Living Trusts: Truth and Fiction

By Charles C. Bell, Esquire and Bradley S. Dornish, Esquire

A number of individuals are considering the use of a Living Trust to “ensure privacy” of their affairs after death, and the belief that this effectuates a substantial savings in probate costs after death. Living Trusts are being publicly marketed as an estate planning tool that is a Will substitute. However, the advertised benefits of a Living Trust as a legal panacea for post-mortem estate privacy, and a major reduction in the cost of probate and fees for estate administration, are grossly exaggerated or non-existent. The purpose of this article is to explain the purpose of the Living Trust, examples of when the use of Living Trust as an estate planning device can be beneficial, but why this legal document does not accomplish the goals of privacy and significant estate administration cost reduction, and is not an effective Will substitute.

To understand the purpose and legal effect of a Living Trust, it is necessary to first explain what a trust is. A trust is a written agreement whereby a property interest, whether real estate or liquid assets, is held by one person, identified as a trustee. The trustee holds the trust property for the benefit of a beneficiary to whom the trustee owes equitable duties to deal with the trust property for the best interest of the beneficiary. The trust is created by the person owning the property, identified as the settlor, who transfers property into the trust and requests that the trustee hold and manage the property for the benefit of the beneficiary. The trust property is the property which the settlor places in the trust by transferring legal title of ownership to the name of the trustee subject to the trustee’s duty to hold and manage the property for the benefit of the beneficiary pursuant to the terms of the trust document.

The most common example is the creation of a trust under Will when an individual has a young child. The parent leaves property under the Will that, upon his death, is conveyed to a trustee to hold and manage for the benefit of the parent’s minor child until the child reaches a certain age. This is to ensure that a trusted bank or individual will manage the property for the maintenance, support, health and well-being of the child until he reaches an age when he is expected to be able to manage the trust property himself without the need for a trustee. However, there are many types of trusts, and many different circumstances in which an individual may want to create a trust and transfer property into it.

A Living Trust, also known as an Inter Vivos Trust, is one type of trust and one of many estate planning tools that an attorney can recommend depending upon the client's circumstances and intentions. Some common examples of circumstances when a Living Trust might be recommended include:

1. The property owner, the settlor, is concerned about his declining ability to manage his property. Through a Living Trust, he selects an entity or person in whom he has great confidence to manage to manage the trust property for him, subject to the terms of trust administration authority and discretion set forth in the document. The settlor is also the beneficiary of the trust.
2. The property owner, the settlor, has a particular reason to separate certain assets from his overall property ownership portfolio so that the trust property is not part of his personal property ownership during his lifetime, and not part of probate estate upon death. The settlor can also be the beneficiary of the trust, and can even be the Trustee.
3. The property owner, the settlor, wants to make a gift of some of his property during his lifetime to benefit a chosen person, the beneficiary, but does not want to give unfettered control or ownership of the property to that beneficiary. The title of ownership of the gifted property is transferred to a Trustee who holds and manages the property for the benefit of the beneficiary. The settlor can also be the Trustee.

A Living Trust, however, is a poor and often ineffective Will "substitute" when the settlor is also the trustee and principal or sole beneficiary of the trust.

First, for the trust to have authority over an asset, title to the asset must be transferred into the name of the trustee of the Living Trust. If the transfer of title of ownership is not made to the Trustee, the Living Trust does not govern it, and the Trustee has no authority over the property. The most glaring example arises in post mortem real estate transfers. After the death of the settlor, the Trustee or successor Trustee under a Living Trust assumes that real estate is part of the Living Trust because the Trust Agreement references or even specifically identifies the realty as trust property. However, if there is no recorded deed from the owner of the real estate as settlor to the Trustee, the real estate is not an asset of the Living Trust and subject to its terms despite what the document itself may state.

The trustee has no authority over the property. Therefore, an estate must still be opened by probating the settlor's Will, or an estate administration opened if the settlor died without a Will. Only when an estate is opened and an executor or administrator is appointed by the Court can title to the real estate then be transferred to a buyer or to the heirs of the estate. The beneficiaries of the Living Trust might not be the same as the heirs and not inherit the realty, or the proceeds from the sale of the realty, through the trust. The same requirement that title of ownership must be transferred from the settlor to the trustee of a Living Trust for the property to be subject to the trust also applies to the title of ownership of cash investments, bank accounts, and other liquid investments.

Therefore, if the settlor is not sophisticated enough to understand that the title to assets, both real and personal, have to be transferred into the name of the Trustee, the Living Trust document is ineffective to pass title to or benefit the beneficiaries of this trust, but must pass through probate.

A Living Trust in which the settlor is also the sole or principal beneficiary does not avoid or reduce death taxes. The Pennsylvania Inheritance tax and the Federal Estate tax are assessed against the value of all property passing by reason of the death of the owner, whether under a Will, under a Living Trust, or to a designated beneficiary of a retirement account or "in trust for" bank account. This tax assessment is made against the value of property which passes under the provisions of a Living Trust to others after the death of the settlor/beneficiary.

After the Living Trust is created and property is transferred into it, the trust becomes a legal entity requiring its own tax identification number (Employer Identification Number) from the Internal Revenue Service, and the filing of annual trust income tax returns to IRS and the Pennsylvania Department of Revenue beginning with the tax year that the trust is created.

The only assets subject to probate upon death are property titled in the sole name of the decedent. Property titled in the sole name of a decedent passes to beneficiaries under a Will, or pass to his heirs at law if there is no Will. The cost of probate is based upon the total value of the probate estate. Property that passes through a Living Trust to a beneficiary is not subject to probate. However, the cost savings for avoiding probate is not substantial. A Living Trust is likely to save only a couple of hundred dollars in probate costs For example, the total amount of filing fees for probate in Allegheny County for an estate worth one million dollars is about $1,500.00.

There is little savings in professional fees. The services of an attorney are still required to handle or assist in the preparation of estate tax returns, payment of the decedent's expenses, and the distribution of the trust property under the terms of the Living Trust. The services of a Trustee of the Living Trust (similar to being an executor under a Will) are also required for the same reasons and the Trustee may charge a fee for his services.

Even if the settlor of a Living Trust is sophisticated enough to take all the steps necessary to transfer the title of assets into the name of the Trustee of the Living Trust and totally avoid probate, privacy is not ensured because the assets in the Living Trust are subject to Pennsylvania Inheritance tax. The trust assets must be reported on the return, and a copy of the Living Trust must be attached to the return as an exhibit. While Pennsylvania Inheritance Tax returns are not on line, anyone can go to the office on the 2nd Floor of the City-County Building and request to see the Inheritance tax return of any individual who dies in Allegheny County. Therefore, even a Living Trust does not cloak the contents of a decedent's estate from the public.

The publicity regarding the pending on-line access to Wills in Allegheny County does not create a new "right". The public has always been able to go to the office of any County Register of Wills office and ask to see a Will or an estate file, just as the public can look up lawsuits and other documents in the Prothonotary's office, or real estate records in the Recorder's Office.

In closing, I reiterate that a Living Trust is a recognized and important estate planning vehicle that can be recommended and utilized in the "right" circumstances. However, for the several reasons set forth in this article, it is not an effective Will substitute, does not guarantee privacy of an individual's affairs after death, and any potential savings in probate costs and professional fees is insubstantial.

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