"Can You Trust What You Hear About Trusts?"

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We have all heard about the legal entities known as trusts and their use in estate planning. But, just what are they, what can these devices do- and more importantly, what can’t they do?

In brief, there are really two primary groupings of trusts- the “revocable” trust and the “irrevocable” trust. Let us begin with the revocable trust, commonly called a Living Trust.

THE LIVING (REVOCABLE) TRUST MYSTIQUE

In the newspapers and trade articles, there are things variously called the “Living Trust,” the “Loving Trust,” the “Grantor Revocable Trust,” the “Family Trust” and various other permutations of the same basic device. All of these descriptions aptly describe it, but just what is it? What can it do- perhaps more importantly, what can’t it do? Are these devices really useful in Texas, where probate is (usually) easy and inexpensive, anyway? What does it cost? Can it protect assets? Can a single person use it, and why would a single person want to use it? Why does the Texas State Bar have an “advisory” about living trusts?

It must be remembered that every individual and family has unique circumstances, and any generalization has the tendency to cause people to think things can be developed only one way, when in fact other options are indeed available. One simply cannot ignore the complexity of the human life and human experience.

A BASIC PRIMER ON TRUSTS IN GENERAL AND THE LIVING TRUST

Many persons are comfortable with the traditional methods used in estate planning: the Will and (usually a) power of attorney. The person has the document prepared, reviews and signs it (and perhaps revises it every few years) and goes on with their business.

The individual isn’t “aggravated” with having to inventory their assets, value and transfer them, as required in an effective living trust. In other words, nothing happens to the title of the assets of the person when they execute a Will. The property continues being titled as they presently

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2 Texas, in contrast to many states, has a simplified probate approach whereby the court is not involved in the vast majority of the estate matters, other than proving up the will, receiving the statutory inventory of assets as existing in the estate at the time of death and perhaps filing a closing with the court. Other states may require judicial detailed review of every significant transaction, which can become rather burdensome and expensive. See TEX. PROBATE CODE ANN. § 145.

3 See generally TEX. PROBATE CODE ANN. § 57 et seq. as to the requirements of properly prepared and executed Wills.
exist, in other words, being held “individually.”

Recall that a trust requires several components- a grantor, a trustee, a beneficiary, and trust corpus (trust property). The key to understanding the Living Trust, or any trust for that matter, is the realization that assets that the individual currently owns “individually” are actually transferred, via legal document, to a new distinct legal party- the trust’s trustee.

While that trustee may well be the same person as the grantor (the person who transferred to the trustee the property and formed the trust), the fact that the legal title has changed (transferred) to a new “legal” party (here the trustee), who is legally and separately existing, is the key to how a trust works. The grantor and the trustee, although perhaps being the same person as in a Living Trust, are separate and distinct in the eyes of the law. The grantor has transformed the property from being owned “individually” (albeit perhaps as community property) to being owned in trust for someone’s benefit as a trustee. A Trustee owns legal title to the property, but the beneficiary receives all benefits and enjoyment of the property, i.e., beneficial interest.

It is the change in ownership of the property from being held individually to that as owned by a trustee that allows so much power and flexibility to any trust. This transition of ownership allows for continuity lacking in the case of property held by a person individually. This legal “slight of hand” is most potent, as will be seen.

While a trust has many advantages, there are more than just a few individuals who are justifiably afraid or skeptical of any trust because they have heard it requires a separate tax return (which, if it applied, would be Form 1041). They also have heard through their friends about how someone else’s trust, usually managed at a bank (of course, the trustee could be any institution or person) has had terrible investment returns and “nothing can get done,” or that the trustee fees were terrible. Many clients also see the trust as a non-responsive device perhaps useful for “someone else” or persons who cannot act for themselves.

While relatively “new” as to use in Texas, the Living Trust has been around for some time. Many famous individuals have used the Living Trust, including Bing Crosby. Perhaps the reason easiest to identify for the relatively slow acceptance (until the last decade) of the Living Trust in Texas was simply because Probate was relatively inexpensive and easy, thanks in part to Texas’s outstanding (and often copied by other states) Probate Code.

It is also arguable- perhaps sarcastically- that many attorneys simply weren’t interested in it, since they a) didn’t understand it or want to take the time to understand it; b) didn’t think they

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4 For sake of discussion here, we will assume the property, even if it is community property, is meant to be held outside of a trust. Thus, for brevity, we will use the term “individually” herein to denote property held outside of a trust.

5 See generally the Texas Trust Code, TEX. PROP. CODE ANN. § 111.001 et seq.

6 Generally the grantor being a trustee is a fundamental factor in a revocable trust.

7 “Trustee” means the person holding the property in Trust. TEX. PROP. CODE ANN. §111.004(18).

8 Often the transference of the property to a trustee results in a lost of control over the asset, but not in a living trust, at least while the grantor(s) are alive. See the later discussion of irrevocable trusts for the tax implications thereof.

