

**Consumer Legal Guide**

# **Your Guide to a Living Trust**



**ILLINOIS STATE  
BAR ASSOCIATION**

## WHAT IS A LIVING TRUST?

Most of us share the same objectives for our estate plan: 1) Provide for our spouse or dependent children; 2) distribute our property; 3) plan for our disability; 4) organize our finances; and 5) reduce our estate taxes. Unfortunately, most of us fail to put together a plan that achieves these goals. There are many approaches that can be used; some are relatively simple, while others are quite complex. The choice of the right plan for your situation requires careful consideration after receiving qualified professional advice.

This pamphlet attempts to answer your questions about one of the most popular estate planning alternatives: the revocable living trust. The answers to these questions will give you a general overview of the advantages and disadvantages of using a living trust as your primary estate planning document.

## WHAT IS A TRUST?

A trust is a legal document designating a person or corporation to act as a trustee to receive and hold legal title to property and administer the property in accordance with the instructions in the trust document. The person who creates the trust is known as the “grantor” or “settlor” or “trustor.” The persons who receive income or other distributions from the trust are called “beneficiaries.”

## WHAT IS MEANT BY A “LIVING TRUST?”

A living trust (also called a “grantor trust” a “revocable trust” or an “inter vivos trust”) is created during your lifetime and is revocable (capable of being changed, amended, or terminated). You can act as trustee and have broad powers to invest and use the trust fund. If you become incapacitated, the trust provides for a successor trustee to manage the trust assets. Upon your death the living

trust contains instructions for the distribution of your assets, just as a will would. The primary difference between a living trust and a will is that assets held in trust do not have to go through the probate process. When you set up a living trust, you transfer your assets to the trust, and the trust is considered the owner of your assets. When you die, there is no probate because the trust is considered the owner of the assets and not you. The assets are then distributed according to the instructions in the trust.

## **WHAT IS PROBATE?**

Probate is a legal process for managing estates of decedents and disabled persons. A court appoints and supervises a responsible individual or trust company, usually as designated by you in your will, who administers and distributes assets. If you have a will, the person appointed is called an “executor,” and if you do not have a will, then the person appointed is called an “administrator.” Probate has the advantage of involving a judge to help sort out disputes and supervise unsophisticated executors. It also has standard procedures for the orderly payment of claims and distribution of assets. Because a court is involved, probate can be somewhat cumbersome, with the need for preparation of special court documents and attorney appearances in court. With a sophisticated trustee or when all the beneficiaries are in agreement, avoiding probate may be desirable.

## **IF I HAVE A WILL, DO MY ASSETS HAVE TO GO THROUGH THE PROBATE PROCESS?**

It is a common misconception that having a will avoids probate. A will does not avoid probate, but there are advantages to having one. A will names an executor to handle your affairs and provides him or her with a set of instructions for distributing your assets. An important feature of a will is that it is inactive until time of death, while a trust (which is intended to avoid probate) needs to be funded and maintained during your lifetime.

Also, a will is the best way to name a guardian for minor children. In Illinois, if the assets in your estate titled in your individual name have a value of less than \$100,000, then your will does not have to be probated. Your assets can be distributed after an attorney prepares a small estates affidavit. To avoid probate with an estate worth more than \$100,000, your property must either be held in a trust or pass directly to a beneficiary by operation of a beneficiary designation or pursuant to some special type of property ownership, such as joint tenancy.

## **IS JOINT TENANCY AN EFFECTIVE WAY TO AVOID PROBATE?**

Probate can be avoided by holding property in joint tenancy with another person, but there are several disadvantages to this. To sell real estate, stocks and many other types of assets held in joint tenancy during your lifetime, you must have the signature of both joint tenants. Thus, if your joint tenant is uncooperative or becomes incapacitated, you cannot readily sell or transfer your assets. Bank accounts can be more of a problem because your joint tenant has the right to withdraw funds at any time without your consent. In addition, if your joint tenant has creditor problems, the creditor can garnish the jointly held asset to satisfy the debt. Finally, adding someone as a joint tenant may be considered a gift to that person and a gift tax may be imposed. In summary, although there are advantages to using joint tenancy, they are usually outweighed by the disadvantages.

## **WHO CONTROLS THE ASSETS OF A TRUST?**

The trustee named under the trust controls the assets of the trust. In a living trust, the individual who creates the trust typically acts as trustee, thus you can act as your own trustee. When this is the case, you retain broad powers to control and use the assets of the trust. When someone other than you

is the trustee, the trust sets forth specific instructions for the investment and use of the trust assets. Typically you will also be the beneficiary of the trust during your lifetime. That means that you have the right to receive all the income of the trust. This is true whether you or someone else is acting as trustee. So long as you are acting as trustee, no income tax returns nor accountings are required. You may appoint someone other than yourself to act as trustee if you feel you want your assets professionally managed, or if you want them in the hands of an independent party.

