TRUSTS – FREQUENTLY ASKED QUESTIONS

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What is a living trust?

A trust is an arrangement in which one or more people manage or take care of property for someone's benefit. A living trust is a trust that is created during your lifetime. In other words, while you are still alive, you transfer title to your property from your name to that of the trustee of the living trust. You can use the trust to gather your property under one document, so that the property is distributed efficiently after your death.

When you put your property into a trust, the trustee of the trust owns the property - you are no longer the legal owner of the transferred assets. This doesn't mean you have no control of your property. Since you will be your trust's initial trustee, you will still be in charge of your property. You can do whatever you want with it - you can leave it alone, take it out of the trust, or use it as you had been before the trust was created. A living trust is an easy way to organize your assets and manage them as a single unit. Most importantly, a trust allows for an efficient property distribution when you die.

Can I transfer property into and out of the trust while I'm alive?

Yes. If you have an individual trust, you can transfer property in and out of it whenever you want - you don't need anyone else's permission. If you have a shared trust, you will need to get your co-trustee's consent if you're transferring property you own together.

Do I still need a will if I have a living trust?

Yes. A will deals with any property that was not included in the living trust. This property may have been left out for any number of reasons. For example, property that wasn't properly transferred into the trust will be distributed under your will. Property you bought or received after the trust was created will be distributed according to your will, unless you transfer the property to, or purchase it in the name of, the trust.

A will also lets you name a guardian for your minor children and covers property intentionally left out of the trust (e.g., cars, personal checking accounts). The Living Trust we prepare includes a simple pour-over will for this purpose.

Introduction to Living Trusts

A living trust lets you control who receives your assets after you die. However, this isn't the only reason to create a living trust. A living trust can offer many benefits to its creator. For example, a living trust can help your beneficiaries avoid the probate-related expenses and delay normally associated with wills. Probate is required if the value of your probate estate exceeds a relatively low amount, which varies by state. Probate can last longer than two years and may be delayed by factors beyond the control of your beneficiaries, like overcrowded court and attorney schedules. The probate process can cost up to 15% of your estate's value.

Living trusts can provide more privacy than wills. Although wills must be submitted to a probate court, and therefore made public, living trusts need not be. Living trusts may help you avoid certain estate taxes if they are prepared and funded properly. Finally, living trusts let you choose someone to manage your assets if you become incapacitated.

Definition of a Living Trust

A trust is an arrangement in which one or more people manage or take care of property for someone else's benefit. A living trust is a trust that is created during your lifetime. In other words, while you are still alive, you transfer title to your property from your name to that of the trustee of the living trust. You can use the trust to gather your property under one document, so that the property is distributed efficiently after your death.
When you put your property into a trust, the trustee of the trust owns the property – you are no longer the legal owner of the transferred assets. This doesn't mean you have no control of your property. Since you will probably be your trust's initial trustee, you will still be in charge of your property. You can do whatever you want with it - you can leave it alone, take it out of the trust, or use it as you had been before the trust was created. A living trust is an easy way to organize your assets and manage them as a single unit. Most importantly, a trust allows for an efficient property distribution when you die.

A living trust is created by a document called a declaration of trust or trust agreement. The declaration of trust (or trust agreement) includes the names of your trustees, beneficiaries, describes the trust property, and provides the terms of the property transfers.

Comparing Living Trusts and Last Wills

Although living trusts and last wills are both used to distribute property to beneficiaries, there are some important differences between them. One of the key benefits of a living trust is that it limits the probate court's involvement in property distribution. Unlike a last will, which can be tied up in probate for years, a living trust can quickly and smoothly transfer assets to beneficiaries. Because a living trust is not registered with a court, the estate's details remain private.

Pour-Over Wills

If you decide to create a living trust, you may also want to create a pour-over will. A pour-over will provides for the distribution of non-trust property that is not otherwise distributed, and lets you name a guardian for your minor children. Our Living Trust includes a pour-over will.

Probate - Reasons to Avoid It

Probate is a court-supervised process used to validate your will and distribute your property. **The process takes anywhere from six months to over two years to complete**, and may require that lawyers or other professionals be hired. Even if you die without a will, if your estate's value exceeds a threshold amount, your estate must still pass through the probate system. In such cases, the court decides how to distribute your estate among your relatives.

Probate procedures often include the following steps, in the following order:

- Your will is filed with the local probate court (and becomes public record)
- Your executor inventories your property
- Your property is appraised
- All debts, including death taxes, are paid
- The court validates your will
- Court costs, attorneys' fees, and executors' fees are paid from your estate
- Then, and only then, the remainder of your estate is distributed to your loved ones

A living trust can help you avoid probate. If your assets are placed in a trust, you do not "own" them: the trustee of the trust does. You control the assets as if they were yours. When you die, only your property goes through probate. Since you do not "own" the trust property, it will not have to go through probate.