9 The living trust, and unfunded trusts, trusted by the grantor/maker, are recognized as valid in Texas. Westerfield v. Huckaby, 474 S.W.2d 189 (Tex. 1972).
could make money at it, or c) thought it would take away from their probate business. Obviously, none of these reasons are very valid, at least to the consumer. However, it is just as true that not every situation is appropriate for the Living Trust, which is one reason the State Bar of Texas has issued a pamphlet on trust scams, including the living trust.

What about the extra tax return possibly being required? Since the living trust is a revocable trust, meaning the client can revoke it at any time and retransfer the property back to themselves, the IRS has taken the position that since the client (individually) and the client as the trustee are the same person (which for once the government is correct about something), there is no sense in filing two tax returns (individually as a 1040 and the trust as a 1041).

Until the trust becomes at least partially irrevocable, which occurs at the time of death of the grantor and/or a spouse, no separate trust tax return is required. The IRS, while technically recognizing the entity, does not require a separate return until the death of a grantor. A separate tax identification number is normally not available until the death of a grantor, as well, and the service will generally refuse the issuance of such an identification number until that the time of partial irrevocability.

The concern regarding the choice of trustee and management will be discussed in greater detail in a later section.

**BUT JUST WHAT IS THE LIVING TRUST?**

Technically speaking, the Living Trust is known as a **Revocable** (meaning you can reverse what you have done, or modify it at will) **Grantor** (meaning the client who is establishing the trust) **Inter Vivos** (meaning you are still living) **Trust** (a distinct legally existing entity separate and apart from the Grantor). Being revocable, the IRS generally disregards, for immediate tax purposes, the normal notions of trust returns as established in Subchapter J of the IRC.

**SO, WHAT COULD BE A PROBLEM?**

One of the biggest problems is the proliferation of the “trust mills” and these trust mill instruments not achieving the intention of the grantor, either legally or in tax and/or estate

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10 Even in Texas, an attorney could charge a fee of approximately 3% of the estate valuation in a probate action. In most other states the 3% fee is relatively standard. This fee, if charged, could vastly outpace the cost of a properly prepared living trust and associated instruments.

11 Total (or significant) control still vesting in the grantor/trustee equates to the grantor being taxed on the income. IRC §674(a).

12 Treasury Reg. § 1.671-4(b).

13 As per the instructions of Form SS-4.

14 See generally I.R.C. §§ 671- 679. The notion is the grantor does not wish to relinquish control of the assets unlike that which would result in the transfer of the assets to an irrevocable trust. As such, no control has been transferred and as such the grantor should continue to be taxed on the property’s income. No “adverse” party is in control of the assets or its income. Of course, the grantor trust provisions may cause clients unexpected results in certain other situations not related to the living trust and not explored herein. See also Helvering v. Clifford, 309 U.S. 331 (1940), IRC § 674(a).
planning. Unfortunately, these trust mill folks seem to be to estate planning as the vinyl siding folks are to the construction industry. In both cases, these products, if improperly used, usually “cover up” but do not correct underlying problems, all at a high price (monetary and procedural) both initially and later when it is time to clean it up.\(^{15}\)

As might be expected, these mills usually use a strong-arm marketing approach of scaring people by predicting delays, high costs, and various estate tax issues that simply might not (and probably would not) develop, at least in Texas. These “trust mill” trusts are usually not tailored to the client, and worse, the underlying property is often not transferred properly into the trust. The FTC has raised a complaint against two companies that sold these types of trusts in 43 states. One of the main charges raised by the FTC was the fact that “the practices… are particularly contemptible because they were designed to prey upon the financial fears of the elderly.”

In essence, the living trust and its attendant devices are portrayed by the vendor to the client as a savior to and from any and all possible problems, and then once signed (and paid for), nothing (or little) is done by the vendor to transfer the assets as necessary. And, of course, the cookie cutter approach is usually vastly overpriced. Often these trusts are not state specific\(^{16}\), which may cause innumerable problems later. The otherwise valuable technique of the living trust is then reduced to an overpriced piece of paper that does not accomplish what it is supposed to do. And when people get burned, they tell others, and as a result the living trust gets a bad rap. But, this, of course, happens in many forms of business activities, unfortunate as that might be.

In an improperly funded or drafted trust, various problems result - and if a Pour Over Will\(^{17}\) is not in place, even more problems can result.

**Example Non Exclusive Problems:**

- **Nothing is funded into the trust and no Pour Over Will exists:** If the grantor dies, the trust does not control. This could well be a case of an intestate succession matter. The state intestacy statutes would control.\(^{18}\) Estate tax issues would probably be disastrous. Since the property would not be part of the trust, where arguably an estate mechanism should be in place, such a technique would be unavailable to the executor/personal representative\(^{19}\) of the estate.

- **Nothing is funded into the trust and a Pour Over Will exists:** If the grantor dies, here, via the “pour over Will” actions, the trust should be funded. However, probate action would be required to effect the provisions of the Will. The purposes of the trust should be achieved, including tax planning, if this is a “first to die” situation.

\(^{15}\) Often these “mills” do not have a Texas attorney supervising the work, although generally they claim an attorney reviews the work before being sent to the client.

