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The Plan of a Lifetime

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Anyone viewing financial planning programs on television or reading estate planning articles in the popular press will likely hear about the revocable living trust (commonly known as a "lifetime trust" or a "living trust") and its many advantages. A living trust does offer many benefits in estate planning, disability planning and estate administration.

However, like any other estate planning technique, one size does not fit all. For a client whose situation warrants the use of a living trust, it can provide tremendous value. For a client whose situation is such that the typical benefits provide minimal value, the living trust can result in unnecessary paperwork and costs. In any event, if the living trust is not properly funded or maintained, then its purposes and benefits can be frustrated.

The purpose of this article is to discuss what a living trust is, describe some of its benefits and note its burdens, so that when a practitioner is considering all the estate planning options in his or her tool bag, it can be determined if the living trust is appropriate for the client.

Anatomy of a Living Trust

A living trust is established during the lifetime of the client, who is called the "settlor" or the "grantor." It is fully revocable[1] by the client at any time, and from time to time without the consent of the trustee or any beneficiary. It must be in writing and executed and acknowledged in accordance with EPTL §7-1.17. If the grantor is an unmarried individual, such individual typically is the sole and initial trustee[2] with a trusted individual (i.e., an adult child or relative) named as a successor trustee. For a married couple, the spouses are generally named as co-trustees of each others' trusts. A will is also prepared as a complement to the living trust, which is commonly known as a "pour over will."

The pour over will essentially lives up to its name in that it generally directs that all of the decedent's assets pour over to the trustees of the living trust and be distributed in accordance with the terms of the trust. A common misunderstanding is that a living trust provides unique estate tax saving benefits[3] or asset protection benefits.

Both are generally not true. A living trust can provide an estate tax efficient structure, but such structure is not unique and is no more superior than what a properly drafted tax efficient will can provide. With respect to asset protection planning, a living trust during the grantor's life provides no asset protection benefits to the grantor. Since the living trust is fully revocable, it is essentially an alter ego of the grantor, and therefore the assets in the trust are fully reachable by the grantor's creditors.[4]

Benefits

There are several benefits for using a living trust for a New York client's estate planning, estate administration and disability planning. Four significant advantages are:

(i) the avoidance of obtaining jurisdiction over the decedent's intestate heirs;

(ii) the avoidance of ancillary probate;

(iii) the reduction of the risk of a will contest; and

(iv) the management of the client's assets in the event of incapacity.[5]

Avoidance of obtaining jurisdiction over decedent's intestate heirs. New York has exacting jurisdictional requirements that must be followed in order for the Surrogate's Court to issue an order granting probate of the decedent's will that will be binding on all parties who have an interest in the probate proceeding.

The decedent's intestate heirs are called distributees[6] and are necessary parties requiring the service of process[7] pursuant to Surrogate's Court Procedure Act (SCPA) §1403. Jurisdiction over the distributees is obtained by either (1) the distributee executing a waiver and consent (which is sent with a copy of the decedent's will) or (2) a citation is served upon the distributee that basically notifies the person that if he or she does not appear in court on the stated date, it will be assumed that such person has consented to the probate of the will, which is tantamount to a default.[8]

The jurisdictional and service of process requirements generally must be strictly followed and will not be dispensed with even in cases where the likely result is an excessive waste of estate assets, even to the point of possibly incurring costs that could constitute a significant portion of the probate estate. Although uncommon, it can happen in certain circumstances.

Furthermore, for those distributees under a legal disability,[9] the court will appoint a guardian ad litem (who is an attorney) to appear for that individual in order to protect the individual's rights in the decedent's estate; and the legal fees of the guardian ad litem will generally be borne by the decedent's estate.[10] The fact that the decedent has never met the distributee or has even intentionally chosen not to have a relationship with the distributee is of no matter, and does not negate such person as a necessary party to the probate proceeding.[11]

Accordingly, if a practitioner can reasonably anticipate a rigorous and extensive jurisdictional exercise for the estate, tremendous value can be provided to the client by implementing an estate plan that fully avoids probate, including the use of a living trust. Some examples of such circumstances are (i) unknown intestate distributees, (ii) a legally incapacitated distributee, (iii) a large number of distributees, or (iv) the closest living distributee is a first cousin or of a later degree.[12]

In summary, if the decedent's family is such that there will likely be extensive jurisdictional and/or service of process issues, then a living trust should be strongly considered so that the delays and costs that are incident to following such processes will be avoided.