As discussed earlier, a trust in itself may not be enough: you may need a simple will to cover property not included in the trust. If all of your significant property is transferred into the living trust, it should be a relatively simple process to probate your pour-over will, if necessary.

Transferring Property into a Living Trust

You must transfer property into a living trust to take advantage of the trust's benefits. The person who transfers property into a trust is called the "grantor." Generally, you should put your most valuable property in the trust:

- house & other real estate
- business interests
- stocks, bonds, and mutual funds
- money market accounts
- brokerage accounts
- royalty contracts, patents, and copyrights
- jewelry and antiques
- precious metals
- works of art
- other valuable collections

Real estate: If you own real estate jointly with someone else (e.g., by joint tenancy or tenancy by the entirety), you do not need to transfer it into the trust: it will go directly to your co-owner if you die. It may still be a good idea to put this property in your trust if you do not want your co-owner to receive your share. Also, if you and your co-owner pass away at the same time (e.g., in a car accident), or the surviving owner later forgets to put the property into a trust, you won't be able to designate who will receive the real estate.

If you hold property as a tenant-in-common with someone else (most often a business partner), consider putting your share of the real estate into the trust. This will allow the real estate to be distributed to your trust beneficiaries without going through probate.

Read your property deed to confirm your ownership structure.

Selling Property in Your Trust

You can still sell property after you transfer it into a living trust. The first and most common approach is to sell the property directly from the trust. In this case, the trustee of the trust (most likely, you, as trustee) is the seller. A second approach, used mostly when an institution requests it, is to transfer the property out of the trust and back to you. Once you own the property again, you can sell it as you would anything else.

What Property does not go into a Living Trust?

- **Property of little value**: This property may not need to go through probate or may be subject to a streamlined process.
- **Personal checking accounts**: These accounts are usually not put into living trusts, since money goes in and out of them so frequently.
- **Property you buy or sell frequently**: This is important if you do not expect to own the property when you die.
- **Cars**: Most cars are not very valuable, and insurance companies may be reluctant to insure a car owned by a trust. If you do own a valuable car, talk to your insurance company about obtaining insurance on a trust-owned car.
- **IRAs, 401(k)s, etc.**: Technically, these accounts can't be owned by a trust. However, money from these accounts can still avoid probate if you designate a beneficiary in the account documents to receive the funds when you die.
- **Life insurance**: Life insurance proceeds are distributed according to your policy. The beneficiary named in that policy will receive the money.

Income or principal from another trust: If you are receiving payments or distributions from another person's trust, you can't put the property itself into your living trust. However, you can transfer your right to receive these items to your beneficiaries in your trust.

Real Estate Placed in a Living Trust

If you are the sole owner of a piece of property, you can include that property in your living trust. You will need to change the property's title to reflect the ownership change. If real property is transferred into a trust, there are several additional issues to consider, including the following:

- **Property tax reassessment**: If you designate yourself as the trustee, many states, including California, will NOT require a tax reassessment when you transfer property into your trust.

- **Transfer taxes**: Transfer taxes are normally assessed on real estate transfers. When the transfer is to a living trust, these taxes are usually not imposed. However, some states do tax living trust transfers. You should check with your County Assessor or Recorder's Office to confirm that you will not need to make these payments.

- **Mortgage interest deductions**: As the grantor, you can still deduct mortgage interest from your income taxes.

- **Insurance policies**: If you are the trustee, you do not need to change the registration of insurance policies if those policies cover property in the revocable trust.

- **Tax breaks for the sale of a home**: You can exclude up to $250,000 of profit from your taxable income when you sell your principal home, even if the trust owns the home . If there are co-owners, such as spouses, this exclusion is doubled to $500,000.

- **Homestead rights**: Homestead rights, which protect a homeowner's equity interest in his or her home, generally apply to trust property.

- **Due-on-sale clauses**: A lender cannot enforce a due-on-sale clause if you are transferring your principal residence to your trust. If you are concerned about this, you may want to get your lender's consent before making the transfer.

- **Partial interests**: You can transfer a partial interest in real property to the trust (like a time share or an ownership percentage).

Beneficiaries of a Living Trust

There are three types of living trust beneficiaries:

- ***Specific beneficiaries***, who receive specific property
- ***Primary beneficiaries***, who receive any property not distributed to specific beneficiaries
- ***Alternate beneficiaries***, who receive property if the primary beneficiary dies before the creator of the living trust

In general, you can choose any person or entity you want to be your beneficiary. In a community property state, you are not required to leave anything to your spouse.

Distributing Property to Your Spouse in Living Trusts

In community property states, your spouse may be able to invalidate part of your trust if you leave him or her with less than a certain amount of your property (usually between one-third and one-half). If a court finds that your spouse has a valid claim, your trust won't be completely invalidated. Instead, the court will modify your trust to accommodate this claim. It is relatively easy to avoid these problems if you designate your beneficiaries carefully.

