

WILL V. LIVING TRUST: UNDERSTANDING THE OPTIONS

Lately, there has been much discussion about the benefits of using living trusts vs. wills. Rarely is information regarding the choice of wills or trusts presented in a fair and objective manner. Proponents of wills often suggest that there is no real benefit from using a living trust in an independent administration state. Proponents of living trusts often overstate the benefits of a trust to the point that his or her information borders on being a scam. This article will give you information in plain English, so that you can make appropriate estate planning decisions, based on your particular situation and priorities.

In essence, both wills and living trusts are designed to do the same thing – to pass on assets at death. Both can be very effective, but they use different methods to do it. Therefore, you need to fully understand these differences in order to decide which method is better under your circumstances.

I. Understanding Wills

A will is a document that sets out the disposition of assets for someone who has died.

1. A will is not made official until (a) the maker dies, and (b) a probate proceeding is filed to confirm the validity of the will and appoint the executor (when needed).
2. Many people falsely believe that if you make a will, you avoid probate. This is not correct. If you make a will the probate generally flows more smoothly in Texas, but it is not avoided.
3. Most horror stories surrounding wills and probate involve situations where there is no will or where the will does not provide for “independent administration.”
4. Texas began the trend toward independent administration, and approximately 2/3rds of the states¹ now allow this option. This does not eliminate probate, but it makes it faster and simpler. There are still several steps to be taken in an independent administration, including: filing the will and an application for probate and appointment of executor, public notices, a formal court appearance, creditor notices, and preparation and filing of an inventory in the public records. It generally takes about 30 days to get the executor appointed in an uncontested case.
5. A will does not have any value for property management while the person who wrote it is alive. If that person is still alive, but physically or mentally incapable of managing his or her affairs, a court appoints a guardian to manage the incompetent person’s assets. This process is always a dependent, or court

¹ Many of the larger states still have fully court supervised probates, such as California, Florida, New York and Illinois.

supervised process, and is usually burdensome and expensive, more so if there is any contest or controversy at all. In many cases guardianship for an incapacitated adult can be avoided when the adult had a good power of attorney, although there are some limitations on managing the estate of another through a power of attorney.²

6. At death, the provisions of the will control any assets that do not pass to beneficiaries by non-probate methods. These non-probate methods include joint tenancy accounts, retirement plan beneficiary designations, life insurance beneficiary designations, payable on death (POD) accounts, transfer on death (TOD) accounts, and similar arrangements. Many people try to simplify probate by using such account arrangements, mistakenly believing that assets will still be distributed under the terms of the will, but they will actually be owned outright by the beneficiary listed with the institution.
7. Passing assets by beneficiary or survivorship arrangements rather than through the will can destroy the tax planning in a will.
8. The state of residence at the time of death determines the type of probate that will be required. Anyone who is transferred frequently or who may retire to another state should consider the type of probate that may be available in the other state.
9. Real estate in another state will require a separate probate for that property in the other state. This is called an “Ancillary Probate Proceeding.”
10. If someone does not leave a will, the court uses the default will built into the state statutes known as “intestate” or “heirship” or “intestate succession” provisions. There are considerable differences in the specific intestate provisions from state to state. A decedent’s assets rarely go to the state. Usually, the assets go to the “nearest relatives” as defined by the statute. Obviously, in the case of second marriages, or “blended” families, this can get quite complicated, and the results may not be what the decedent intended. For example, if the deceased has a child by a prior marriage, “half” of the family home would be owned by his children after death. Assets passing to children will be managed by the court in a separate court case call a “guardianship for minor child” until the child is 18, at which time the child gets the assets with no strings attached. If administration is needed and there was no will, the court will determine who the heirs are and open a dependent administration so that the court can supervise the settlement process. This is typically more expensive and time consuming.

² Because a power of attorney can be revoked at any time, some banks and brokers impose irritating demands and proofs of continued validity at each use. A few institutions simply refuse to honor powers of attorneys. If you are relying on a power of attorney for management in the event of incapacity, you should discuss with each institution in advance its basic policy for accepting the authority of an agent under a POA. Some require special language to be included in the POA before you are disabled.

