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LIVING TRUSTS

Revocable living trusts, sometimes also called “intervivos trusts,” can be an effective estate planning tool. This brochure will explain what a living trust is, how one is created, its effect, and under what circumstances a living trust may be most appropriate. For purposes of this brochure, a revocable living trust will be referred to as “living trust.”

Who is involved in a living trust?

Trustmaker(s): the person or persons who create the trust agreement while living

Trustee(s): the person or persons who are responsible for carrying out the instructions set out in the trust agreement

Successor Trustee: the person or persons named to step in when the original trustee(s) are unable or unwilling to serve

Beneficiary: the person or persons who are to benefit under the terms of the trust agreement

What is a trust?

A trust is a written agreement (or contract) between the trustmaker and the trustee under which the trustee holds and manages property for the benefit of the beneficiaries chosen by the trustmaker. In a living trust, the trustmaker is often also the trustee and the beneficiary during their life.

Like a will, a living trust is a set of directions. Unlike a will, it provides direction to the trustee about how the assets are to be distributed and managed during the trustmaker’s life and upon the trustmaker’s mental incapacity. Like wills, living trusts include directions for how the remaining assets are to be distributed upon the trustmaker’s death.

Can a living trust be changed?

A living trust may be revoked or amended at any time while the trustmaker is alive and able. After a trustmaker dies, however, his or her trust becomes irrevocable, which means it cannot be changed.

The information provided in this document is meant for the sole use of Active Duty service members, retirees, their families, and those individuals eligible for legal assistance. The information is general in nature and meant only to provide a brief overview of various legal matters. Rights and responsibility vary widely according to the particular set of circumstances in each case. Laws can vary across states, services, and civilian jurisdictions and laws are changed from time to time. Do not rely upon the general restatements of background information presented here without discussing your specific situation with a legal professional.

What is trust funding?

Trust funding refers to the retitling or acquiring of assets in the name of the trust. The trustmaker conveys all or some of his property to the trustee so that the trustee becomes the owner of the property subject to the terms of the trust agreement. Once property is properly titled, the trustee may manage and distribute the property as instructed in the trust agreement.

A trust may be created, but may never be funded or not funded completely. It is common for the trustmaker to execute a “pour-over will” in conjunction with their living trust. This will direct all of the trustmaker’s property that is not properly titled in the name of the trustee to be distributed to the trust.

When is a trust appropriate?

Living trusts are not just for wealthy people. A living trust is an effective estate management tool before and after a trustmaker’s death, and allows for a safe way to manage and use trust property for the benefit of the trustmaker and his chosen beneficiaries.

Living trusts provide additional benefits, particularly when the trustmaker owns real estate in different states or becomes incapacitated.

How can a living trust provide protections for mental incapacity?

A properly drafted living trust often includes terms that protect the trustmaker and their property if the trustmaker becomes mentally incapacitated. The trustmaker can name a successor trustee to manage the trust property upon their incapacity. The living trust instructions can provide the successor trustee with guidance on how property is to be managed, bills are to be paid, and the how the trustmaker’s support and maintenance needs are to be met. This can prevent the trustmaker’s loved ones from having to go to court and be appointed as a guardian and/or conservator for the trustmaker.

How is a living trust administered upon death?

A living trust commonly includes instructions on how to administer the trust property upon the trustmaker’s death. Instructions can include terms that allow for beneficiaries to receive the benefit of trust property in a manner that protects them from their creditors and maximizes the benefit of the trust property for the beneficiary.

Like a living trust, a will includes instructions for the distribution of a decedent’s estate. However, a will must be probated. Probate is the legal process during which a judge validates the will, gives the personal representative the authority to act on behalf of the decedent’s estate, and supervises (either informally or formally) the process of distributing the decedent’s property and paying their valid debts. Probate cases are generally included in the public record. Unlike wills, a trust administration does not require court involvement and allows for a private distribution of the trustmaker’s property.

