Living Trusts: Fact vs. Fiction

Many myths surround these popular estate planning tools.

Provided by IWM Partners

Living trusts are created with a clearly defined objective: to avoid probate. Misconceptions about living trusts have spread to the point where people think they can accomplish much more than they really do. Here is a realistic assessment of living trusts.

If you fear probate, consider a living trust. If you worry about your will being contested or your heirs fighting over your assets, a revocable living trust may be your best option.

You fund a revocable living trust with all, or largely all, of your assets during your lifetime. The trust owns the assets, yet you can still use these assets while you live. Once you die, the revocable living trust becomes irrevocable and the trust assets are distributed according to your wishes by designated successor trustees, exempt from probate.[1,2,3]

In addition to giving you more control and privacy, a living trust may save your heirs time and money. An AARP survey finds that it takes roughly 18 months to distribute the typical estate because of probate. Settlement costs from probate may eat up as much as 5% of an estate.[1,2]

Living trusts do not reduce taxes. Assets within a living trust are fully taxable at the federal and (generally) state level. Unless someone has drafted the trust to include tax-saving provisions, it will offer no particular estate or income tax advantages to the grantor or the beneficiaries.[4]

Living trusts lead to a lot of paperwork. As the trust has to become the legal owner of your assets to be effective, the title needs to be changed on those assets. That means filling out myriad forms and revising others. Expenses may be incurred along the way.[4]

Living trusts do not relieve trustees of their duties. When a grantor of a living trust passes away, the language in the trust document will not magically “do all the work” for the successor trustee. While a successor trustee will usually not have to deal with probate, other responsibilities remain. Titles will need to be changed and appraisals may be necessary.[5]

A living trust is not necessarily inexpensive. A lawyer may charge you $1,500 or more to create one. If you have significant assets and fear a dispute over your will, it may be worth it.[2,6]

There are living trust solutions available on the Internet, or via books or software. However, when cutting and pasting boilerplate language and filling in some names here and there, what kinds of legal and financial risks are you taking?[6]

While having a living trust drawn up with the help of an attorney is certainly advisable, paying a fee is no guarantee of competence; amending simple errors could cost you another $300-500.[7]

A living trust is not a will. You still need a will when you have a living trust. In fact, you are probably going to need a "pour-over" will down the road, assuming you will keep accumulating assets after the trust is drawn up. A pour-over will place these stray assets into the trust.[4]

Additionally, you need a will if you want to make charitable bequests or gifts to friends or relatives upon your passing. A living trust cannot carry out these gifts on your behalf, nor can it name a guardian for any minor children.[4]

A living trust is not a living will, either. A living trust does not function as a health care directive or a power of attorney. These are separate estate planning documents. While some families ask attorneys to create them concurrently with a living trust, a living trust won't stand in for them.[8]

While living trusts are highly touted and can be highly useful, that does not mean every family should get one.

You may not need a living trust to begin with. If your financial life has been largely free of "creditors and predators" and your estate isn't complex, a thoughtfully drafted, well-executed will could prove sufficient when the time comes. For some middle-class families, a living trust can be like a fifth wheel on a car, seeming to provide stability, but actually unnecessary.

After all, not all assets are subject to probate when someone passes away: IRA, Keogh and pension plan savings, life insurance death benefits, checking and savings accounts that have POD beneficiaries, Treasury bonds, and property owned jointly with the right of survivorship.[4]

In terms of time, often there isn't much difference between distributing assets via probate and through a living trust. In terms of savings, the filing and court fees that come with a probated will may not be that onerous. While the fees may total a small percentage of the value of the estate, the executor may decline a commission if he or she is a family member and require only hourly legal advice.

A living trust isn't the only type of trust out there. Some families opt for the testamentary trust. Assets move into this basic, irrevocable trust as directed in a grantor's will. As the grantor's will directs the assets, the estate still proceeds through probate but more expediently than usual. Other families opt for more complex and specialized trusts.[2]

As a reminder, this article is intended as an overview of living trusts, and not any kind of legal advice. If you are considering a living trust or another kind of estate planning vehicle, the best "first step" is to talk to an attorney before you proceed further.

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