PacificCPE

COURSE
40351A

Living Trusts: Foundations and Key Concepts

Get grounded in the essentials of living trusts with this introductory course. You'll explore how living trusts are created, what makes a trust legally valid, and how trust gifts are constructed and interpreted. The course also covers powers of appointment, trust modification, and the practical role living trusts play in estate planning—including common misconceptions and scams clients may encounter. Ideal for CPAs and tax professionals who want a solid foundation before advising clients on trust-based planning strategies.

CREDIT HOURS 2 | FIELD OF STUDY BUSINESS | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize the basics of a living trust.
- Identify characteristics of living trusts.
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TABLE OF CONTENTS

CHAPTER 00

Introduction 5

CHAPTER 01

An Overview Of Living Trusts 8

1.01 I. Introduction To Living Trusts 8

1.02 II. Creation Of Living Trusts 11

1.03 III. Elements Of A Valid Trust 15

1.04 IV. Construction Of Trust Gifts 22

1.05 V. Powers Of Appointment 23

1.06 VI. Modification Of Trusts 29

Test Your Knowledge 33

CHAPTER 02

The Abcs – The Role They Serve (And Don'T Serve) In Estate Planning 37

2.01 I. Introduction 37

2.02 II. Common Claims About Living Trusts 38

2.03 III. The Relationship Between Living Trusts And Wills 45

2.04 IV. Living Trust Scams 49

Test Your Knowledge 56

Final Exam Copy 76

Glossary 61

Index .....

INTRODUCTION

> *Probate is expensive and can take years to complete. Estate taxes can take nearly all of the assets your loved ones intended to leave you. Living trusts can eliminate the need for probate and reduce the burdens of death taxes.*

These are just some of the claims commonly made about living trusts by a variety of individuals and companies in the business of selling these instruments. Given the important role accountants play in advising clients of both lifetime and estate planning tax considerations, it is imperative that they be able to properly advise their clients on the value of such instruments and the circumstances under which they may be useful devises. On the other hand, accountants must also be able to explain to clients the limitations of these instruments.

The goal here is to explain the value and limitations of living trusts, and to discuss other probate avoidance tools, including trusts. It is not to bash the use of revocable living trusts. They play an important role in estate plans for millions of people and have tremendous advantages for many people. For other people, however, they can be a chore to maintain, expensive to set up, and do not yield significant benefit. The key in all cases is to understand the client and their needs. It would be remiss, however, not to mention that there are people who unscrupulously sell living trusts at high prices to those who have no need for them.

Officials from the Federal Trade Commission (FTC) testified before a special United States Senate committee investigating the subject of living trust scams. The testimony points out that while living trusts can be a legitimate and valuable estate planning tool, scam artists often prey on older Americans' concerns that their estates will be subject to long and costly probate, and misrepresent the costs and benefits of trusts versus wills. "Putting the spotlight on this problem will help alert consumers to the danger they may face by buying living trusts or other estate planning products from strangers who play on their fears that their loved ones will not get the benefit of their estates in a timely fashion," the FTC told the Senate committee.

The American Association of Retired Persons (AARP) and the Michigan Attorney General reported data showing a significant increase in the number of people aged 50 and older, with incomes of $25,000 or less, who own living trusts. Given the exclusion from federal estate tax of estates considerably larger, one has to wonder whether many of these people got what they paid for. The growth in sales of living trusts outpaced the living trust ownership growth rate of seniors with moderate and higher incomes. This is a cause for concern, according to the FTC, because generally consumers of modest means are the least likely to benefit from sophisticated estate planning services.

Misinformation and misunderstanding about estate taxes and the length or complexity of probate provide the perfect cover for scam artists who have created an industry out of older people's fears that their estates could be eaten up by costs or that the distribution of their assets could be delayed for years. In such cases, it is not uncommon for the salesperson to exaggerate the benefits or the appropriateness of the living trust and claim, falsely, that locally-licensed lawyers will prepare the documents.

Other businesses are advertising living trust "kits," whereby consumers send money for these do-it-yourself products, but receive nothing in return.

What should an individual do? It is true that for some people, a living trust can be a useful and practical tool. But for others, it can be a waste of money and time. This author is not opposed to living trusts in general. In many cases, they are an important component of estate and financial planning. Like everything, however, they are not right for everyone. What is a living trust, and how does it differ from a will? Who should you trust when it comes to estate planning? And how can an individual tell which tools and strategies will work best for his or her particular circumstances?

Everyone should proceed with caution before opting for a living trust or any other type of estate-planning vehicle. Because state laws and requirements vary, "cookie-cutter" approaches to estate planning are not always the most efficient way to handle an individual's affairs.

Accountants should also advise their clients of a federal law called the "Cooling Off Rule." If an individual purchases a living trust in their home or somewhere other than the seller's permanent place of business (i.e., at a hotel seminar), the seller must provide the individual with a written statement of his or her right to cancel the deal within three business days.

The Cooling Off Rule provides that during the sales transaction, the salesperson must provide the customer with two copies of a cancellation form (one for the customer to keep, and one to return to the company), and a copy of the contract or receipt. The contract or receipt must be dated, show the name and address of the seller, and explain the purchaser's right to cancel. Customers can write a letter and exercise their right to cancel within three days, even if they did not receive a cancellation form. Individuals are not required to provide a reason for canceling.

This course explains the role of living trusts in estate planning and how other vehicles can be used to obtain similar results. It also discusses the limitations of living trusts by providing readers with an overview of the probate process and the federal estate tax scheme. This is not to say that there is value in avoiding probate or that many millions of people annually create living trusts that have a key role in their estate plans and are entered into with full understanding of the benefits and limitations of a revocable living trust.