Having a living trust in place at the trustmaker’s death does not mean that the trustmaker’s survivors will be able to avoid a probate action. If the living trust is not properly funded, the property outside of the trust will need to be transferred into the trust through the use of the pour-over will and a probate action. After the pour-over will is probated and the property is transferred into the trust, the trustee will then distribute the property per the instructions provided in the trust agreement.

How are living trusts taxed?

Income tax during the trustmaker's life. With the exception of certain retirement assets, the transfer of property to a living trust does not cause the recognition of a gain for income tax purposes. The trustmaker is treated as the owner of the living trust property because he or she has the right to amend or revoke the living trust and reclaim the trust property in his or her individual name. Additionally, the living trust uses the trustmaker's social security number for its tax identification, and so no special income tax filing is necessary for the trustmaker or the living trust.

Gift tax. The transfer of property to a living trust does not constitute a gift for gift tax purposes.

Estate tax ("death tax"). For an estate of any decedent dying during calendar year 2012, the basic exclusion from estate tax amount is \$5,120,000, up from \$5,000,000 for calendar year 2011. Also, if the executor chooses to use the special use valuation method for qualified real property, the aggregate decrease in the value of the property resulting from the choice cannot exceed \$1,040,000, up from \$1,020,000 for 2011.

Living trust property will be treated as part of the trustmaker's estate for estate tax purposes, just as if he owned the property in his own name. Both a will and a living trust, when properly drafted and funded, can save substantial estate taxes.

Do living trusts provide creditor protection?

While a trustmaker is alive, the trustmaker's creditors may have access to trust property. After the trustmaker dies (at which point the living trust becomes an irrevocable trust), the trustee may pay the valid debts of the trustmaker. Unlike in a probate action where creditors face a time deadline, there is no such deadline for creditors in a trust administration. In addition, a probate action allows a surviving spouse and dependents to protect some of the decedent's property from creditors by electing to take a family allowance, which must be paid to the family before any creditors are paid. In a trust administration, however, it is not certain that family members will be given such priority over creditors.

Is a living trust subject to attack?

Disgruntled heirs. Both wills and living trusts are vulnerable to challenges by disgruntled heirs. A properly drafted will or trust will contain language that can be used to discourage such challenges and provide instructions for the trustee or personal representative on how to deal with them.

Disinheriting a spouse. Colorado law provides many protections for surviving spouses, including provisions that prevent anyone from disinheriting his or her spouse. The rights of a surviving spouse may not be avoided through the use of a will or a living trust.

Living trusts and government benefit

Most governmental benefit programs, especially Medicaid, have complicated rules related to wills and living trusts. For example, if property is held in a living trust created by a deceased spouse for the benefit of the surviving spouse who is a Medicaid recipient, the trust property and income is counted as available. It is particularly important to consult an attorney when a beneficiary of a will or a trust is receiving or may receive any governmental benefits in the future.

Estate planning and administration costs

Although costs will vary depending on where you live, the attorney you choose to hire, and the complexity of your situation, having a simple will drafted can cost \$250 and up. While a will may be less expensive to prepare, the costs of probate are unpredictable and generally range from \$1,000 to \$6,000, including attorney fees, court costs, and other related expenses.

The costs associated with preparing a living trust also vary, but generally run from \$750 to \$5,000. Regardless of whether you choose a will or a living trust, in order for them to be effective, there are fees associated with funding the trust and titling property to coordinate with your will.

For more information, you should make an appointment with an estate planning attorney to help you determine which estate planning arrangement best suits you and your family. Many attorneys will offer a free initial consultation. Remember that in estate planning, one size does not fit all; while your will or living trust may look similar to your neighbor's, each is different for special and personal reasons.

Living trusts and wills are complex legal documents that require the use of competent and experienced estate planning attorneys. For this reason, you should not try to create your own living trust or will or purchase a pre-printed living trust or will. Beware of purchasing a living trust or will from a national marketing organization that will not consider your individual needs and where the attorney who prepares the document is not available to meet with you in person. If you think you have been a victim of fraud in the sale of a living trust, please call the Colorado Attorney General's Consumer Protection Division at (303) 866-5189 or (800) 332-2071, and ask for the pamphlet titled "Living Trust Scams."

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