Avoiding ancillary probate. All *real* estate located in a state outside of the decedent's domicile[13] will require local probate since the transfer of title for real estate is governed by the state where the property is located.[14] This is called ancillary probate.

Ancillary probate is obtained once primary probate is completed in the state of the decedent's domicile. Generally, a court exemplified copy of the probate documents is obtained from the probate court of original jurisdiction and is then submitted to the probate court of the state where ancillary probate is needed. The costs can be meaningful even where the ancillary estate qualifies as a small estate under local law (which provides lesser paperwork) since the probate process requires the completion and submission of certain forms and compliance with court procedure.

Since the small estate threshold is $30,000 in New York and is suggested to be $25,000 for a state adopting the Uniform Probate Code (UPC), one can anticipate that if the asset requiring ancillary probate is a second home, the ancillary estate will not likely qualify for the small estate diminished probate process, and therefore, the full ancillary probate process must be followed.[15] Where the ancillary estate does qualify for the small estate procedure, the legal and out-of-pocket costs can ultimately constitute a significant part of the ancillary estate.

In either case, the need for ancillary probate means that the sale or transfer of the out-of-state real estate will be delayed until both original and ancillary probate are complete. With a living trust, the client's out-of-state real property will be deeded to the trust and upon the grantor's death, will pass according to the terms of the living trust with the execution and recording of a new deed by the trustees. The costs associated with the preparation and recording of the new deed are significantly less than any ancillary probate proceeding. Accordingly, avoiding ancillary probate is value added for the client and may be reason alone to establish a living trust.[16]

Reducing the risk of a will contest. Building upon the New York requirement to obtain jurisdiction over all of the decedent's distributees in order for the will to be admitted to probate, if any of the distributees is disappointed in the bequest given to them (or lack thereof) under the will, such disappointed distributee is in the strategic position to hold up probate and cause meaningful delays and costs to the estate. The service of the citation upon the disappointed distributee is in a sense an invitation to a will contest. Pursuant to SCPA §1404, any distributee has the right to conduct an investigation into the validity of the will, even where there is no known (or reason to know) factual basis that could support a claim to contest the decedent's will.

Specifically, the distributee has the right to conduct an examination of the attesting witnesses to the will, the person who prepared the will, the nominated executors of the will and the proponents of the will. The costs of these examinations will be borne by the estate if they are performed before the distributee files objections to the will. It is predictable that the larger the estate, the greater the incentive for a disappointed distributee to use the probate process as weapon to extract a "bequest" from the decedent that is more in line with the distributee's feelings of entitlement.

Indeed, a well-seasoned trusts and estates litigator explained "[t]hat there is an additional basis for a Will contest other than fraud, undue influence, lack of capacity or lack of due execution—that is, a large estate." A further cost that is a consequence of the SCPA §1404 investigations, is that the nominated executor will likely have to apply to the court for preliminary letters testamentary so that the decedent's assets can be collected and the estate obligations can be paid while the examinations take place. With all these costs and the anticipated delay in the administration of the decedent's estate, it may be economically advisable to strike a business deal for the disappointed distributee's cooperation.

The living trust, on the other hand, places the fiduciary in a much more advantageous position and the "invitation" to a will contest by the service of the citation on potentially disappointed distributees is avoided. The living trust provides that upon the decedent's death, the acting trustees of the decedent's living trust continue to have immediate access and control of the trust's funds. No distributee is needed to be identified or contacted and there is no need for the distributee to cooperate by executing a waiver and consent.

The objective is that, with a fully funded living trust, there will be no assets left in the decedent's name, and therefore there is no need to probate the decedent's will. With a fully funded living trust, the decedent's assets pass outside of probate in accordance with the terms of the trust. The burden to attack the decedent's estate plan is now on the disappointed distributee who, after the death of the decedent is learned, must hire an attorney to initiate an action to contest the living trust or to otherwise make an inquiry.

