocable trust set up by a mother for her two adult children. She named only one child as trustee, and unfortunately the two children did not agree on the valuation or method of distribution of the trust. There were considerable legal fees and emotional costs that would have been avoided had the mother simply left the assets in her will, because the executor would have been under the supervision of the court, with prescribed valuation methods and distribution procedures.

Avoiding creditors' claims. During your lifetime, assets in a living trust are subject to the claims of your creditors. After your death, these assets are subject to the claims of your estate's creditors.

Avoiding your spouse's claim to a share of your estate. Most state laws provide that a surviving spouse may claim a share of revocable trust assets.

Avoiding the expense of guardianship. While a living trust

may avoid the expense of a guardianship in case of your future incapacity, a durable power of attorney is a simpler and less costly alternative to achieve the same goal.

Avoiding lengthy probate delays. There are rare circumstances where families and others clash for an extended period after a death. Such disputes can cause delays in the administration of either a probate or a living trust (as noted above). In other circumstances, disputes with the Internal Revenue Service can cause more delays. However, in most circumstances the administration of a living trust is no more time efficient that the administration of a will in probate.

The living trust is the only way to avoid probate. If your goal is to avoid probate, there are several ways to do so. Joint tenancy with rights of survivorship, multiple party accounts with financial institutions, and transfer on death or pay on death (TOD or POD) designations of securities and bank accounts are common and inexpensive methods of avoiding probate.

When revocable trusts work. Let me identify a few specific situations as being particularly suited to revocable trusts:

- Where a person has significant real estate holdings in a number of states. Here a revocable trust could avoid the necessity of a probate filing in each locale.
- For a elderly surviving spouse with an uncomplicated asset structure (e.g., one or two brokerage accounts), the revocable trust may be the appropriate instrument. This is because the costs and aggravation encountered with the transfer of the assets to the trust (e.g., re-titling brokerage accounts) is minimal. In these cases, the assets would pass upon death simply and without delay.
- For what might be called Machiavellian estate planning, there are some states, including Maryland, where the revocable trust – unlike a will – may still be used in

certain instances to bar the grantor’s surviving spouse from obtaining a statutory share of such trust property.

- A revocable trust may be an excellent tool for the orderly management of the affairs of an elderly person or someone otherwise unable or unwilling to manage his or her property. A similar result can usually be achieved through the use of a Durable General Power of Attorney – a document appointing another individual to manage your affairs. Maryland even permits a “springing” power which would not take effect until the incapacity arises. Nonetheless, the revocable trust may be the proper tool in certain situations. It is certainly preferable to a formal guardianship or conservatorship.

There are other situations where the revocable trust may be beneficial. However, the purported advantages of a revocable trust do not seem to stand up to a close comparison with more traditional estate planning vehicles in many situations. In short, the decision to use a will or a revocable trust needs to be evaluated based upon a client’s specific circumstances. In this regard, please feel free to contact us to discuss these issues more closely.