\(^{16}\) “State specific” refers to the situation where the trust and its documents may not correspond specifically to the underlying statutes of that particular state.

\(^{17}\) As explained later, a “pour over Will” is a document that transfers into the trust any property that had not been transferred during the grantor’s/testator’s lifetime.

\(^{18}\) See TEX. PROB. CODE ANN. § 38.

\(^{19}\) Here the personal representative might not be the trustee named in the trust. The court may have to appoint an executor.
• **Partial funding and a Pour Over Will exists:** Basically the same result as the previous problem requiring the probate action and the funding of the trust. While the intent of the Grantor will probably be achieved, the hoped for benefits from an administrative point of view would be lost.

• **Real Property located outside of Texas is not placed into the Trust:** Dependent upon the state involved, a probate action would be required to carry out the pour over Will requirements. This could be costly and result in a delayed situation.

• **Real Property located in Texas is not placed into the Trust:** Either the pour over Will will be necessary to be probated or a process known as Affidavit of Heirship would be necessary for later sale by the beneficiaries.

• **Trust does not consider estate tax issues.** Here the danger of the computer “canned” programs can come into effect, where the drafter does not recognize the true nature of the client or adequate questions had not been asked. For example, if a client had “home done” his or her trust (or Will, for that matter) on a computer from a shelf bought program, they may not recognize certain assets are considered part of their “tax” estate. As a result, very significant estate problems will result unless extremely aggressive action is taken before the death of the surviving spouse.

• **Trust does not consider succession issues.** A properly drafted trust should include all succession possibilities, including both grantor/spouses passing away together in a car accident, children passing away prematurely, and similar such issues. In addition to the beneficiary provisions being affected, the trustees should be properly provided for via appropriate succession, including naming an institution as “worse case” trustee. It is not uncommon to see a poorly drafted trust whereby succession is not thought out- particularly as to successor trustees if the “primary” parties are deceased.

• **Trust does not consider Minor child issues.** Properly drafted trusts should include provisions to care for the minor children’s property, although a separate guardianship declaration should be drafted for the care of their “person.” This feature is often overlooked and can cause undesirable results. If a parent does not wish property to be “reachable” by a young adult, they can establish certain age limits within the trust or in “pour over” trusts for the children.

• **Trust does not consider special child or person issues.** One of the most disheartening things to observe is when a special child has not be properly “considered” within any legal

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20 See TEX. PROB. CODE ANN. § 48. This approach would not result in placing the property into the trust, rather it would pass directly to the heirs. If tax planning had been contemplated, this Affidavit of Heirship procedure would not be advisable since it would not allow for the proper use of the credit shelter trust but still must be counted as part of the overall estate.

21 It is amazing how many persons do not understand that generally life insurance and retirement funds (and, of course, many other assets) are part of their estate. Presumably they are under the misconception that since the death benefit is paid to “someone else” it is not part of their estate- probably confusing the notion of probate assets with their estate. Many persons also forget to consider the effects of an inheritance on their estate, as well.

22 Of course, such considerations should also be thought about in an ordinary Will, as well.
document and as a result, they are not protected as they should be. Usually certain provisions for protection of the beneficiary, if properly inserted and used in the trust document, would assure that state and federal assistance programs could be utilized by the beneficiary.

- **Trust does not consider spendthrift issues.** When a living trust becomes at least partially irrevocable, the trust corpus cannot be attached (although the income can be attached) if a spendthrift provision is included in the trust. A very powerful asset protection shield against creditors and judgments can thus be raised.\(^\text{23}\)

- **Trust does not consider Non US Spouse.** There are special and specific devices that must be used in the case of a non US citizen spouse. Without such provisions, tax disaster will likely occur.\(^\text{24}\)

- **Trust does not give sufficient and/or appropriate investment and property management flexibility.** While it doesn’t happen often, it is not unheard of for a trust not to delegate to the trustees sufficient investment or other property management flexibility\(^\text{25}\), and the trust is slowly and figuratively strangled to death, unless the trustee is intelligent enough to get the trust reformed in a court proceeding.

- **Trust does not give “no contest” protection.** While there is no assurance that the “no contest” clause will prevent such an attack by unhappy interested persons, it certainly gives notice to all persons that such an attack might well prove to be unfortunate for the attacker. If there is discord in the family, such a provision must be included.

- **Trust does not properly establish jurisdiction.** If the grantor owns property in more than one state or country, such a jurisdictional statement is essential to assure Texas laws will be followed as opposed to the possibly more oppressive laws of another state.

- **Trust is not properly executed and/or accepted by trustees.** It is not unheard of for the trust document to be prepared and never be properly (or incompletely) signed\(^\text{26}\). Various legal issues then erupt, including validity, intent and the like. Perhaps the trust was never accepted by the trustees, which again basically will cause a court issue.

- **Trust does not consider children or family by prior marriages.** One of the most surprising things observed by myself is the unwillingness by some clients to place onto paper how their children are to be provided for after their death in a blended family. Usually the statement is made that they want to leave it all to their spouse who will “take care of” the situation. Unfortunately, many blended families are less than harmonious, and this passive approach

\(^{23}\) Note, however, that generally a living trust does not of itself (during the grantors lifetime) provide asset protection from creditors. This is a direct byproduct of the trust being revocable.