Where the distributee has a poor or a non-existent relationship with the decedent, the assets in the living trust could very well have been transferred before the distributee learns of the decedent's death and takes the necessary actions to commence a proceeding in Court. The end result is the disappointed distributee may in reality be left with an option to pursue assets from the living trust beneficiaries at his own expense after the decedent's death is learned. This reality places the fiduciary (and beneficiaries of the decedent's estate plan) in a far superior bargaining and strategic position when facing a situation where a distributee may not feel appropriately remembered by the decedent.

Management of assets in the event of incapacity. A living trust that is properly and fully funded by the client during life, has all of the trust assets titled in the names of the trustees and accordingly, the trustees have control over all of the grantor's assets. If the grantor later becomes incapacitated, the trustees will continue managing the trust's assets and will have the ability to pay the grantor's expenses.

For administrative efficiency and ease, the client could consider naming a trusted individual (like a child of the grantor) or a corporate trustee to act as a co-trustee with the grantor. Alternatively, where the grantor wishes to serve as the sole and initial trustee, then upon the grantor's later incapacity, paperwork will need to be completed to organize the successor trustee taking control over the trust's assets. This paperwork is generally less burdensome then the paperwork needed for an agent to act under a durable power of attorney (discussed below). Therefore, for those clients who are older or where the incapacity of the grantor is anticipated, naming a trusted individual or a corporate trustee to serve as co-trustee with the grantor (or even naming the trusted individual or a corporate trustee to act as the initial sole trustee) will be beneficial to the client.

The bottom line: With a fully funded living trust where the grantor names a trusted individual or a corporate trustee as a co-trustee or as the sole trustee, the change of control over the trust's assets in the event of the grantor's later incapacity is relatively seamless. A durable power of attorney, on the other hand, requires substantially more time, effort and paperwork to obtain control over the client's assets upon the client's incapacity. With a durable power of attorney, the agent, upon the client's disability, will need to contact each financial institution that is holding an account, determine the procedure and paperwork required to obtain control, complete the necessary paperwork, submit it for review and approval, and thereafter wait for the agent to be added to the principal's account. All of this takes time and effort, and with the living trust there is less of both.

As a final point, a living trust provides substantial value to a client for the management of assets in the event of the client's later incapacity, but it is by no means a substitute for a durable power of attorney. For reasons that go beyond the scope of this article, the living trust is not a replacement of the durable power of attorney, but rather is a strong complement to it.

Burdens

A living trust has disadvantages that should be considered before it is recommended to a client.

First, the living trust generally should be fully funded, meaning that all (to the extent practicable) of the client's assets need to be re-titled to the trust. Assets that remain in the client's name at death will require the probate of the will, which, as discussed above, could frustrate an important purpose and advantage of the living trust. This means that the client will need to organize the transfer of his or her assets into the living trust after the trust is established, as well as remain aware that new assets need to be titled to the trust as well. This reality may exceed the administrative abilities of some clients.

Second, if the client owns a cooperative apartment, the transfer of the apartment into the living trust could be prohibited by the cooperative corporation or, the cost of the transfer may not be acceptable to the client. If the cooperative apartment constitutes a significant part of the decedent's estate and is not transferred to the living trust, then for a single client the value of the living trust will be reduced, as probate will be required for the transfer of the apartment.[17]

Third, revisions to a client's estate plan could incur greater costs and the procedure to revise the plan can be more cumbersome. Changes to a living trust are typically achieved through an Amendment and Restatement, and a new pour over will is executed as well. In addition, where the living trust is amended many times over a client's lifetime, the changes to beneficiaries' gifts could be seen and may have a negative impact on personal and/or family relationships.

Lastly, some clients, for personal reasons, may just not feel comfortable with having their assets titled in the name of the trust as opposed to themselves individually.

In conclusion, a revocable living trust can offer significant advantages to New York clients, but there are drawbacks as well. Each client's individual circumstances are unique and the practitioner should carefully consider all of the relevant factors for the client in order to determine if the revocable living trust is an appropriate fit.