11. Wills should be prepared by a qualified attorney. Many homemade and internet wills fail to give you everything that is needed, such as independent administration, probate without bringing in witnesses, designations of guardians or trustees for minors, and adequate backup provisions for various other contingencies.
12. Many people now live in a different location than when they made out their will. The universal rule is that if a will was valid when and where it was made, it remains valid even if the testator moves to a different state with different laws. However, any ambiguities or omissions are usually interpreted by the laws of the state of domicile, not the laws of the state where the will was made. Moreover, if the old state did not have independent administration as an option, that will probably does not provide for it to be used. In addition, there are many other state-specific documents (living wills, durable powers of attorney, etc.) that should be created in the new state after each move.
13. The executor is responsible for legally administering the estate appropriately, and is personally liable to anyone harmed by his or her failure to do so. Though state laws differ on whether or not a non-resident can serve as executor, one usually can, but may require bonding or other assurances to the court that the duties will be carried out correctly. The level of court supervision over the executor varies from state to state. In Texas if the will provides for independent administration the executor will receive it, unless the named executor(s) predecease, fail to serve or are disqualified. Any substitute or successor not named in the will may be subject to court supervision.
14. If a will contest is filed, the estate is often placed under court supervision until the lawsuit is settled.
15. All executors must give notice to all known creditors (including those whom the executor should know about with due diligence) and notices must be published in a local newspaper to notify any unknown creditors. Probate proceedings are public records and are open for anyone to see. An executor must file an inventory of assets. This is always a public record. Many people are concerned about setting out a public record (complete with account numbers and balances) of all assets passing at death, out of concern that “bad guys” might exploit a surviving spouse or child.
16. There are simpler types of probate depending on size and type of assets and whether or not there is any contest to or controversy over the will. Small estates of \$75,000 or less in value may be dealt with by a “small estate proceeding,” which is less formal, but still requires an inventory. Texas has a special type of probate called “Muniment of Title” which probates the will (so that it becomes like a document of title), without appointing an executor. This is most commonly used when the estate is simple, there is no need for an executor to conduct sales or make decisions on property division. This is only available when there are no

debts (other than mortgages on real estate). Because this is not a procedure common in other states, it is sometimes cumbersome to try this type of probate when stock transfers or out-of-state personal property interests are involved.

17. Ambiguities or discrepancies in a will, or the clarification or interpretation of a will's provisions, are resolved according to Texas statutory and case law. Each state has different statutory and case law on issues such as who takes an asset if the named heir is dead; what to do about an omitted heir; what to do about apportionment of taxes; etc. In Texas, if all parties agree, heirs and devisees to a will may agree to settle disputes and divide assets according to agreement rather than following the terms of the will.
18. If a will requires it, a trust may be set to receive a part of the probated assets. This is known as a testamentary trust and is usually employed for tax planning purposes, personal asset planning purposes, or to avoid assets going to heirs until they reach a certain age.
19. Wills are amended by codicils, which must meet all the same requirements as a will. A codicil must be executed with the same formalities as the original will. Sometimes it is simpler to do a new will instead. The original will and any codicils must be presented after death; copies are acceptable only in special circumstances.

II. Understanding Living Trusts

Trusts are not new, and have been a part of the legal system for many generations. There is much less state-to-state variation in trust law and its interpretations, so trusts are often more transportable from state to state. In general, while wills rely on the body of statutory and case law for their application and interpretation, trusts are contractual, so that you can write in almost any terms and conditions you want (subject of course to the certain legal limitations, practical common sense and public policy).

1. Trusts can be more complex documents, since you have to set out all of the specifics that are simply assumed in wills. Trusts that can be contained in only a few pages leave a wide opening for misinterpretation and consequent problems later, so they are often longer and more precise.
2. A trust is a contract between the creator of the contract (called a grantor, trustor or settlor), and the trustee who agrees to hold assets, for the beneficiaries. The trustee and beneficiaries can change over time.
3. Each trust must have three necessary parties – grantor, trustee and beneficiary. One person (subject to tax considerations in more advanced tax-planning trusts) could serve all three roles. Married couples can have individual trusts, or may create a joint trust together. In Texas joint trusts are common to avoid splitting up

the community property. Additional planning in the trust language can preserve the separate property nature of assets in the trust or deal with asset protection.