\(^{24}\) See IRC §2056(d). Generally the marital deduction is disallowed in the case of a Non US spouse unless a qualified domestic trust is used.

\(^{25}\) In general, a reference in the Trust to “all of the powers and rights established by the Texas Trust Code” gives tremendous latitude, although the grantor may wish to provide even more expanded powers and rights for the trustee. However, some institutions want to see specific powers enumerated within the document.

\(^{26}\) Or worse, the grantors did not sign the trust in front of a notary public, which makes the instrument impossible to be filed for record if this was later necessary.
may cut certain children out of their parent’s bounty inadvertently.

- Trust does not consider charitable contributions techniques properly or not at all. Properly drafted both as part of the trust or via separate instruments (which should be integrated with the overall trust plan), valuable income and estate tax deductions can be achieved as to charitable contributions. But, of course, these provisions must be properly drafted or the gift will fail at least as far as the IRS is concerned.

- Trust does not consider the use of a Trust protector. As discussed later, there may be concern that a trust may not be properly managed by the proposed successor trustees. A trust protector is usually another trusted person who effectively acts as an overseer but is not a trustee themselves. However, the trust protector has tremendous powers albeit limited to protection of the trust and its beneficiaries.

The reader may observe that some of these problems can also result in an improperly drafted Will, which is true. The particularly sharp reader will also observe that there are numerous devices available in a trust setting (but complained above as being lacking in the defective trust) that are not available in a Will alone. Such is the potential power of a properly drafted trust.

Despite these problems generally caused by other’s attempting to make a quick buck, a properly executed trust and ancillary documents can prove to be a very valuable estate planning technique.

**OK, TRUST MILLS ASIDE—WHAT ARE THE ADVANTAGES OF A PROPERLY DRAFTED TRUST—IF ANY?**

Let’s examine them more closely and in a balanced manner:

**PRIVACY—ONE REASON TO AVOID PROBATE**

Bluntly stating the reality, one function of the living trust is to effectively “pre-settle” the estate. In fact, that is what probate is all about- in addition to proving the Wills’ validity, it is the transferring title from you (actually your estate) to another person or entity. Clearing title, if you will. But yet many people say they didn’t have to go through probate when their spouse died—why? Reason: They didn’t sell any real estate or similar titled property (yet). Eventually, some method of clearing the title will be necessary.

Let’s think about one very practical thing- doesn’t it make sense to transfer property now, while the individual is alive and well and knows where and what it is, into a device that allows the individual to transfer the income, principal and other attributes to whom they desire and keep that information away from public records?

Many people value this privacy, and this certainly one of the nicer advantages of the Living Trust. Logically, it doesn’t make too much sense to wait for the individual to be gone and let someone else try to make sense out of their assets and liabilities after they are gone.
The traditional Will generally requires it be probated and the preparation of an inventory of estate assets subject to probate. Assets of the Living Trust are non probate assets and need not be filed of record after death. Privacy is achieved, even for non-sizable estates. However, there may be the need for filing a federal estate tax return.

**Disability and Maintenance of Control**

What if the client has a car wreck and cannot handle their affairs? Or worse, the client becomes hospitalized for Alzheimer’s? Guardianship is obviously one alternative- an expensive one at that, even in Texas. Changes to the Probate Code require a third party to represent the disabled party against a Guardian- obviously an expensive matter (some writers have referred to this aspect as “living probate.”)

Other existing methods used to assist handling this type of situation include the traditional Durable Power of Attorney for Property. While very useful, it is constantly observed that there is significant reluctance to rely on even a *properly executed* power of attorney. The classic example is that many title companies simply will not accept an otherwise valid power of attorney to sell a home in certain circumstances. It seems like every legislative session the Legislature attempts to make the power of attorney “easier” to be accepted, but invariably it winds up causing confusion for at least the near term.

Here is where the living trust can shine as a very useful tool *before* one passes to the great beyond- the trust provides for such a circumstance and simply transfers control to a more appropriate trustee that the client, the grantor, has already predetermined. No court action is required. The next trustee simply steps into the client’s shoes, so to speak.

This continued management and protection of the assets (and management of the “person” via a separate legal document is preferred to allow changes more easily) is why many widows and widowers tend to use the Living trust more frequently than younger clients and/or married couples. It offers the continued management of one’s estate (their life’s property) by the person of one’s choice; on the terms of one’s choice, and without court intervention.

Contrast this against the judge’s discretion in a guardianship situation, which means he will appoint the person the judge deems best able; and that person may or may not be whom the client would have chosen had they taken the time. This doesn’t mean the judge would arbitrarily assign just anyone, rather the point is that the judge may not assign the task to whom the client would have preferred or had more faith in versus another individual.

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27 Assets may pass outside of probate, such as insurance proceeds payable to a beneficiary other than the decedent’s estate. Certain Joint Tenancy accounts also do not require probate action.