Estate planning deals with what happens to an individual's assets after he or she dies. Even people without tremendous wealth should have an estate plan. The right strategy for each person depends

on his or her unique circumstances. The value of the person's estate is just one component in determining an individual's estate plan. Other factors that need to be considered include, but are not limited to, the following:

- Whether the individual is married,
- Whether the individual has dependents, such as minor children or disabled adult children,
- Whether the individual has any disabilities which do or may in the future require expensive, long-term care, and
- Whether the individual wants to leave money to help support a family member. or a cause such as a favorite charity.

A living trust is an estate planning tool in which a person's assets are transferred to the trust during his or her lifetime and distributed after his or her death. In virtually all cases, a living trust should be viewed as an adjunct to a will, not a replacement. The trustor typically retains control of the assets during his or her lifetime. A living trust can avoid what could be a costly, lengthy probate process for some estates in some states. However, whether a living trust is an appropriate estate-planning tool depends on each individual's circumstances, estate planning goals and the laws of his or her state of domicile.

Note: Some of the material in this course is similar to that in PES's *"An Accountant's Guide to Trusts."* That course, however, is designed to provide a more introductory discussion of trusts in general, while this course offers a more focused look at living trusts.

Chapter 1: AN OVERVIEW OF LIVING TRUSTS

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the basics of a living trust.

I. INTRODUCTION TO LIVING TRUSTS

A trust is a legal arrangement that creates a separate legal entity. The duties, powers and responsibilities of the parties to this arrangement – to this new legal entity – are determined by a combination of state law and the written trust instrument. To create a trust, legal title to property must be conveyed from the trustor to a trustee, who is then charged with the responsibility of using that property for the benefit of another person or persons, called the beneficiary or beneficiaries (though in the case of a standard living trust, the trustor can also serve as the trustee and beneficiary during their lifetime). The trustee manages the trust, holds legal title to trust assets, and exercises independent control. Trusts can be used to accomplish many goals, including tax planning, estate planning, providing income to a spouse or disabled child, or charitable giving, among others.

A revocable living trust (also referred to as an *"inter vivos"* trust) has become a popular probate avoidance tool. A revocable living trust can, as the name suggests, be revoked by the trustor or trustors. This means it is not a permanent distribution or transfer of assets. If an individual's circumstances change, so too can the trust.

Example

Mitchell creates a living trust in which he placed all of his assets. The trust document makes Mitchell the trustee and the beneficiary during his lifetime. Upon his death, the trust will become irrevocable and the assets will be distributed to his designated beneficiaries, which in this case are his adult children. If Mitchell changes his mind and decides to leave the trust assets to the Humane Society, he can make that change or revoke the trust entirely prior to his death, so long as he is mentally competent when the changes to his estate plan are made.

Living trusts are commonly used to transfer the assets of the trustor after his or her death without the necessity of probate. Probate is the court supervised process of distributing the assets of a deceased. Any competent adult can establish a living trust. There is no minimum asset requirement,

although the benefits typically increase with the size of an individual's estate or net worth. The trustor can either designate a trustee or serve in that capacity himself or herself.

TABLE 1.1 TABLE OF TRUST TERMINOLOGY

Beneficiary	The person, persons, or institution for whose benefit a trust is created. A beneficiary is frequently a close relative of the trustor, but need not be. Other typical beneficiaries include charities, friends of the trustor, and others whom the trustor wishes to benefit in some way.
Corpus	The "body" of the trust; refers to the assets, be they real property or stocks and bonds, that are transferred into the trust.
Living Trust	Atrust created and activated while the trustor is still alive. It is different from a "living will," a document used to control medical care of the drafter in the event of certain catastrophic events.
Revocable Trust	A trust that can be revoked or amended at the election of the trustor during his or her lifetime, so long as the trustor remains mentally competent to do so.
Testamentary Trust	A trust created within and as part of a person's will. It has no effect until after the death of the trustor. The terms of the trust can be changed through modification of the trustor's will, again, so long as the trustor remains competent to do so.
Trust	Generally, a legal device designed to provide financial assistance to someone without giving that person total control over the trust assets. A trust may be either revocable or irrevocable.
Trustee	The person or institution entrusted with administering the trust. In the case of living trusts, the trustor frequently appoints himself or herself as trustee. The trustee can be an individual or, in the case of very large trusts, a financial institution.
Trustor	The individual whocreatesatr ust, also referredtoas the"settlor"or"grantor."

A. THE RELATIONSHIP BETWEEN A TRUST AND A WILL

Regardless of what any so-called "expert" tells you, no trust – no matter how elaborate – is ever an effective substitute for a will. Even though a revocable living trust may be considered the principal document in an estate plan, a will should accompany a revocable living trust. This issue is discussed in greater detail throughout the course.

B. THE RELATIONSHIP BETWEEN A TRUST AND PROBATE

Property held in a revocable living trust at the time of the trustor's death is not subject to probate administration. Thus, the value of the property is not considered when computing the statutory fee for the personal representative or the estate attorney. Furthermore, the amount of any required bond for the personal representative will be reduced to the extent the property is held in the trust and not subject to probate administration. These are important reasons for election to use a living trust, along with other probate avoidance tools discussed herein.

Nevertheless, certain expenses associated with the death of a person are not eliminated. Deeds to real estate transferring the property from the trust to the beneficiaries must be prepared. Estate tax returns must be filed when the total value of the property owned at death (including assets in a revocable living trust) exceeds the maximum federal exemption in the year the trustor dies. The decedent's final income tax returns must still be filed and income tax returns for the trust must also be filed.