## **WHAT HAPPENS IF I BECOME INCAPACITATED?**

One of the great advantages to a living trust is that it provides for comprehensive disability planning. If you become incapacitated, a living trust provides for a successor trustee to take over the control and maintenance of the trust. The successor trustee invests the trust funds and uses them for your benefit, according to the instructions in the trust. No other disability plan provides these complete instructions. The successor trustee cannot use the assets for his or her own benefit, although he or she may receive compensation (if allowed under the terms of the trust). Additionally, the trust avoids the necessity of having a family member or other person named as a guardian by the probate court to manage your assets.

## **CAN A LIVING TRUST AVOID DEATH TAXES?**

Both a living trust and will can be used to reduce or eliminate death taxes under certain circumstances, and especially for married couples. Tax saving clauses that are included in your living trust are virtually identical to the tax saving clauses that would be included in your will. However, in addition to potential tax savings derived from a comprehensive estate plan, a living trust can also assist in organizing your finances. Thus, a living trust is well suited to both of these purposes.

## **HOW DOES A MARRIED COUPLE INCORPORATE TAX PLANNING INTO THEIR ESTATE PLAN?**

Gifts between spouses are generally non-taxable regardless of the amount. If all of your property passes to your spouse upon your death, no estate tax is paid. Upon the death of your surviving spouse, however, estate taxes may be due. Both you and your spouse are allowed an exemption on your estate taxes. The amount of the exemption is gradually increasing over the next years pursuant to the 2001 Tax Act as follows:

2002-2003: \$1,000,000

2004-2005: \$1,500,000

2006-2008: \$2,000,000

2009: \$3,500,00

2010: No estate tax-repealed

2011: \$1,000,000 for all years after 2010.

The applicable exemption is determined in the year the individual dies. If your surviving spouse leaves an estate of less than the applicable exemption, no estate taxes will be due. However, without proper planning, an estate tax may be due if the surviving spouse's estate exceeds the applicable exemption amount – and estate taxes are very steep. The goal, therefore, of estate tax planning for married couples is to take advantage of the applicable exemption of both spouses, thus doubling the amount that can be left estate tax-free.

## **HOW DO WE TAKE ADVANTAGE OF BOTH EXEMPTIONS?**

In order to take advantage of both exemptions, the first spouse to die must leave assets which are not included in the estate of the surviving spouse. This can be done by leaving up to the applicable exemption amount in a trust from which the surviving spouse receives income, but does not have direct control of the assets. Upon the death of the surviving spouse, the trust assets pass to the couple's heirs or other beneficiaries. The assets in this exempt trust, including appreciation in value,

are not included in the estate of the surviving spouse and not subject to the estate tax. Thus, when the surviving spouse passes away, his or her own applicable exemption will be applied to his or her estate.

## **CAN I PLAN FOR ESTATE TAXES IF I AM NOT MARRIED?**

Single persons cannot shelter twice the applicable exemption from estate taxes in the same way as married couples, but there are other methods of reducing estate taxes. These methods are centered around making gifts during your lifetime to reduce the size of your estate. Normally the gifts are made to the persons who would receive your property at the time of your death. The tax rules regarding gifts are very complex, and, therefore, a competent estate planning attorney should be consulted for a full explanation of the alternatives.

## **DOES A LIVING TRUST SPEED UP THE DISTRIBUTION OF MY ASSETS?**

Probate estates usually remain undistributed for at least six months after the probate process has started to allow creditors an opportunity to present claims. A partial distribution can be made within the first six months if family members are in need. The trustee of a living trust has the same responsibilities as an executor in a probate administration: identify and transfer assets, render an accounting, pay creditors, file and pay death and income taxes, and resolve any pending litigation. Usually this will take roughly the same amount of time as administering a probate estate. If a Federal Estate Tax return is due, the trustee or executor may elect not to distribute all of the probate or trust assets until the return is audited and the tax paid. Probate can be delayed by disputes in court. A living trust does not automatically protect the trust assets from a dispute. Dis-

appointed family members or creditors may file a lawsuit against the trust which could delay distribution. Often, whether it is a trust or probate estate, the time for distribution depends upon how long it takes to liquidate the assets. For example, real estate will normally take longer to liquidate and distribute than will bank accounts.

## **CAN I AVOID CREDITORS WITH A LIVING TRUST?**

Your assets cannot be “hidden” from your creditors by putting them into a living trust. At the time of your death your trustee will pay off any final expenses and debts that may be outstanding. Moreover, while you are living, you retain complete control over the trust assets and therefore, they will, for example, be included in any calculation to determine if nursing home care is to be paid for by public aid.

