PacificCPE

COURSE
40352A

Living Trusts: Probate Avoidance and Trust Alternatives

Probate can be costly and time-consuming—but is a living trust always the right solution? This course examines how probate works, strategies for avoiding it, and ongoing reforms that affect the process. It also explores practical alternatives to living trusts, including powers of attorney, conservatorship, guardianship, medical advance directives, and life insurance. Sample legal documents are included to help you better understand the tools your clients may already have—or still need—in their estate plans.

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

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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

- Identify various probate-avoidance tools.
- Recognize alternative options to trusts, including powers of attorney, conservatorships, guardianships, and life insurance.

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Chapter 1: PROBATE AVOIDANCE

Chapter Objective

After completing this chapter, you should be able to:

- Identify various probate-avoidance tools.

One of the most common benefits of living trusts cited by their promoters is their usefulness in avoiding probate. What the so-called experts don't say is that even with a living trust, there are obligations that must be carried out after the trustor dies when the individual has substantial assets. For example, a federal estate tax return must be prepared and filed and, where applicable, taxes paid. Even without the probate process, it can take time to distribute assets to the trust's beneficiaries. This is particularly true when assets must be liquidated. Assets like land can take months – or even years – to sell. In the case of a very large trust administered by an institution or other professional trustee, this process can also be expensive. So much for eliminating the time and expense of the probate process by drafting a living trust.

That is not to say that there is no benefit to a living trust. If the trustor properly transfers assets into the trust before his or her death, probate can be avoided. On the other hand, the trustor must ensure that all of his or her assets are properly placed in the trust. This can be a time-consuming process depending on the complexity of the individual's assets. In situations where an individual has a relatively simple estate, therefore, the benefits of a living trust may be trumped by the administrative work involved. Take, for example, a man in his 70s who is married and has no children. Should he really have a living trust? Even if this man died without a valid will (a practice I do not recommend), all of his assets would be transferred to his wife under the laws of intestate succession.

Persons concerned about probate need to know that there are a number of vehicles besides trusts that can be used to avoid probate. Many of these can be used by the same individual based on the type of assets he or she has. In all cases, I strongly recommend that every adult have a valid will to dispose of any assets that may not otherwise be accounted for using one of the probate-avoidance tools discussed in this chapter. Also remember that anyone using any of these alternatives needs to realize that none of them, not even living trusts, will reduce or eliminate federal taxes. Most states with some sort of death tax also impose their tax on property or other assets transferred in or out of probate.

So what is probate? What are probate-avoidance tools? Is probate really something that needs to be avoided in all cases? Is a living trust necessarily the best probate-avoidance tool? These issues are addressed below.

I. PROBATE: AN INTRODUCTION

A. OVERVIEW OF PROCESS

The term "probate" refers to the court-supervised process of determining the validity of a decedent's will, gathering his or her assets, paying the decedent's debts, if any, taxes, and the expenses of will administration, and then distributing the remaining assets to the decedent's heirs. This process is overseen by the appropriate court in each state, typically referred to as the "probate court."

1. The Cost of Probate

The cost of probate – often an issue proponents cite when recommending living trusts – depends on the complexity of the estate and amount of professional assistance required. Each state charges a court-filing fee, which generally varies depending on the value of the decedent's estate. Additional costs include fees for lawyers, executors or personal representatives, and a CPA or tax preparer to file the decedent's final tax return and a return of the decedent's estate. In some states, attorneys and personal representatives are allowed to charge a percentage of the estate; in other states, they are limited to flat or hourly rates. In Florida, for example, attorneys' fees are suggested by statute. The law, Florida Statutes § 733.6171(3), outlines what is presumed to be reasonable compensation for attorneys representing a personal representative in a formal estate administration:

Value of Estate	Suggested Legal Fees
$40,000 or less	$1,500
More than $40,000 to $70,000	$2,250
More than $70,000 to $100,000	$3,000
Above $100,000 to $1 million	Amount above plus additional 3 percent of the value above $100,000
Above $1 million to $3 million	Amount above plus additional 2.5 percent of the value above $1 million
Above $3 million to $5 million	Amount above plus additional 2 percent of the value above $3 million
Above $5 million to $10 million	Amount above plus additional 1.5 percent above $5 million
Above $10 million	Amount above plus additional 1 percent above $10 million

The above "reasonable fees" are for ordinary legal services only and do not include such things as will contests, contested claims, tax advice and ancillary administration, to name a few "extraordinary" services sometimes requested of probate attorneys. Please note that Attorney fees in estate matters are subject to review by the Court for reasonableness.

