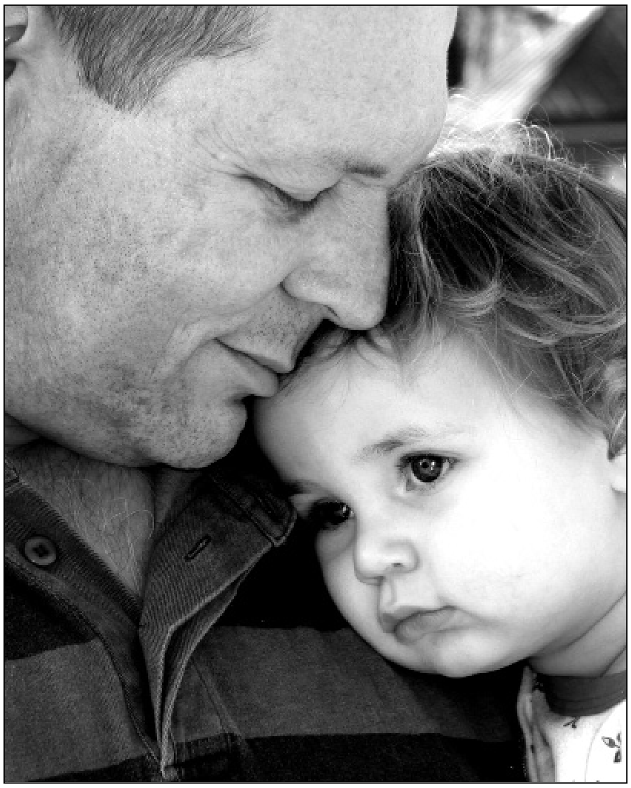
The Montana Lawyer
The State Bar of Montana
May 2011
Volume 36, No. 7



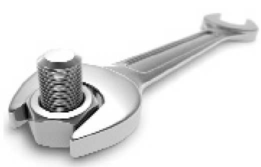
Rethinking living trusts

Montana attorney says it's time to reconsider the unfunded-trust taboo

© Anita P Peppers - Fotolia.com

Law-practice tools

Tips from experienced attorneys



Modest Means

How to join the State Bar program

See application form inside

The Russian mob meets a high-tech courtroom (finally)

A Tatarstan judge visits Montana & tells the story

The fate of Bar-watched bills as Legislature adjourns

A second look at living trusts

The old taboo against ‘unfunded’ trusts is lifted

By **Richard M. Baskett**
Missoula attorney

At one time, most property of a decedent passed through court-supervised probate, and the central estate-planning document was the will. The property of anyone dying with a valid will passed as provided by the will; the property of anyone dying without a valid will passed as provided under the state’s intestacy statutes. Either way, the decedent’s property passed in accordance with the laws of probate, which had built into them protections for the heirs. But these protections also came with costs and delays; many people came to look for means by which they could avoid probate in order to save time and money in passing on their property. The idea was to make things simpler.

The traditional use of living trusts

Living trusts (also referred to as revocable trusts) have been promoted for many years as a means to avoid probate. They often failed to achieve that goal, however, because they were not fully funded upon creation, or if fully funded then when assets subsequently were acquired they were not put into the trust. As a result, upon the death of the settlor (the person creating the trust) there often were assets held outside the trust. A probate had to be opened for those assets, and the probate-avoidance goal had not been achieved.

For this reason, an “unfunded” living trust was often considered to be undesirable.

A second failing of living trusts was with settlors who did not like to deal with assets through their trusts. They had been used to owning assets in their own name and either were confused by or did not like the necessity of dealing with their property through their trusts. This frustration sometimes resulted in the trust being revoked.

Other probate-avoidance devices

Other means to avoid probate developed over the years. Joint tenancy has long been available, as have beneficiary designations in life-insurance policies and retirement plans. Of more recent origin are Payable on Death (POD) beneficiary designations for bank accounts, Transfer on Death (TOD) beneficiary designations for security accounts, and, since 2007, beneficiary deeds for real estate. As the use of these probate-avoidance devices increased, the significance of wills declined. These means of avoiding probate have their own disadvantages, however. For example, joint tenancy can have drawbacks when it is used between parent and child.

> **Example 1:** Parent had three children, only one of whom (Child 1) lived in town; the others lived across the country. Parent put Child 1 on Parent’s bank account as a joint tenant so that Child 1 could pay Parent’s bills. When Parent died, the bank account passed automatically to Child 1 to the exclusion of Child 2 and Child 3. Is that what Parent intended? Child 1 thinks so; Child 2 and Child 3 do not.

