

THE LIVING TRUST EXPLAINED IN ENGLISH

A 2005 Article by
WILLIAM A. TAYLOR
(One of The Business Lawyers)

This article will attempt a clear and short discussion of California living trusts.

How Living Trusts Operate A trust is created by the drafting of a legal document and immediately thereafter, transferring the title of assets into the name of that trust, which is fully described in that legal document. The person or persons who create the trust and transfer assets to it, no longer legally own those assets. When those people die, their trusts will hold their assets and the state will consider those people to be not worth the attempt to probate their estates - because the value of their estates, including the fair market value of the real property, will be less than \$100,000. The creator of the trust is the trustee of that trust. At his or her death, a previously selected alternate trustee is charged with following the trust instructions to the letter.

What is Probate Probate is the name given to court proceedings designed to do two things. First, probate is the forum where heirs (the recipients of the decedent's estate) get what they are due or can argue about it. Secondly, probate is a proceeding to protect creditors upon someone's death. Creditors are given a forum (county court) and time period (four months) in which to assert their claims against the decedent's estate. Failure to prove their claims in court or failure to assert within that time period will leave their claims uncollectible against the decedent's estate.

Avoidance of Probate and Conservatorship The avoidance of probate is the primary reason for establishing a living trust. The nine month time period and the payment from the decedent's estate of attorney's fees (absolute requirement) and executor's fees (which can be waived by the executor) stick in the craws of a lot of people who will be dead at the time of the payments. Another reason for creating a trust, however, is to avoid conservatorship of a person who is unable to manage his or her financial affairs. Trusts generally name a person to assume management of the finances of the creator of the trust upon his or her loss of ability to manage financial affairs. The creation of a living trust saves the cost of conservatorship filings and hearings.

Privacy Concerns The trust creation also avoids the public exposure of the "business" of the decedent or the subject of the conservatorship.

The Will Even though a trust is created, a will is still necessary. The trust will "own" the assets placed in its name. However, the million dollar Lotto that is won two years after the creation of the trust may not be listed as an asset of the trust in the excitement of the moment. The "pour-over" will pours all assets acquired after creation of the trust into the trust so that these new assets will be distributed in accordance with the plan laid out in the trust. Some people die

without wills. Such people have died intestate and the law will determine who gets their assets, generally favoring persons closest in relationship to the decedent. If a valid will exists, the court will generally follow its dictates (which is sometimes impossible when a beneficiary dies before the decedent). To be valid, wills must be created and signed with certain formalities.

Taxes California has no estate tax; the federal government does have an estate tax on estates in excess of \$1.5 million. The living trust is not a shield from estate taxes in any way. The same exists with income taxes. During the life of a trust, its assets (e.g., apartment buildings) might earn income. While the creator is alive, that income is taxed to him or her in spite of the existence of the trust; the trust is disregarded for income tax purposes because the creator of the trust has the right to terminate the trust at any time. At termination, the trust assets will immediately revert back to the ownership of the trust creator.

Creditors The trust is also disregarded for purposes of creditor collection rights. The creator of the trust has the right to terminate the trust at any time; at termination, the trust assets will immediately revert back to the ownership of the trust creator. Therefore, in the law, a living trust is not a shield against creditors in any way.

Probate Savings In considering the choice of a trust or not, the money costs and time costs of probate (and of conservatorship) will always prove to be a factor in the decision. The money costs of probate are set by law, not by an attorney. A \$410,000 probate estate (consisting of a house and \$10,000 car) will generate \$11,200 in fees to the probating attorney (absolute requirement to be paid) and a similar \$11,200 in fees to the executor of the probate estate (which can be waived by the executor). A \$210,000 estate will generate \$7,200 in fees to the probating attorney and \$7,200 in fees to the executor of the probate estate (waivable).

Additionally, since creditors are given four (4) months to make a claim in a probate estate, the procedure will cost over six months of time, probably nine months – if there are no will contests or special creditor hearings. Only after that nine months can the assets be distributed to the heirs – but not if a probate homestead is declared by or for the surviving spouse or children under the age of 18. If they convince a judge, they can maintain possession of, and have the right to delay the sale of, the family house (including the furniture) for the lifetime of that surviving spouse. The delay in distribution of the estate is a time cost usually not acceptable by the heirs – although the decedent may not care by then.

There is an argument or two to be made for probating an estate and paying an executor. There are certain cases where multiple creditors exist, whose claims need to be proven as to legitimate amount, where the estate (or the decedent's separate property portion of the estate) is less than the total of the claims. A probate proceeding to apportion the payments to the creditors will avoid the problem to be faced by the trustee of a trust – because the judicial determination will be final. A trustee of a living trust, will have to individually deal with each creditor and possibly fight off each creditor in individual lawsuits against the trust. A probate will finess that problem.

Life Insurance and Joint Tenancy Life insurance will pass to the beneficiaries outside of probate unless the beneficiary named is the estate of the person who bought the insurance. “Joint Tenancy” is a status of holding title where, at the instant of one person's death, the other

person(s) immediately own the portion owned by the just-deceased person. With not even one second of time elapsing between death and the ownership by the others, the portion owned by the just-deceased person is not considered owned at death and, therefore, is not part of his or her estate at his or her death; there is nothing to probate. The status of “Community Property with right of Survivorship” is, for married folk, the same as joint tenancy. Neither status exists unless those specific words are written immediately after the names of the property owners.

Trusts in Court Nothing should be taken from the statements above to imply that trusts can be immune from the scrutiny of the courts. Testamentary trusts (formed by the wording in a will) are automatically subject to the courts for their duration. Living trusts (existing during and after the lives of the creator(s)) can be brought into court if the beneficiaries believe the trustee has shortchanged them or if they demand a bond to be posted by or for the trustee – to ensure peace of mind.

ABOUT THE AUTHOR: William A. Taylor, attorney at law, is the managing partner of Taylor & Goins LLP, which does business as “*THE BUSINESS LAWYERS.*” He can be reached at (510) 893-9465 or www.thebusinesslawyers.com