

## REVOCABLE LIVING TRUSTS

Revocable living trusts, sometimes also called “intervivos trusts,” can be an effective estate planning tool. A trust is a written agreement (or contract) between the trustmaker and the trustee under which the trustee holds and manages the assets for the benefit of the beneficiaries chosen by the trustmaker. In a living trust, the trustmaker is often also the trustee and the beneficiary during their life.

A living trust is a set of directions that provides direction to the trustee about how the assets are to be distributed and managed during the trustmaker’s life and upon the trustmaker’s mental incapacity. In addition, living trusts include directions for how the remaining assets are to be distributed upon the trustmaker’s death.

### Who is involved in a living trust?

- **Trustmaker(s):** the person or persons who create the trust agreement while living
- **Trustee(s):** the person or persons who are responsible for carrying out the instructions set out in the trust agreement
- **Successor Trustee:** the person or persons named to step in when the original trustee(s) are unable or unwilling to serve
- **Beneficiary:** the person or persons who are to benefit under the terms of the trust agreement

### What is trust funding?

Trust funding refers to the retitling of property or adding other assets, e.g. bank accounts in the name of the trust. The trustmaker conveys all or some of the assets to the trustee so that the trustee becomes the owner of the assets subject to the terms of the trust agreement.

Once the assets are in the name of the trust, the trustee may manage and distribute the assets as instructed in the trust agreement.

A trust may be created, but may never be funded or not funded completely. It is common for the trustmaker to execute a “pour-over will” in conjunction with their living trust. This will direct all of the trustmaker’s assets that are not properly titled in the name of the trustee to be distributed to the trust.

### When is a living trust appropriate?

Living trusts are not just for wealthy people. A living trust is an effective estate management tool before and after a trustmaker’s death, and allows for a safe way to manage and use trust assets for the benefit of the trustmaker and chosen beneficiaries. Living trusts provide additional benefits, particularly when the trustmaker owns real estate in different states or becomes incapacitated.

### How can a living trust provide protections for incapacity?

A properly drafted living trust often includes terms that protect the trustmaker and their assets if the trustmaker becomes incapacitated. The trustmaker can name a successor trustee to manage the trust assets upon their incapacity. The living trust instructions can provide the successor trustee with guidance on how assets should be managed, bills are to be paid, and how the trustmaker’s support and maintenance needs are to be met. This can prevent the trustmaker’s loved ones from having to go to court and be appointed as a guardian and/or conservator for the trustmaker.

### Can a living trust be changed?

A living trust may be revoked or amended at any time while the trustmaker is alive and able. After a trustmaker dies however, the trust becomes irrevocable, which means it cannot be changed.

### How is a living trust administered upon death?

A living trust commonly includes instructions on how to administer the trust assets upon the trustmaker’s death. Instructions can include terms that allow for beneficiaries to receive the benefit of trust assets in a manner that protects them from their creditors and maximizes the benefit of the trust assets for the beneficiary.

A will includes instructions for the distribution of a decedent’s estate. However, a will must be probated. Probate is the legal process during which a judge validates the will, gives the personal representative the authority to act on behalf of the decedent’s estate, and supervises (either informally or formally) the process of distributing the decedent’s assets and paying their valid debts. Probate cases are generally included in the public record. Unlike wills, a trust administration does not require court involvement and allows for a private distribution of the trustmaker’s property.

Having a living trust in place at the trustmaker’s death does not mean that the trustmaker’s survivors will be able to avoid a probate action. If the living trust is not properly funded, the assets outside of the trust will need to be transferred into the trust through the use of the pour-over will and a

probate action. After the pour-over will is probated and the assets are transferred into the trust, the trustee will then distribute the assets per the instructions provided in the trust agreement.

### How are living trusts taxed?

- **Income tax during the trustmaker’s life.** With the exception of certain retirement assets, the transfer of assets to a living trust does not cause the recognition of a gain for income tax purposes. The trustmaker is treated as the owner of the living trust assets because they have the right to amend or revoke the living trust and reclaim the trust assets in their individual name. Additionally, the living trust uses the trustmaker’s social security number for tax identification purposes so no special income tax filing is necessary for the trustmaker or the living trust.
- **Gift tax.** The transfer of assets to a living trust does not constitute a gift for gift tax purposes.
- **Estate tax (“death tax”).** In 2011, if a person dies and his or her assets on the date of their death are worth less than \$5 million, then no federal or Colorado estate taxes will be imposed. The assets in the living trust will be treated as part of the trustmaker’s estate for estate tax purposes, just as if the assets were in the name of the trustmaker. Both a will and a living trust, when properly drafted and funded, can save substantial estate taxes.

## Do living trusts provide creditor protection?

While a trustmaker is alive, the trustmaker's creditors may have access to trust assets. After the trustmaker dies (at which point the living trust becomes an irrevocable trust), the trustee may pay the valid debts of the trustmaker. Unlike in a probate action where creditors face a time deadline, there is no such deadline for creditors in a trust administration. In addition, a probate action allows a surviving spouse and dependents to protect some of the decedent's assets from creditors by electing to take a family allowance, which must be paid to the family before any creditors are paid. In a trust administration, however, it is not certain that family members will be given such priority over creditors.

## Is a living trust subject to attack?

- **Disgruntled heirs.** Both wills and living trusts are vulnerable to challenges by disgruntled heirs. A properly drafted will or trust may contain language that can be used to discourage such challenges and provide instructions for the trustee or personal representative on how to deal with them.
- **Disinheriting a spouse.** Colorado law provides many protections for surviving spouses, including provisions that prevent anyone from disinheriting his or her spouse. The rights of a surviving spouse may not be avoided through the use of a will or a living trust.

## How does a living trust affect a beneficiary's eligibility for government benefits?

Most governmental benefit programs, especially Medicaid, have complicated rules related to wills and living trusts. For example, if assets are held in a living trust created by a deceased spouse for the benefit of the surviving spouse who is a Medicaid recipient, the trust assets and income are counted as available. It is particularly important to consult an attorney when a beneficiary of a will or a trust is receiving or may receive any governmental benefits in the future.

## Estate Planning—Living Trust vs. Wills

For more information, you should make an appointment with an estate planning attorney to help you determine which estate planning arrangement best suits you and your family. Many attorneys will offer a free initial consultation. Remember that in estate planning, one size does not fit all; while your will or living trust may look similar to your neighbor's, each is different for special and personal reasons.

Living trusts and wills are complex legal documents that require the use of competent and experienced estate planning attorneys. For this reason, you should not try to create your own living trust or will or purchase a pre-printed living trust or will documents. Beware of purchasing a living trust or will from a national marketing organization that will not consider your individual needs and where the attorney who prepares the document is not available to meet with you in person. If you think you have been a victim of fraud in the sale of a living trust, please call the Colorado

Attorney General's Consumer Protection Division at (303) 866-5189 or (800) 332-2071, and ask for the pamphlet titled "Living Trust Scams."

For additional information regarding estate planning please review the following brochures:

- **Estate Planning**
- **Wills in Colorado**



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