28 An estate tax return is required in estates with combined assets in excess of $1,000,000 (for calendar 2002). An estate tax return is also protected under the various privacy acts of the United States.

29 Each term sees changes to the basic “statutory” form (which is not mandated), and vacillates between a filing requirement (usually required for most title companies) at the county courthouse and not requiring such a filing.

30 There may be the need to file an affidavit of trusteeship or some similar document with certain parties relying on the trust and trustee; however, such filings are relatively rare and are simple to have prepared and executed.

31 A Guardianship Declaration of the *person* may be separately executed apart from any other power of attorney of the *property*. 
Other examples of the Trust’s power is the providing for a special child or family member via the trust (including full utilization of federal and/or state benefits such as Medicare); or to provide for a financially irresponsible family member. The trust, if properly structured, can include spendthrift provisions to protect the beneficiary from “themselves” or perhaps more importantly, the beneficiary’s creditors.\textsuperscript{32}

\textbf{TAXES- ESTATE PLANNING OPPORTUNITIES}

There surely is nothing more certain than taxes other than death. It is only appropriate the Living Trust, while helping mitigate the effects of the death of a family member, also legally fights the effects of the taxman. For those fortunate enough to have sizable assets, the trust can be written to give the trust the maximum “credit shelter” protection\textsuperscript{33} and maximum marital deduction\textsuperscript{34}, for married individuals, upon the first to die. As might be expected, as long as the ascertainable standard as to invasion of the “protected” or sheltered amount is in effect, such property will not be included in the survivor’s estate at the time of their demise.\textsuperscript{35} As the trust is created or continues for the surviving spouse, a spendthrift provision can and should be included to protect the beneficiary.\textsuperscript{36}

In general, the trust, properly drafted, can shelter at least $2,000,000 (in 2002) for a married couple ($1,000,000 for a single person in 2002) from estate taxes \textit{(not} income taxes)\textsuperscript{37}. Obviously, other more sophisticated methods can assist reduction of taxes for estates that exceed these thresholds.\textsuperscript{38} However, a tax Will can and will accomplish the same “basic” estate tax benefit\textsuperscript{39}.

\textbf{MORE EFFECTIVE AVOIDANCE OF CONTESTING THE INTENT OF THE GRANTORS}

Think about it- if the living trust is in existence, functioning, and performing the expected and desired results during the grantor’s lifetime, it would seem difficult to contest it by someone after the client’s death, wouldn’t it? If there is a possibility of a Will contest, the Living Trust is an attractive alternative. In Texas, at least, an existing trust- particularly one in existence for some time- is very difficult to contest\textsuperscript{40}. Sometimes a good offense is the best defense.\textsuperscript{41}

\begin{itemize}
\item \textsuperscript{32} TEX. PROP. CODE. ANN. § 112.035
\item \textsuperscript{33} I.R.C. § 2056(a).
\item \textsuperscript{34} I.R.C. § 2010(a).
\item \textsuperscript{35} Treas. Reg. § 20.2041-1(c)(2).
\item \textsuperscript{36} TEX. PROP. CODE. ANN. § 112.035
\item \textsuperscript{37} Note that the amounts excludable from estate taxation will incrementally increase over a ten year period until they are abolished for one year in 2011, but then are reestablished in 2012.
\item \textsuperscript{38} For example, family limited partnerships, charitable trusts, life insurance trusts, etc.
\item \textsuperscript{39} In general, both the Trust and a tax Will provide for specialized language that enables the grantor or principal to utilize the various legal estate tax planning devices otherwise available that must be affirmatively set into the instruments. These estate planning devices are not “automatic”, thus the affirmative insertion of these devices must be made into the various instruments.
\item \textsuperscript{40} Time and time again, the courts give credence to an existing and functioning trust as evidence the grantor had intended a specific result and had purposefully established a trust to achieve such a result. A Will generally does not receive such “respect”.
\item \textsuperscript{41} As quoted from numerous athletic coaches.
\end{itemize}
NON TEXAS SITUS COST SAVINGS

If the individual has real property (and even certain personal property, such as boats and other titleable items) in other states, the individual should seriously consider the Living Trust. Consider if you owned property in state “A” and Texas, a probate procedure would be required (1) in Texas to transfer the title to Texas property and (2) another probate procedure in the other state “A”- in which situs probate usually may not be as easy as Texas. If the title is already transferred to the trustee, no probate is required. Cost and time savings can be substantial.

WHEN MIGHT PROBATE BE DESIRABLE?

Probate requires the filing and giving notice to creditors, and with such notice begins a statutory time line for their acknowledgment. Consider the case where the person has a high risk occupation where lawsuits tend to arise (medicine, construction, etc.). These time restraints can run, even on personal injury claims. Unfortunately, the creditors about whom the executor is aware must receive real notice, effectively mitigating such perceived advantage. But, it does clearly run the statute of limitations, and does cut off claims not brought in a timely fashion.

Probate is useful in the fact that a known procedure is established to transfer title to property, by the issuance to the executor of a document known as Letters Testamentary. This document serves as notice to the recipient, such as a bank or stock broker, that the person has authority to deal with the assets of the decedent.\(^{42}\) This single page document is obviously easier to look over than a twenty-page trust. However, this assumes that the financial institutions representatives had little if any contact with the decedent.