> **Example 2:** Same facts as Example 1 except that Parent is still alive. Child 1 gets into a terrible car accident, resulting in deaths of other people. Child 1 is sued and a large judgment is obtained against him. The judgment creditors of Child 1 are now seeking to attach the bank account on which Child 1 is joint owner with Parent.

Beneficiary designations on life insurance policies, retirement plans, POD accounts, and TOD accounts usually use forms provided by the company holding the asset, each with its own default provisions as to what would happen in the event one of the beneficiaries did not survive until the death of

ABOUT THE AUTHOR: *Rick Baskett is an attorney and CPA at the Baskett Law Office in Missoula. He obtained his initial tax experience in the tax department of Price Waterhouse in New York City and Baltimore. A former general counsel for Washington Corporations, he worked for tax law firms in Baltimore and Washington, D.C., before returning to Missoula and his present practice. He has been adjunct lecturer of Partnership Taxation at the University of Montana School of Law and has spoken at various continuing-education courses on tax. He maintains a private practice emphasizing estate planning, probate, business and tax issues, and speaks regularly on tax and estate planning topics.*

the asset owner.

Example 3: Parent had made a TOD designation of Parent's stock accounts held at three different brokerages. The TOD designations provide that Child 1, Child 2, and Child 3 are to be equal beneficiaries upon Parent's death. Each Child has children (Parent's grandchildren). Child 1 dies before Parent. Should Child 1's share go to Child 1's children? Or be added to the shares provided for Child 2 & 3? Brokerage A has a default provision that Child 1's share goes to Child 1's children, while Brokerage B's default is that it is divided between Child 2 and Child 3, and Brokerage C's default is that it goes to Parent's probate estate to be distributed from there.

An additional problem arises when the account owner wishes to change the shares of the beneficiaries and there are multiple beneficiary designations. To effect the change, the account owner now has to revise each beneficiary designation.

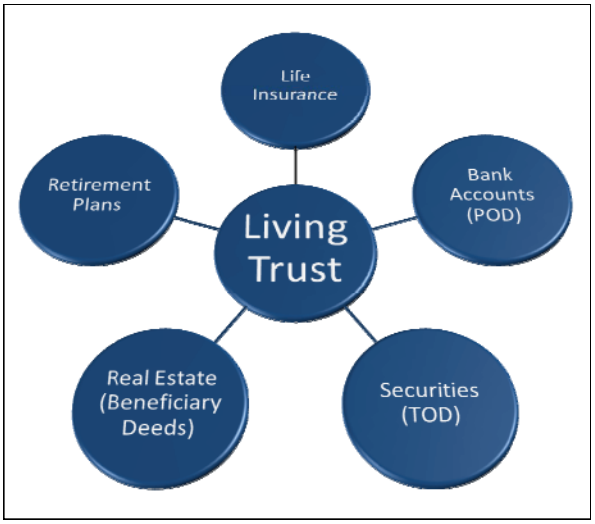
Example 4: Parent has designated Child 1, Child 2, and Child 3 as equal beneficiaries of her life insurance policy, her two stock accounts (using a TOD designation), and her three bank accounts (using a POD designation). Child 2 has made a fortune and has no need of the money from Parent. In order to benefit just Child 1 and Child 3, Parent now has to amend six different beneficiary designations.

Another problem can arise from the use of beneficiary designations that have not been coordinated with formula clauses in wills and trusts. A common estate-planning objective is to set aside property in a trust at the death of the first spouse so that the property in that trust can be used for the benefit of the surviving spouse, yet not be counted as part of the surviving spouse's taxable estate. Formula clauses are used to make sure the desired amount of property is set aside for that purpose. With multiple beneficiary designations and joint-tenancy property, the formula may not achieve the desired results, because beneficiary designations and joint tenancy override the provisions of the will or trust.

Example 5: Husband has a will leaving an amount equal to the current estate tax exemption in trust for Wife, with any excess passing outright to Wife. The trust is intended to be used for Wife for her lifetime, and upon her death to pass to their children, and is structured so that it is not taxable at her death as an asset of her estate. However, all of Husband's assets are either titled in joint tenancy with Wife or have beneficiary designations naming her as beneficiary. Upon Husband's death, all of his assets pass outright to Wife, with none passing into the trust and as a result, upon Wife's death, her taxable estate exceeds the estate tax exemption. Upon Wife's death estate tax is due that could have been avoided had some of Husband's property passed at his death into the trust that was to be used for her benefit.

Answer: Use an unfunded living trust

Ironically, the use of various probate avoidance devices – originally intended to make things simpler – has created more complication than ever before. They can achieve the purpose of avoiding probate, but often at unnecessary tax cost or in frustration of the decedent's intent. When most property passed through probate, the will was a central document controlling disposition of a decedent's assets. Today, with the multiplication of probate avoidance devices, it is important to try to regain centralized control.