Distributing Property to Children in Living Trusts

You can leave property to children through a living trust. You can keep your property in trust and designate an adult to manage that property on your child's behalf. This is called a children's subtrust. The subtrust will end when your specified conditions are met (e.g., when your child turns 21). If you want to exclude a child from your trust, you need to say so explicitly. If it seems like you left out one of your children by mistake, a court may modify your trust for that child's benefit.

Designating a Guardian

You can't nominate a guardian for your minor children in a living trust. You should make this designation in a will. This can be a pour-over will, as discussed in Section 3.

Both Married and Unmarried Couples Can Create Living Trusts

Both married and unmarried couples can create living trusts. Married couples should consider whether they live in a community property or a separate property state before deciding what type of trust to create.

For many married couples, a basic joint living trust will meet their needs. Each person can act as both a grantor and a trustee of the trust. In addition, each person can choose a beneficiary for his or her share of commonly-owned trust property, and for his or her individually owned trust property. Both spouses will have control over all of the trust property, and either person may revoke the trust at any time. If the trust is revoked, property will be owned in the same way it was before the trust was created.

When one grantor dies, the property contributed by that grantor will be distributed to his or her beneficiaries, either directly or in trust. For example, if a husband dies first and gives his property to his wife under a joint trust, the property is hers to do with as she chooses. When the wife dies, if any of her husband's property still exists, it will be included in her estate for estate tax purposes. Any property contributed by the surviving spouse remains in the trust. The trust continues until the surviving spouse dies or the trust is revoked.

Benefits of Individual Living Trusts

There are good reasons to create individual trusts. You may find individual trusts useful if you and your spouse own most of your property separately, or if you do not want your spouse to control the property you contribute. If you are recently married and want to keep your previously acquired property separate, you can use individual trusts to do this.

Keep in mind that jointly-owned assets don't fit neatly into individual trusts. With co-owned real estate, for example, you and your spouse would need to sign and record two new deeds to transfer half-ownership interests into separate trusts. Forming a separate joint living trust for joint assets may solve this problem.

What is an AB living trust and how does it work?

With an AB living trust (sometimes called an "exemption" or "bypass" trust), the property contributed to the trust by the first grantor to die will be distributed to his or her beneficiaries when the surviving grantor dies. The surviving grantor cannot change the beneficiaries of the deceased grantor's trust property.

Imagine that a husband and wife create a typical joint trust and the husband passes away. Under the Our Joint Living Trust (and many other joint trusts), some or all of the husband's share can be held in trust for the wife during her lifetime. During her lifetime, she can change who will receive that trust property after her death. This may be exactly what the husband wanted. On the other hand, the husband's wishes may have been, "I want my wife to be able to use my share as long as she lives. But after she dies, I want to make sure that whatever is left goes to my beneficiaries instead of to people she chooses after I'm gone." If you want to make sure that each person's property goes to his or her separate beneficiaries, an AB trust may be a better choice than a joint trust or a simple will, regardless of the size of your estate.

Some married couples prefer an AB living trust over a traditional joint trust because of its flexibility and the tax benefits it offers. For many years, the AB living trust has allowed couples to avoid certain estate taxes. However, with the recent revisions to the federal estate tax law, only a very small percentage of people will owe estate tax on death. Under current law, $5 million of a person's estate is exempt from federal estate tax, and married couples can exempt $10 million from federal estate tax without establishing an AB trust.

Nonetheless, the AB living trust is still a powerful estate-planning tool. Many states impose estate taxes on estates valued at significantly less than the federal estate tax exemption amount. Moreover, the flexibility provided by a revocable AB living trust ensures that the trust can be amended to reflect life changes while both grantors are alive. Also, under an AB trust, your surviving spouse has access to your property after you die, but the property remaining after your spouse's death will be distributed to the beneficiaries you select.

Administrative Requirements of an AB Living Trust

After the death of the first spouse or grantor, the trustee of an AB Trust must comply with certain administrative requirements, including keeping separate books and records for Trust A and Trust B to prove that trust assets are being used properly. The trustee of Trust B (usually the surviving grantor) must file annual income tax returns for Trust B, although the trust will not owe income tax because its net income is distributed to the surviving grantor.

Estate Taxes and Living Trusts

Estate planning is the organization of your financial and personal interests, so your property can be distributed to your family as easily and inexpensively as possible. Estate planning can also limit the amount of taxes your estate will have to pay. The following is some general information about estate taxes:

- The federal estate tax, if any, is imposed on the transfer of a person's property when that person dies.
- The taxable estate is the total value of all property transferred at death (the "gross estate"), with deductions for specific types of expenses, debts and transfers.
- The gross estate can contain all kinds of property interests, including life insurance, jointly owned property, and (in some cases) property the deceased person gave away before he or she died.
- If a decedent's gross estate exceeds a certain value, currently $5,000,000, a federal estate tax return must be filed within nine months of a person's death, although an automatic six-month extension is available.

If you have additional questions about the tax implications of a living trust or about estate taxes generally, we recommend that you consult with a licensed tax professional.