

Revocable Living Trusts

1. Basics of Revocable Living Trusts

Revocable Living Trusts are primarily used to 1) avoid probate and the related costs, delays, and loss of privacy, 2) provide for the management of assets while temporarily or permanently incapacitated, and 3) provide for the management and/or distribution of assets upon death.

A revocable Living Trust is created with a legal agreement or declaration where a trustee is responsible for managing your assets while you are living and then manage and/or distribute those assets on your death. There are three parties involved in a trust:

Settlors (sometimes referred to as Grantors:) the persons providing the assets to be managed under the trust

Trustees: the persons managing the assets while the Settlers are living and after they pass;

Beneficiaries: the persons benefiting from those assets after the Settlers pass.

Funding the Trust. Once the trust is created, the assets to be managed under the trust must be transferred from the Settlers as individuals to the Settlers as trustees of the trust. For example, real property is transferred using a Special Warranty Deed that is filed with the county clerk. Investment accounts are also renamed to reflect they are owned by the trustees of the trust. Non-titled, personal property can be transferred using a General Assignment and Bill of Sale. Assets that are managed under the trust avoid having to be probated by a court under the terms of the Will.

Management of Assets During Settlers' Lifetime. In most cases, the Settlers will also be the initial Trustees. During that time, the Settlers have complete control of the trust assets, including selling, refinancing, transferring out of the trust, etc. If the Settlers become temporarily or permanently unable to manage the assets of the trust, the alternate trustee named in the trust document will take over management of the assets without the need for court intervention.

Amending and Revoking the Trust. During the lifetime of the Settlers, the trust can be revoked entirely or amended.

Upon Settlers' Deaths. The alternate trustee named in the trust will be responsible for paying any taxes and debts upon the deaths of the Settlers and to manage the property under the terms of the trust document. For example, they may be responsible for managing the assets for the benefit of the Settlers' children until they reach a certain age. Or, the trustee may be responsible for immediately distributing trust assets to those the Settlers have designated in the trust.

2. Advantages of Revocable Living Trusts

Avoids Lengthy and Expensive Probate. Revocable Living Trusts are the most common method used to avoid probate. Probate is a court proceeding whereby a person's assets are inventoried and distributed under the terms of the person's Will. These proceedings are often lengthy (sometimes taking years) and expensive (attorney and court fees). In contrast, while the administration of a trust may still require the aid of an attorney or an accountant, the distribution of the trust assets under the terms of the trust does not require court intervention and is generally much more simple.

Maintain Privacy. Probate proceedings are public, so your Will (listing your beneficiaries), a list of all of your assets and their value, and an order as to how those assets are to be distributed all become public records. Generally, the provisions of your trust are private and operate without court involvement.

Avoids Multiple Probate Proceedings in Other States. A Texas court cannot issue orders regarding property located in another state. Consequently, real property owned in another state will require a separate probate proceeding in that other state. This is avoided if your real property from other states is under the management of the revocable living trust.

Planning for Incapacity. Should the Settlers become temporarily or permanently incapacitated, the alternate trustee can take over management of the trust assets. The trust document provides what qualifies as being "incapacitated," such as requiring two physicians to sign a statement that the Settlor is no longer able to manage their own affairs. This helps avoid expensive court proceedings to establish a guardian over the Settlers' finances. Also, unlike the agent under a financial power of attorney, an alternate trustee has legal title to the trust assets, so their authority to transfer real estate and write checks is more likely to be recognized by title companies and financial institutions.

Amendments. The legal requirements for amending a revocable living trust are more simple than amending a Will.

Distributions with Split Families. Revocable Living Trusts can make it easier for split families to ensure children from a previous marriage are covered.

3. Disadvantages of Revocable Living Trusts

Funding and Maintenance. Transferring ownership of assets to the Trustees is necessary or the trust has nothing to manage. This is initially more time consuming than simply relying on a Will and placing the burden on the Executor of the Will after passing. Also, when purchasing new assets, it is important to ensure the assets are purchased on behalf of the trustee of the trust, not as individuals or as husband and wife. None of these processes are overly complicated, but do require diligence. This diligence will likely be greatly appreciated by your beneficiaries and those who will be managing the distribution of the assets.