## **IS A TRUST MORE PRIVATE?**

Like most court records, probate files are open to the public. Anyone can go to the courthouse and review your probate file; however, as a practical matter, this rarely happens. In Illinois, under modern probate procedures (called “independent administration”) an inventory and accounting do not have to be filed with the court, and therefore the key documents showing the assets of the decedent are not made public. A living trust provides the ultimate in privacy because it does not pass through probate at all.

## **WILL A LIVING TRUST SAVE ME MONEY?**

The cost of preparing a living trust as part of your estate plan is generally about the same as incorporating a similar estate plan in a will. There may, however, be additional costs associated with creating a living trust. These generally include the preparation of additional documents required to transfer assets

into trust name and fund the trust. Although it costs somewhat more to have a living trust prepared and funded than to have a will prepared, the cost savings from a living trust occur after the death of the grantor. Because there is no probate involved, there are no court costs and no attorneys fees for preparation of documents or court appearances. In some instances these savings are substantial. Even without probate there may be fees for attorneys, accountants and other professionals who assist the trustee in liquidating and distributing the assets of the trust. The trustee is normally entitled to a fee, just as an executor or administrator would be.

## **ARE THERE ANY SPECIAL ADVANTAGES TO HAVING A LIVING TRUST?**

A living trust is especially useful if you own real estate in more than one state. The general rule is that real estate is probated where it is located. Owning real estate in more than one state will give rise to one main probate administration in the state of your legal residence and another (called “ancillary administration”) in each additional state in which you own real estate. If you own a second home, vacation residence or any other real estate outside your home state, a simple form of living trust to avoid ancillary probate of that real estate frequently is appropriate.

## **HOW DO I FUND MY LIVING TRUST?**

The primary disadvantage to a living trust is that it must be funded to be effective. The trust controls only the assets which are registered in its name, so all of your assets must be transferred to the trust. This is not a problem when the trust is set up, but every time you acquire or exchange assets, you must make sure they are registered in the name of the trust. Any assets that have not been transferred to the trust before your death will have to pass through probate, thus negating one of the primary advantages to having a living trust. The amount of time and fees associated with re-

titling property depends upon the number of assets, the type of assets, where they are located, and how they are titled.

For example, if you and your spouse are doing tax planning, you have to decide how to divide joint tenancy property. Deeds for real estate and bills of sales for personal property need to be prepared. If stocks and bonds are held in certificate form, stock powers must be prepared and delivered to the transfer agents, who are frequently out of state and often operate under varying rules. Transfers of closely-held business interests to a living trust may present special problems which require a very careful analysis, particularly if the interests are subject to some form of restriction, stock redemption, or stock purchase agreement. To fully fund the trust, all assets for which you have title documents must be transferred to the trust.

## **IS IT NECESSARY TO FUND MY LIVING TRUST?**

Some attorneys who recommend living trusts prefer to leave the trust unfunded until a later “triggering” event such as a major decline in health. When the trust is created you sign a power of attorney to your successor trustees which enables them to transfer assets from your name to the trust when you become incapacitated. You also execute a will which leaves all your assets to the trust. (These documents are normally prepared even with a funded trust in case assets are acquired later outside the trust.) This arrangement avoids the headaches, paperwork, and expense of funding the trust when it is created. An unfunded trust does not avoid probate, but has all the other advantages of a funded trust, and probate itself can be a simple process. Unfunded trusts are also private. If anyone did look up your will at the courthouse, they would know only that your will left your assets to the trust. Disposition of the trust’s assets would be private. Many people find this easier than the pre-death process of transferring and keeping assets in the name of the trust.

## HOW DO I CREATE A LIVING TRUST?

It is always important to have appropriate professional advice in tackling something as complicated as a living trust. In Illinois, only attorneys are allowed to assist in this process. If you need help finding a lawyer, see information on back panel concerning Illinois Lawyer Finder.

## CONCLUSION

The use of a living trust is an important estate planning option. While a living trust can serve a number of valid purposes, it is generally not the only answer. Simply executing a living trust will not materially affect the disposition of your assets, will not save death taxes and may not reduce administration costs after your death. On the other hand, a well-prepared living trust as part of your overall estate plan has many benefits and will facilitate the implementation of a plan that meets your goals.

If you're looking for an Illinois lawyer, look to **IllinoisLawyerFinder.com**



Find a lawyer near you 24/7 on the Web at **IllinoisLawyerFinder.com** or call us from around the state at **217-525-5297** or **800-922-8757** Monday through Friday from 9:00 a.m. to 4:00 p.m.



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Every effort has been made to provide accurate information at the time of publication.

For the most current information, please consult your lawyer. If you need a lawyer and do not have one, call Illinois Lawyer Finder at (800) 922-8757 or online **[www.IllinoisLawyerFinder.com](http://www.IllinoisLawyerFinder.com)**

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