Many states now have informal probate processes designed for relatively smaller estates. This can reduce both the cost and time of probating an estate. Factors that complicate probate include the existence of minor beneficiaries, disputes among heirs, insolvency and other circumstances that require formal probate.

Aside from professional fees, one major area of cost is filing with the probate court. Fees vary from state to state. For purpose of illustration, Table 3.1, below, provides a sampling of probate court fees from around the country. These fees are the actual court filing fees and do not include professional fees including attorneys' fees, discussed above.

TABLE 3.1. SURVEY OF PROBATE FEES (UPDATED AS OF 2026)

New York		Oregon	
Estates less than $10,000	$45	Less than $50,000	$278
Estates $10,000 to $19,999	$75	$50,000 to $999,999	$591
Estates $20,000 to $49,999	$215	$1,000,000 to $9,999,999	$882
Estates $50,000 to $99,999	$280	$10,000,000 or more	$1,176
Estates $100,000 to $249,999	$420		
Estates $250,000 to $499,999	$625		
Estates $500,000 or over	$1,250		

2. Process of Probate

While the formal probate process can vary somewhat from state to state, the process involves the following steps:

- Filing the will of the deceased with the appropriate court (in some states, individuals actually file their wills with a court prior to their death) by the decedent's executor or personal representative;
- Proving to the court that the decedent left a valid will;
- Taking an inventory of the property of the deceased;
- Appraising the property of the deceased (using professional appraisers in appropriate circumstances, e.g., real estate);
- Paying all debts of the decedent, including estate taxes; and
- Distributing the property to the heirs.

In some cases, an individual may die without ever having executed a will or executing a will that is, for a variety of reasons, not valid. When this occurs, the decedent is said to have died "intestate." In such cases, probate is still necessary. Rather than distributing the property according to the wishes of the decedent, however, a court in such a case will order distribution according to the laws of "intestate succession" in each particular state. These rules govern the distribution of property when an individual dies without executing a valid will.

B. ADVANTAGES OF PROBATE

Much is said about the cost and time of the probate process. However, readers should be reminded that the probate process is not without its benefits. Having a judge oversee the process ensures first that the decedent's will is valid and that his or her wishes are properly carried out. This is particularly useful if there are claims of creditors, challenges to the will, or disputes that arise from the will.

One advantage of probate, in particular, is a shortened statute of limitations for creditors who have claims against the decedent's estate. A decedent's creditors generally have a very limited period of time to submit claims against the estate once a personal representative is appointed. If they are not made in a timely fashion, they are barred. If, however, there is no probate because assets are transferred through a living trust, these statutes do not apply. The estate will have to wait longer for creditor claims and has affirmative obligations to notify potential creditors through publication of notices in local newspapers.

II. PROBATE AVOIDANCE

For those desiring to do so, there are, however, many ways to avoid probate, either in whole or in part. These mechanisms are sometimes called "will substitutes." They are simply ways to transfer property without the necessity of a will. Common mechanisms for avoiding probate do include living trusts. However, there are a number of other options available to individuals concerned about the process of probate.

TABLE 3.2 COMMON PROBATE AVOIDANCE TOOLS

Tool	How It Works
Life Insurance	Proceeds are paid directly to beneficiary following death of insured.
Joint Tenancy	Decedent's interest in property passes automatically to surviving joint tenant.
Pay-on-Death Accounts	Funds are immediately dispersed to survivor(s) beneficiary.
Trusts	Flexible vehicle that vests interest in money or property in trust subject to conditions established by trustor. Living trusts, which are generally revocable during the lifetime of the trustor, become irrevocable upon his or her death and control the disposition of the corpus of the trust.
Gifts	Individual transfers title to property to another person before death. Federal law allows maximum gifts per year to avoid gift tax and exclusion for married couples.