4. As with other contractual arrangements, trusts are not usually required to become public knowledge. Courts exist to resolve disputes if necessary, but absent disputes, the operation of a trust is usually outside of court jurisdiction. This can be of great importance when one of the objectives is to provide protection for a substance-abusing heir, assure privacy regarding estate value, provide incentives for a less-than-ambitious heir, or deal with any other issue that you would not want to be public knowledge.
5. A living trust is the common name used for a revocable inter vivos trust. Since the right to revoke the trust is retained, the trust is essentially the “alter ego” of the grantor and is totally transparent for income tax purposes. A living trust therefore is not required to have a tax identification number or file a tax return while the Grantor is living.
6. A living trust is designed so that assets in the trust (or passing to it by beneficiary provisions at death) are not a part of the probate process. This only works if ownership and beneficiary provisions are properly put in place during life. Assets will not avoid probate if they are trapped in the owner’s name at death, having never been titled in the trust.
7. Once assets are transferred to the trust, the trust is the legal title owner of the assets, not the grantor. Depending on the type of asset, you use whatever method of titling is necessary to transfer ownership to the trust. For example, for real estate, use a deed; for a bank account, the account application form; for a securities account, the new account application; for a motor vehicle, the title; etc. This process is known as “funding” and is essential to the proper operation of a trust.
8. Often inexpensive legal services or do-it-yourself trusts fail miserably in funding. In fact, most of the living trusts created to date are not funded. A “pour-over” will should be created which provides that all assets not in the trust (and thus subject to probate) are given to the trust as a result of the probate process. This will give you a backup for minor errors, and can usually utilize the small estates or muniment of title proceeding. It is foolish, however, to go through the time, effort and expense to create a living trust and not to fund it.
9. Qualified plans and IRAs are never transferred to a trust while the grantor is alive (that would trigger income taxes) but a trust can be a beneficiary of a retirement plan if appropriate. This is a complex area of planning and requires expert advice. When done properly, the trustee can still rollover part to a spouse, partially fund a bypass trust without triggering the income tax, and utilize “spread IRA” techniques.

10. In a traditional living trust, the grantor usually retains all rights to manage the trust as he or she wishes while alive and mentally competent. Assets can be added, taken out, sold, used, etc. without asking or telling anyone, and without any tax consequences.
11. The first benefits of a trust come to light when the grantor cannot legally manage the trust because of mental disability or death. The typical living trust provides that if the trustee is unable or unwilling to serve as trustee, then a successor trustee will take over and continue to manage the trust. If the grantor named successor trustees (which is always done in well-drafted trusts), the successor assumes management duties and responsibility whenever the original trustee becomes disabled. Management of a trust as a successor trustee is generally much simpler than management of a disabled person's assets through use of a power of attorney.
12. Since the trust is a contract, the grantor can determine what criteria will be used to determine disability. Usually, a well-drafted trust will allow two licensed physicians to sign a written statement that the grantor has lost the ability to carry on his or her affairs, which will serve to transfer authority to the successor trustee. No court action is necessary, and the costly and burdensome requirements of a guardianship are avoided. Usually, the backup trustee is a family member (such as an adult child or a brother or sister), with a list of further successors named as desired.
13. It is never necessary to name a bank or other outside entity as backup trustee unless it has been determined that such an independent trustee would be appropriate for the circumstances. Usually these circumstances arise when:
 - (a) There are no family members available to serve as a backup trustee;
 - (b) The assets or tax issues are sufficiently complex to require the certainty of competence an institutional trustee would bring;
 - (c) Family disputes or irresponsible heirs would benefit from having a professional trustee; or
 - (d) You question whether a family member is adequately trustworthy.
14. At the death of the grantor, the terms of the trust determine who is to get the benefit of the trust. The assets can be distributed to the new beneficiaries in any amounts, manner or methods the grantor chooses. The distribution is private and does not need any court supervision.
15. Funding a trust yourself during life can be much simpler than having someone else transfer your assets to a testamentary trust upon death for many reasons, including the following:

- (a) You are more familiar with the assets, or you have the benefit of input from both spouses; and
 - (b) Transfer based on your signature is simpler than the red tape required of an executor.
16. The successor trustee can step in immediately after death and write checks or take care of other business and does not have to wait to be appointed executor by the court.
17. Trust contests are possible, but much less common and more difficult to pull off than will contests. Moreover, the trust assets generally are not immediately frozen upon a contest, as are estate assets.

III. Comparing Wills and Trusts

Wills and trusts are essentially two different tools that accomplish the same goals. Deciding which tool is better for you depends on how you value the different advantages and disadvantages of each one. Whether done through a will or a living trust, the owner can choose to have the assets, or portions of the trust, remain in trust for a variety of reasons after death, such as to:

- Provide for a spouse, siblings, elderly parents, etc;
- Provide basic tax planning (a credit shelter trust a/k/a A/B trust);
- Ensure that at the death of a spouse, any remaining assets will go to the grantor's children, not to someone else (a QTIP trust);
- Provide personal, tax and/or asset protection for heirs;
- Keep assets from heirs until they reach certain ages; or
- Provide instructions that require expenditures that perpetuate the grantor's values (e.g., money is to be used for education, investing, etc., rather than be spent frivolously).