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Endnotes:

1. Pursuant to EPTL §7-1.16, a lifetime trust is presumed to be irrevocable unless it expressly provides that it is revocable. Accordingly, it is advisable to expressly state in the trust instrument that the trust is revocable by the grantor at any time, in whole or in part, without the consent of the trustees or any beneficiary of the trust.

2. In 1997, EPTL §7-1.1 was amended to dispense with the legal doctrine of trust merger. The statute allows a valid trust to be established by a person (including the creator of the trust) where such person is or may become the sole trustee and the sole holder of the beneficial interest in the trust.

3. A living trust is not subject to court supervision, as compared to a testamentary trust, which is. This means that after the client's death (which makes the living trust irrevocable), the trustees of the living trust have the ability to move the trust to another jurisdiction to take advantage of certain favorable laws in the form of lower income taxes, decanting and asset protection benefits, as examples, without first having to seek court permission to do so.

4. Zaritsky, Howard M., "Revocable Inter Vivos Trusts," 860 Tax Mgmt. (BNA) Estates, Gifts, and Trusts, at A-43 (April 26, 2010).

5. Some of the benefits described in this Article are not exclusive to New York domiciliary clients and would also be applicable to clients living in other states.

6. A distributee is defined by EPTL §1-2.5 as a person entitled to take a share of the decedent's estate under the statutes governing descent and distribution. EPTL §4.1.1 sets forth the rules governing the descent and distribution of a decedent's estate for the property of the decedent that is not disposed of by will. In other words, distributees are the decedent's intestate heirs.

7. Service of process is accomplished through the issuance of a citation by the court. Turano, Margaret Valentine, and Radigan, C. Raymond, New York Estate Administration §2.02 (2005).

8. The service of the citation can be a burden in of itself, as SCPA §307 directs how the citation is to be served upon the distributees. For New York individual domiciliaries, personal service of the citation is required unless, for good cause shown, personal service would be impracticable. For non-New York domiciliaries, service of the citation is accomplished by registered or certified mail, or by special mail service. If the distributee does not cooperate, alternative service must be requested of the court. Additional legal fees, process server costs, certified mail costs and costs associated with the delay of the proceeding are all the natural byproducts of following these rigid procedures.

9. SCPA §103(40).

10. SCPA §405.

11. Where a decedent intentionally excludes a distributee as a beneficiary under his or her will, the requirement of obtaining jurisdiction over such person and process that must be followed can be a challenge to explain to clients, as sometimes, in their opinion, the requirement seems unfair and intrusive.

12. For point (i): Research to determine the decedent's family tree, the possibility of the public administrator being appointed over the unknown distributees along with the requirement to publish notice of the proceeding to the unknowns and the possible need for a genealogist is avoided; for point (ii): The avoidance of the appointment of a guardian ad litem; for point (iii): the avoidance of meaningful and possibly substantial service of process costs, including the incurrence of additional legal fees to apply to the court for alternative service where the distributees avoid or ignore service; and for point (iv): the avoidance of the appointment of the public administrator, which would be required under SCPA §1123 2(i)(2). The role of the public administrator is to conduct an independent investigation on behalf of the distributees and to file a report to recommend probate or to file objections to probate with its legal fees generally paid out of the estate.

13. The domicile of the decedent is generally the residence that the decedent considers to be home. In determining a decedent's domicile, factors such as where a decedent files income tax returns, registers to vote and conducts business activities are considered. Turano, Margaret Valentine, and Radigan, C. Raymond, New York Estate Administration §1.02[b] (2005).

14. It is important to note that any tangible personal property that is located in the out-of-state real estate will also be subject to ancillary probate. Accordingly, the assignment of such tangible personal property to the living trust should be considered.

15. SCPA §1301 and UPC §3-1201.

16. The establishment of the living trust and funding it solely with the client's out of state real estate may be a beneficial part of a client's overall estate plan.

17. For a married couple, this factor is not as important upon the death of the first spouse, as probate of the apartment can be avoided by titling the cooperative apartment as tenants by the entirety between the spouses, which means that the apartment will pass to the surviving spouse upon the first spouse's death.