The unfunded living trust – long considered a bad thing – may be just the solution. The plan is to create the trust and transfer few if any assets into it, but designate it as the beneficiary of the settlor's real estate, bank accounts, brokerage accounts, life insurance, and sometimes even retirement plans, and back it up with a pour-over will. In general, do not name individuals as the beneficiaries; rather, name the living trust (actually, the trustee of the living trust). Doing so will provide multiple benefits:

- The settlor will not have to administer the living trust, transfer assets into it, or deal with buying and selling assets in the name of the trust.
- The beneficiaries have no ownership rights in the property while the settlor is alive.
- The settlor continues to own property in his own name, completely free to sell, give away or encumber the property without having to deal with co-owners, which would not be the case with joint-tenancy property.
- If a beneficiary has creditors, those creditors will have no right to reach the settlor's property. If the property were held in joint tenancy, creditors might attempt to seize it.
- The settlor can provide in the living trust what is to

More *LIVING TRUSTS*, Page 27

Cover grrrrr

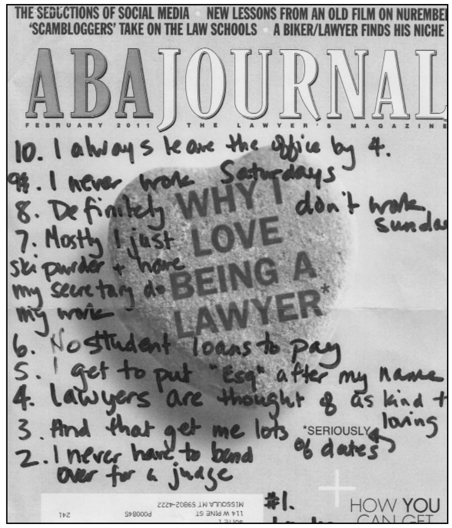
Someone at a Missoula office building – it just had to be a lawyer – decided to "personalize" a cover of the *ABA Journal*, said Missoula attorney Amy S. Rubin.

The February 2011 *Journal* cover photo was of a valentine candy heart with the words "Why I Love Being a Lawyer." The title was asterisked to a subtitle that said "*seriously."

We don't know what the ABA's love list consisted of, but the Missoula office wag's list could have been asterisked "*facetiously."

The latter list about Why I Love Being a Lawyer, scrawled in Sharpie over the *ABA Journal* cover, says:

10. I always leave the office by 4.
9. I never work Saturdays.
8. Definitely don't work Sundays.



7. Mostly I just ski powder and have my secretary do my work.
6. No student loans to pay.
5. I get to put "Esq" after my name.
4. Lawyers are thought of as kind and loving.
3. And that gets me lots of dates.
2. I never have to bend over for a judge.
1. I makes tons of $$!

"It was done so well that at first I thought it was perhaps legitimate – and that this was the actual magazine cover," Ms. Rubin wrote to *The Montana Lawyer*. "However, I wondered about the ABA publishing such a humorous (albeit facetious) cover," she said.

Ms. Rubin's office is in a hallway of 12 office spaces, four of which are rented to lawyers, all solo practitioners, she said.

"After several days of questioning among the lawyers, we finally figured out who was responsible," Mrs. Rubin said. It was *not* one of the attorneys. It was Geraldine Carter, the administrator of a nonprofit down the hall, who obviously wanted to jab a lawyer, or four, in the ribs.

LIVING TRUSTS, from Page 7

happen if a child (or other beneficiary) dies before the settlor (or some other event). It will not be necessary to provide language for each separate beneficiary designation; it will all be coordinated by the living trust agreement.

- The settlor can amend one document – the living trust agreement – at any time without having to amend multiple beneficiary designations when there is any change.
- With all the property coming to the living trust at the time of death, any formula clause in the living trust agreement would not have to be coordinated with outside beneficiary designations or joint-tenancy arrangements.
- If it is eventually determined that it is advantageous for the settlor (or the settlor's agent) to fund the living trust while the settlor is still alive, the living trust is already in place.

Some assets do not have beneficiary designations available, and it may be appropriate to transfer those into the living trust while the settlor is alive. For example, personal and household effects might be transferred into the trust by a bill of sale upon creation of the trust. For other assets, it may continue to be preferable to name an individual beneficiary; designating a spouse as beneficiary of a retirement plan might be one time this would apply.

This is not a plan that will work in every instance, but with some exceptions, by using an unfunded living trust, the settlor can have all the benefits of avoiding probate, while continuing to own and manage assets directly rather than through a trust. It's worth a second look. ❍