A. LIFE INSURANCE

Life insurance is a contract purchased by an individual that provides for a pre-determined amount of money to be paid to a designated beneficiary or beneficiaries upon that person's or a third party's death. These proceeds are paid directly to the designated beneficiary or beneficiaries and are not subject to probate. There are a number of different types of life insurance, each of which contains this probate- avoidance mechanism.

There are a number of reasons people consider life insurance. The most common is to provide support for loved ones such as a surviving spouse or children. However, life insurance can also be used to provide funds to pay estate taxes, thus avoiding the need to sell certain assets of the estate. This is particularly true in the case of a family business that the decedent's heirs do not wish to liquidate. Insurance can prevent a forced sale or liquidation of the business.

1. Tax Implications

Life insurance proceeds are not taxable to the beneficiary. This makes life insurance an important component of many estate plans, especially when the insured is looking for a way to support family after his or her death. One of the principal advantages of life insurance is that proceeds from a policy owned by the decedent and paid to a named person as beneficiary are excluded from the decedent's federal income tax, as well as state income or death taxes in most states. On the other hand, if the decedent was the owner of the policy at the time of his or her death, the proceeds from the policy are includable in his or her federal taxable estate, even though they are paid to a third party. This is not an issue where the decedent's estate is too small to be subject to estate tax. In some cases, however, the proceeds from the policy will lift the value of the decedent's estate to the level subject to federal tax.

If an insured wants to name their spouse as beneficiary of the policy, the distinction is not important. The assets will pass to the spouse tax-free so long as the surviving spouse is a citizen of the United States. If the insured wants to name anyone else as the beneficiary, however, there are steps that can be taken to protect the proceeds from estate tax. The first option is to have a trust purchase the policy. If the insured is not the owner of the policy, it cannot be part of his or her estate upon death. The trust can then designate the beneficiary of the policy according to the wishes of the insured.

Life insurance proceeds are also includible if the policy owner names his or her "estate" as the beneficiary. Placing the proceeds of the policy in the decedent's estate also exposes them to potential claims from creditors and is therefore not advisable. Thus, the proper ownership of life insurance is critical to avoiding a variety of unwanted tax consequences.

Example

Mary owns a life insurance policy on her husband, Owen. The couple's children are the named beneficiaries of the policy. Mary pays all of the premiums with her own separate funds so that the IRS cannot argue that Owen owned the policy. As a result, the proceeds of the policy will not be included in Owen's estate when he dies. When Owen dies, the proceeds will be paid directly to his children. There will be no estate taxes due on the proceeds. On the other hand, the IRS will find that Mary has made a taxable gift to her children by giving them the proceeds of the policy. If the children turn around and provide Mary with money from the policy to help pay the gift tax, assuming any is due, then they might be deemed to have made a taxable gift to their mother.

2. Life Insurance Trust

Individuals who own a life insurance policy can avoid estate taxes on the proceeds if the policy is transferred to an irrevocable life insurance trust. There are, however, limitations, under federal law. First, to avoid estate tax, the insured must live for at least three years following transfer of the policy to the trust. In addition, in cases where the cash value of the policy exceeds the maximum annual gift exclusion, the transfer will use up part of the insured's gift and estate tax exemption. Having multiple beneficiaries named in the trust can alleviate this problem.

If the individual does not already own a life insurance policy, he or she can avoid the three-year holding requirement by simply having the trust purchase the policy. Remember, the trust must be irrevocable to take advantage of the tax benefits.

B. JOINT TENANCY

Joint tenancy can be a useful probate-avoiding device. It is a way for two or more people to own property together. For estate planning, its most important feature is survivorship: when one joint owner dies, the surviving owner(s) automatically inherit the property. No probate is necessary. Joint tenancy can work well as a probate-avoidance method for property an individual acquires with someone else or if an individual transfers property he or she already co-owns (or is buying) with someone into joint tenancy. While there are exceptions, as a general rule a husband and wife should always hold title to real property as joint tenants.

1. Transfer by Operation of Law

Each of the two or more "tenants" has an equal, undivided interest in the whole account or asset. Most couples own their house and checking accounts in this way. By what is called simply, "operation of law," a decedent's share is automatically transferred to the surviving joint tenant(s) upon the death of the other joint tenant. The transfer of ownership is complete when one of the