If the grantor has had a good relationship with their banker or broker, these persons have already been made to understand, both legally and practically, what the client’s intentions and desires are, and as a result the “transfer” of the trusteeship is usually very simple and practically invisible to others. It’s like everything else, if the job is done right initially, there is little effort necessary later.

EMOTIONAL TRAUMA

Some clients simply do not like the idea of a trust. However, the author has found these same concerns are often the same noted in preparing executing a Will- this based on the simple fact is people often do not want to face, much less talk about, their own mortality. And this is only natural.

As might be expected, an education of what the trust (or Will) will accomplish by the Grantor usually offsets these fears. In a family matter, it certainly is easier to deal with these fears while the individuals are both alive rather than having to deal with the post death trauma of these

\(^{42}\) It might be useful to think of the Letters in a similar fashion as a power of attorney for the deceased in that it is a document that provides the holder the power to act on the property. However, realize that a power of attorney does not survive the decedent’s death and thus the necessity for Letters.
matters, when they could have been “taken care of” ahead of time. Many clients are simply amazed that there is little if anything to be done, other than perhaps the filing of an estate tax return and the obtaining of a tax identification number.

COST

Pay me now, or pay me later- so goes a commonly heard and realistic advertisement. Unfortunately, this is what many persons perceive the living trust drafting and asset funding (the asset transfer procedure) to be- expensive and not needed “yet”.

Invariably, the total cost of the properly executed and transferred trust is actually cheaper to the family, to say nothing of being more humane to the client’s loved ones as opposed to going through the emotional pain of assembling things for Probate. Of course, this cost savings statement can be disputed, but usually the higher costs would result from the “cookie cutter” type of trusts discussed earlier.

TRUST AND ABUSE- PROTECTION FROM ABUSE

One very powerful feature of a trust is the ability of the grantor to name their successor trustees and also allow those trustees to name their successors. In the usual situation, the trustee by original appointment (i.e., normally the grantors) can name their successors both in the original trust (as kind of a fall back) but still retain the flexibility to modify those successor trustees. They can also give the successor trustees they have named the ability to name their own successors, something a Will simply cannot provide. This feature is particularly attractive if the grantors wish to rely on the judgment of their immediate successor.

There is danger of abuse by a successor trustee. The dark side of the privacy virtue can be the inaction, abuse or malfeasance by a successor trustee. There is the danger that minor children may be taken advantage of since they are relying upon this “trusted” trustee. Malfeasance occurs daily with the most trusted of individuals.

The trust is no different in providing an opportunity for a devious trustee, nor is there any difference in a crooked executor of a Will. However, with the Will at least some accounting may be forced as part of the process, where under a poorly drafted trust, it might not be “automatically” forced. Most well drafted trusts provide ample protection to the beneficiary and the trust corpus by allowing review of the books, records and assets and allow for court intervention if necessary.

Of course, by having co-trustees or a trusted friend or family member as the trustee, this problem should be mitigated. But this discussion does illustrate the importance of who is named as successor trustee or executor.

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43 The appreciation of these affected persons is real and often these persons are “unbelieving” that their parents or spouses had taken care of them “so well.” Contrast this with other survivors having to go and dredge out the past and relive events when looking for various assets requiring title changes and getting things in order “after the fact.” There is no comparison in the “humanity” involved.

44 TEX. PROP. CODE § 113.083
If there is any lingering or real concern about the trustees fulfilling their scope and "mission" by the grantors, a useful alternative or adjunct power the grantor may wish to seriously consider is for the grantor to establish a trust protector. A trust protector is usually another trusted person who effectively acts as an overseer with the power to review all proposed transactions and even remove a trustee (including even a spouse!) but who does not serve as a trustee themselves. The reason they do not serve as a trustee is to provide an independent and neutral "authority" base.

Part of the functions of the trust protector would include the ability of the trust protector to have veto power on business decisions that a trustee may be planning. The trust protector may independently bring a lawsuit on behalf of the trust. If necessary, as already indicated, the trust protector may remove the serving trustee(s). The trust protector(s) position and authority is specifically set out in the trust, along with naming the protector’s successors if the protector does not name a successor.

**Asset Transfers/ Funding of the Trust(s)**

As briefly noted previously, it is extremely important to know that if the significant assets are not all in the trust, some probate will be required, usually effected via the “Pour Over Will” which simply does one thing: it says anything that wasn’t in the trust at the time of your death goes into the trust after probate. And there may be good cause for this asset to exist.

My favorite example to explain the purpose of the pour over will is I would probably have a heart attack and die if I won the Lotto. Of course, the Lotto proceeds wouldn’t yet be titled to the trust. Thus, the need the Pour Over Will- to get these type of assets into the trust. Another common example would be the result of a claim by the estate for personal injuries resulting from the grantor’s death in a car accident negligently caused by someone else.

