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A BASIC EXPLANATION OF LIVING TRUSTS IN ESTATE PLANNING

Confusing and misleading information has been published about the use of "Living Trusts" in estate planning. This summary is intended to provide a basic explanation of how Living Trusts work, and to give you some of the advantages and disadvantages of Living Trusts.

I. USE OF LIVING TRUSTS TO AVOID PROBATE.

A "Living Trust" is a trust that you set up during your lifetime. The most common purpose is to avoid probate of your assets when you die.

When you set up a Living Trust, in order to avoid probate, you must transfer ownership of most of your assets from yourself to your Living Trust. For example, title to your home and your investments are transferred from yourself to the "John Doe Living Trust." The person who controls the assets of the trust is called the "trustee," and the person or people who receive the benefits of the trust property are called the "beneficiaries." Initially, you can be both the trustee and the beneficiary of your Living Trust, so you retain full control over the trust property. This is similar to transferring your assets to a corporation, where you are the president, and the only shareholder. When you die, the Living Trust continues to own the assets, so they do not have to go through probate. Instead, the trust directs how the assets will be administered after your death, much like a Will.

The advantages of a Living Trust include:

A. Avoiding Probate: If all of your major assets are put into your Living Trust before your death, your estate does not have to go through probate, so your affairs can be settled more quickly, and with less cost. Living Trusts are especially helpful if you own property in other states, because probate might otherwise be required in each state.

B. Privacy: Probate documents are public records, so your Will, a list of your heirs, and in some cases an inventory of your assets are available for anyone to read and copy. Your affairs can be settled more privately if you have a Living Trust.

Although Living Trusts can avoid probate, save time and expenses, and maintain your privacy, they do have some disadvantages:

1. Administration: As mentioned above, in order to avoid probate, most of your assets must be transferred into your Living Trust. This involves a deed of your real estate, and changing the name on your bank accounts and investments from your name to "John Doe, as Trustee of the John Doe Living Trust." If you own a lot of different stocks, and you (rather than your account representative) have possession of the stock certificates, each stock must be individually transferred to your Living Trust. However, if you do not buy and sell stocks and bonds frequently, or if they are held by an account representative in a custodial account, then the administration of a Living Trust is relatively simple.

2. Initial Cost: Unlike a Will, which does not take effect until your death, a Living Trust takes effect as soon as you set it up. Consequently, there is more work involved for your attorney, so the fees are more than if you just have a Will.

Setting up a Living Trust generally has no effect on your income taxes, as long as you are acting as the trustee. There are things that you can do in a Living Trust to reduce estate or "inheritance" taxes (see Section B below), but you can accomplish those same things with the right kind of Will.

These are some of the major advantages and disadvantages of Living Trusts. There are other facts and details which you can discuss with your attorney.

II. USE OF TRUSTS TO AVOID ESTATE TAXES.

In general, there are no estate or "inheritance" taxes if your total "estate" is less than the "estate tax exemption amount" that is in effect the year of death. This federal estate tax exemption amount is roughly $5.3 million, the Illinois estate tax exemption amount is $4 million, for those who passed away in 2014.

In addition to your home, investments and other assets, your taxable "estate" includes all of your life insurance, retirement benefits, property held with someone else in joint tenancy, property that you receive through an inheritance, and any other assets over which you have ownership or control. Some large gifts that you make while you were alive may also be included in your taxable "estate."

Although a husband and wife are each entitled to the estate tax exemption, without proper estate planning, the exemption of the first spouse to die can be lost without proper estate planning. There is generally no tax due when the first spouse dies, as long as all of the property goes to the surviving spouse. However, *without proper estate planning*, <u>all</u> of the assets of the first spouse to die will be included in the estate of the second spouse to die, so inheritance taxes will ordinarily be due where the combined assets of a husband and wife (including life insurance and all other benefits) exceed the individual estate tax exemption amount . This loss of the estate tax exemption of the first spouse to die can be avoided with proper estate planning.

The estate tax rates average around 40%, so the estate tax can be quite substantial. However, that tax can be minimized or entirely avoided with proper estate planning.

A. <u>The Problem with Joint Tenancy</u>: Since each person has an individual exemption from estate taxes, owning property in joint tenancy is wise only if the combined assets of the owners, including the joint tenancy property, life insurance, IRA's, pensions, and all other assets, are less than the estate tax exemption amount if effect at the time of death .

B. <u>Taking Advantage of Individual Estate Tax Exemptions</u>: In the case of a married couple, there are two basic steps to avoid or minimize estate taxes. First, property should be taken out of joint tenancy, so each spouse owns roughly 50% of the assets. Second, the Will or Living Trust of each spouse should be written to take advantage of the full estate tax exemption of each spouse. Basically, the assets of the first spouse to die can be used for the "support, maintenance and medical care" of the surviving spouse, for as long as he or she lives. Any remaining assets are then distributed to whoever is designated in the Will or Trust. Using these methods, each person can "shelter" up to the full estate tax exemption amount, so you essentially double the amount passing tax-free compared with the typical situation.

Of course, this is only a general explanation of how estate taxes can be minimized or avoided. You should discuss these issues with your attorney for specific advice.

III. OTHER INFORMATION ABOUT TRUSTS.

Trusts can be created for several other reasons, such as to provide for those who are disabled or incompetent, to pass property on to future generations, and many other reasons, which are not discussed in this summary.

It is very important to remember that setting up a trust will not accomplish your purposes unless your assets are actually transferred into the trust.

FINALLY, AS STATED ABOVE, THIS IS INTENDED ONLY AS A GENERAL EXPLANATION OF TRUSTS, TO HELP YOU UNDERSTAND SOME OF THE USES OF TRUSTS IN ESTATE PLANNING. YOU SHOULD NOT RELY ON THIS SUMMARY FOR YOUR SPECIFIC LEGAL NEEDS, BUT YOU SHOULD INSTEAD DISCUSS THEM WITH YOUR ATTORNEY.