Limitations on Assets Managed Under the Trust. Importantly, because of adverse income tax consequences, retirement plans should not be managed under the trust, but should have beneficiary designations. Also, debt on automobiles will generally have to be paid off before they can be transferred. (New automobiles should be purchased directly by the trustee of the trust.)

Costs of Preparing a Revocable Living Trust. The initial cost of creating a Revocable Living Trust is more expensive than using only a Will. However, these costs are easily offset by the advantages of the trust.

Less Oversight for Estate Administration. One of the primary advantages of the revocable living trust is the cost and time savings due to the lack of court oversight. However, this means you need to have trustees you can trust to follow the terms set forth in the trust document.

Non-U.S. Citizens as Trustees. If a trust names a non-U.S. Citizen or a U.S. Citizen who resides in another country as a Trustee, the trust could be considered a “foreign trust” by the IRS, resulting in significant adverse tax consequences. To avoid classification as a foreign trust, the trust must meet two tests: the “court test” and the “control test.” If this is an issue, please ensure to discuss this with your estate planning attorney or accountant.

Qualifying for Medicaid benefits or Public Assistance. Managing assets in a revocable living trust does not help qualify for Medicaid benefits or other public assistance as you still have full control over the assets. Placing your home in a living trust can jeopardize your eligibility for Medicaid nursing home benefits as a home

owned in a trust is not an exempt asset, while owned outright is. Although the home can be transferred out of the trust to become eligible, the delay could cost some benefits. If qualifying for such benefits is an issue, particularly in the short-run, consult with an attorney specializing in elder law.

3. Myths About Revocable Living Trusts

Tax-Free Transfer to Trust. In Texas, transferring real estate to your trust is a tax-free transfer and will not trigger a re-assessment for property taxes (which is done every year regardless.)

Homestead Exemption. A transfer to a revocable living trust does not jeopardize your homestead exemption, but the deed should include language specifically addressing the homestead exemption.

“Due on Sale” Mortgage Clause. A transfer of your residence to a revocable living trust does not trigger any due on sale clause on your mortgage. Most mortgages have a due on sale clause which allows the mortgage company to demand that the full amount of the mortgage owed be immediately due if the property is sold. Federal law provides an exception if the property is transferred to a revocable living trust and the owners and the beneficiaries are the same. This could be an issue, however, under erroneous regulations issued by the Office of the Comptroller, if you are transferring rented property to a trust. If this is a concern, please ensure to discuss this with your estate planning attorney who can prepare a letter explaining the law to your mortgage holder in an effort to obtain confirmation they will not pursue a “due on sale” clause on any rented property.

Tax Benefits. A revocable living trust does not provide any special tax benefits. However, it can be used to help maximize the estate tax exemption if your assets exceed the exemption threshold. While this is not as common as it once was (the individual threshold is \$13.61 million for 2024), this threshold may be cut in half soon as tax cuts expire and may be changed by Congress at any time.

Asset Protection. A revocable living trust does not provide asset protection from creditors. After all, you continue to have full use and control of the assets. An irrevocable trust may provide such benefits, but then you must be willing to permanently place the asset into a trust that cannot be amended. Those types of trusts are outside the discussion of this booklet.

Need for a Will. A Will is still required even with a revocable living trust. The trust affects only the property managed under the trust. Property outside the trust, including property that may have been recently received just prior to death or which was overlooked, would not be managed under the trust. A “pour-over” Will is still

required to provide that any such property should be distributed to the trustee and managed under the provisions of the trust document. The Will can also be used to name guardians for minor children, although a Declaration of Guardianship is a better document for that purpose.

Prevent a Contest of Your Wishes. A revocable living trust can still be challenged in court based on allegations that the Settlor lacked mental capacity to create the trust or was under undue influence when creating the trust. However, these claims requires a separate court action to be filed rather than simply allowing someone to file a claim in the existing probate action. Historically, they are also less likely to succeed and the Settlor's efforts in managing the funding the trust and managing the trust assets provide strong evidence of competency. If there is a concern over such challenges, a trust can include a no contest provision similar to that for a Will.