Table 1 shows a comparison of the advantages and disadvantages of each.

As a planning vehicle, wills are usually easy and cheaper up front, but more effort and expensive later on, while living trusts are more work and more expense up front, but usually much less work and expense later on. Wills are back-loaded, with the heirs assuming the burdens while living trusts are front-loaded, with the effort and expense up

front, leaving less burden on a surviving spouse, children or other heirs later. Table 2 lists various factors that would tend to favor one or the other planning tool.

Deciding which tool is more appropriate depends on many factors. A choice that is more appropriate now may not be later because of different domicile, circumstances or desires.

TABLE 1		
Areas of Concern	Will	Living Trust
Privacy	No privacy, all proceedings and documents are public.	Is private unless court intervention is necessary, usually due to improper or deficient drafting.
Disability	No provisions at all for disability. The disabled person's assets will be subject to the court process for guardianship. A power of attorney is essential in a will-based plan, and can be used successfully but may require more effort.	The trust continues to privately manage assets if the grantor becomes disabled, without any need for court involvement.
	Medical powers of attorney can prevent the necessity of a guardianship for health issues only.	
Tax Planning	Neither wills nor living trusts require any difference in current income tax rates or reporting requirements. Technically, both wills and trusts can accomplish exactly the same degree of estate tax planning. However, for will-based estate tax planning to be effective, you must ensure that the assets are correctly titled to pass through probate (i.e., you cannot use extensive joint tenancy, beneficiary designations, etc. to avoid probate). Failure to do so may make the tax planning provisions in a will practically worthless. Also, funding of trusts created by a living trust is usually quicker and easier than a testamentary trust funded through the probate process. Often when a living trust is correctly and completely employed, the details of asset transfer are more likely to have been done thus resulting in its being more likely that maximum tax advantage is taken. For estates with tax issues, the client may have to rearrange accounts and beneficiary designations whether using a will or a trust.	
Disposition of Assets at Death	Both wills and trusts can be used for immediate disposition or for creation of subsequent trusts. For such dispositions in trust, you are limited only by the requirements that the trust so created be for a legal purpose which does not violate public policy and that its provisions are enforceable. This is done in public through the probate process for wills, or in private for living trusts. Wills usually take longer than living trusts to settle and incur more costs through probate transfers.	
Creditor Protection	None while alive. At death if a creditor has knowledge of the probate proceeding and does not make a claim within a specified amount of time, the claim will be forever barred. The executor is required, however, to contact the creditor and give it notice.	None while alive. No creditor claim shut-off exists for living trusts, but rarely does this theoretical issue come up, as almost all persons direct (either through wills or trusts) that valid debts be paid.
Effort Required	Little now (unless you are attempting to do tax planning via a will which would require retitling of assets); however there is usually quite a bit by your surviving spouse, and then by the final recipients after disability or death.	Some effort now to transfer assets to trust ownership. Usually far less effort after each death.
Cost Now	Usually small, if no tax planning is needed. The cost difference between wills and living trusts diminishes if you are doing tax planning.	Moderate, if no tax planning is needed. The cost difference between wills and living trusts diminishes if you are doing tax planning.
Cost Later	Can be little, especially for simple estates (although the cost of one probate is often similar to the cost of a living trust without tax planning). Remember that a probate is generally needed after the death of each spouse. Can be extremely high (i.e. contested probate, ancillary probate, conservatorship, etc.).	Usually minimal.

In Texas, Factors Pointing Toward One Method or the Other	Will	Living Trust
Limited Current Cash Flow	X	
Younger Clients	X	
Older Clients Who Will Not Need an Administration*	X	
Limited Assets	X	
Simple Disposition of Assets at Death	X	
Likelihood of Moving to Another State		X
Older Clients Who Will Need an Administration		X
Likelihood of Disability		X
More Sophisticated Disposition of Assets at Death		X
Privacy Issues		X
Desire to Make Everything as Easy as Possible for Survivor(s)		X
Out-of-State Real Estate		X
Non Prorata Dispositions		X
Out-of-State Executors/PRs		X
Tax Planning		X

*Probate may be unnecessary if there is no real estate and all assets pass in a non-probate manner at death. This technique generally should not be utilized, however, for spouses that need tax planning.