All titleable assets should be transferred into the trust—i.e., the home, real estate, mutual funds, stocks and bonds (or the investment account in which they reside), vehicles and bank accounts should generally be transferred into the trust. And, this will cost money in the form of deed preparation, filing fees, and- of course- time. But the necessity in accomplishing this is extremely important in accomplishing the desired end results.

Dependent upon the particular situation, the various life insurance policies of the grantor(s) should have their beneficiary designations redesignated to the trust. Usually simple letters to the insurance companies suffice, and the companies provide their desired forms to the clients.

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45 The trust protector concept hails from the mind of Larry Gibbs of San Antonio, Texas. While the trust protector device used in other states, Mr. Gibbs seems to have introduced the concept into the mainstream in Texas.

46 Recall the “magic” of the trust does not come into effect unless title has been transferred from an “individual” status to a “trustee” status.

47 Life insurance is generally taxable to the estate. See I.R.C. § 2042(1).
At one time there was concern about taxing authorities not recognizing the homestead exemptions of persons filing a deed associated with a living trust, but for the most part, this issue is now practically non-existent. And, a properly drafted deed usually already provides for these concerns.

A more practical problem is the transference of the deed of a home or real estate encumbered via a mortgage and the attendant concern of a due on sale clause. Several approaches are taken in this instance, usually obtaining permission in advance from the mortgage company and/or reserving in the deed an estate sufficient to prevent the due on sale clause from being triggered. This is specialized language not found in the traditional warranty deed.

Some assets may not be appropriate for transfer to the trust. For example, certain limited partnerships may have concerns that such transfers would adversely affect the partnership or violate federal or blue-sky securities acts. Buy-sell agreements of small businesses may not allow such transfers. However, such transfers are usually (but not always) acceptable, albeit more cumbersome to accomplish. In addition, the grantor usually has enough influence with the other entities to have them accommodate the grantor’s estate planning motives and mechanisms.

One asset that generally should not be transferred into the living trust is the grantors/spouses IRA and KEOGH plan- the Living Trust should only be listed as the contingent beneficiary. Why? As currently constructed although in the process of being attempted to be changed (and unfortunately, still unsuccessfully), the transfer would be considered comparable to an outright distribution, and therefore taxable.

Dependent upon the type of scheme used in the trust estate tax planning mechanisms, the trust may be managed as one fund, effectively only requiring the singular transfer of the assets into the family trust even after the death of one of the grantors.

**WHAT OTHER THINGS ARE REQUIRED?**

While the Living Trust is the cornerstone of most estate plans, there are other documents required to effectively handle the client’s estate planning process. The Pour Over Will—previously discussed, is designed to handle anything not transferred to the Trust, either by design or omission.

The so called “Living Will”- a declaration by the client of their desires as to medical treatment—more directly, whether or not the desire the “plug” to be pulled is usually very important to the

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48 See TEX. PROP. CODE § 41.002.
49 See TEX TAX CODE §11.13(j) which provides for “qualified trusts.”
50 The IRA would become immediately taxable at the grantor’s individual tax rate, as well as possibly exposed to the 10% penalty.
51 The fractional share marital deduction formula allows the “single fund” approach as to managing, in a singular fund, the marital deduction share, the credit share and the community share of the surviving spouse. The credit shelter shares in the appreciation and/or depreciation of the fund. While not favored by some, this approach is actually simpler in many respects than other approaches requiring “separate” funding of the various trusts/funds. This approach has survived many an estate tax return review by the IRS. This approach is favored if the surviving spouse will continue as a trustee of the trust after their spouse has passed away.
client. Autonomic gifts may be considered via a separate document.

Usually a durable power of attorney for health care is prepared, generally naming a spouse or child as the attorney for health care decisions, if the client is unable to react to the situation. This document, as part of an all encompassing single document, may include certain other powers, usually considered as part of the traditional power of attorney, to allow asset transfers of non trust assets, if any are later discovered and the grantor is incapacitated.

Deeds, transfer instruments, beneficiary designations, and a “blanket” transfer of assets via a distinct legal instrument (known as a self declaration of trust and transfer of property\(^{52}\)) are also recommended. This “blanket transfer” instrument, unfortunately, is usually exclusively relied upon by the trust mill vendors as the *only instrument* necessary to transfer all of the property, titled or not. While it is quite effective for personality that is not titled (such as furniture and the like) and has a certain appeal as being “all powerful,” the device should not be exclusively relied upon to transfer titled assets. The instrument should be used in conjunction with these other instruments and as clear evidence of the desire of the grantor. As indicated in the footnote, there is precedent for such an action but it should not be relied upon exclusively to accomplish the desired end result.

Obviously, other instruments may well be required or desirable, only the “basics” have been listed above.

**IRREVOCABLE TRUSTS**

So, you ask, why do we even need an irrevocable trust\(^{53}\)-something the grantor cannot modify once it comes into existence? It sounds like the Living trust is all one needs... but while the living trust can do a great many things, it cannot effect certain planning techniques due to the very nature of its existence. The entire theory of the revocable trust is the fact modification and reversion is possible. By default, this means you have control over the assets. For certain desired results, this control is unacceptable, both legally and tax wise.

The setting up of an irrevocable trust may be unacceptable to the grantor, because the *grantor loses total control*\(^{54}\) over the trust assets- only the trustee has control. Due to space limitations, it is impossible to fully detail all facets of the irrevocable trust device. However, a few examples of the instrument’s use may be useful. Notice that the grantor cannot or should not be their own trustee (generally speaking) in some of the following trusts.


\(^{53}\) The irrevocable trust is a separate entity for taxing purposes, with the immediate need for a tax identification number and the attendant filing of Form 1041 as applicable. In general, a most trusted trustee should be used for the irrevocable trust as certain actions and decisions will be difficult to reverse. However, the irrevocable trust provides numerous tax advantages and estate planning opportunities not otherwise available. The irrevocable trust can also be used successfully for persons with nominal incomes.

\(^{54}\) Unfortunately, the tax code consistently demands grantor control be removed or it will be considered part of the grantor’s estate.
It is not necessarily true that an irrevocable trust must be used by someone of great wealth. One of the most powerful examples of the use of an irrevocable trust for someone of modest means is the Medicaid Trust. Medicaid effectively requires the patient to have “no” assets before it steps in and assists financially, usually after totally depleting the patients (and spouses) assets to an unacceptable point. While oversimplifying the explanation, the irrevocable transfer of the patient’s assets (if done 30 months before going into a nursing home) to a trustee and making it clear no trust principal can be used by the trustee to assist the patient effectively entitles the patient to become Medicaid eligible. This type of device has been very successful in protecting the family estates from decimation. Of course, this has been a very simplified explanation.

A Miller Trust is also used in Medicaid Planning. Here, however, the problem is the client has too much income from (usually) an annuity to fall under the Medicaid limits, but not enough to be able to personally afford to be placed into a nursing home, i.e., the inevitable “Catch 22” problem. What the Miller trust accomplishes is the client’s income is irrevocably channeled into the Miller Trust, with the end result being the client has no income of significance “directly” and as such becomes Medicaid eligible. The funds received by the trust are paid to the nursing home and Medicaid picks up the remainder.

A life insurance trust may be used to provide funding for possible estate tax expenses, or to simply keep the significant insurance proceeds out of the estate for various reasons. Very strict rules as to how the insurance is titled, how it is owned, and how it is funded must be followed or the trust can be brought back into the estate unwittingly.

Another reason an irrevocable trust may be used is for simple tax planning reasons - the grantor wishes to divest himself or herself of the principal and allow the income to be taxed to someone else, usually at a lower tax rate. Consider trusts for minors - usually support and education trusts, which are still qualifying for the annual $11,000 gift tax exclusion (per parent/per child), is another example of the irrevocable trust - however, the beneficiary, the child, must have the right to receive the remaining assets at age 21. Generally this type of trust is used to distribute assets out of the grantor’s property at no gift tax cost.

Still another application of the irrevocable trust is the blending of it “into” the living trust plan-

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55 It was a criminal offense to assist elderly individuals needing assistance in Medicaid matters if a fee was charged. However, the previous Attorney General of the United States has conceded publicly that no action would be taken against anyone appropriately assisting an individual in the need of Medicaid planning. It never made sense that if a person could pay for tax planning and preparation services why Medicaid planning would be treated differently, and a constitutional issue was in the background. However, the issue is now apparently laid to rest since no prosecutions will be forthcoming, and the “chill” that existed in Medicaid planning has now been lifted.

56 Broadly speaking, the applicant’s home and a car are the most significant assets allowed to be “retained.” Detailed rules must be followed and procedures are carefully checked and followed by government agents.

57 Many people think the holding period is 30 months or nothing. This is incorrect, it is a prorata sheltering approach. For example, if a trust was established 14 months before needing to go into a nursing home, 14/30 of the estate would be sheltered. Thus, it is always better to do something rather than nothing.

58 Volumes could be written on the uses of a properly designed insurance trust. Generally life insurance is includable in the decedent’s estate but excluded from income taxation. The purpose of the life insurance trust is simply to separate the insured from all incidences of ownership that would cause the insurance to be included in the decedent’s estate.
for example, the grantor establishes a living trust, but also establishes a trust for their children (particularly useful for special children, but certainly applicable for all of the grantor’s children). Generally the living trust provides that the assets of the trust are to roll over into the children’s trust(s) instead of via a direct distribution to the children. These trusts may have very definite purposes, including provision for education, health issues, spendthrift concerns, etc.

These simple everyday examples illustrate that- as might be expected- the use of the irrevocable trust has its benefits and its burdens. While very useful, the irrevocable trust is not for everyone.

**SUMMARY**

The living trust is not a mandatory solution to every estate planning situation, and in fact is prohibitively (and excessively) expensive in certain situations. However, despite the negative press and abuse that has occurred as the result of unscrupulous vendors, the living trust continues to be a viable and often necessary part of effective estate planning if prepared and executed correctly and completely.

The irrevocable trust, assuming the grantor is willing to give up control of the underlying asset or income, is an extremely useful device in estate planning, from the most modest of estates to the largest of estates.