Practical Probate

Taking the Mystery Out of Trusts Part 2: Who Controls the Trust

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The Mystery

A concern that new clients to my law practice often express is that a trust will somehow take control of their affairs out of their hands and place it with a third party. While this is true with irrevocable trusts, it is not the case with revocable inter vivos trusts, often referred to as "living trusts." Technically, a living trust is simply a trust that is created during my clients' lifetime. The term "revocable" means my clients retain control over their trust while they are alive, and may change or terminate the trust as they please.

Trusts Increase, Not Reduce Control

In fact, one of the most important advantages of revocable trusts is to *increase* my clients' control of their finances and assets. Trusts allow people to maintain control of their affairs even if they become incapacitated. Without a trust, incapacity may result in the owner losing control of his or her finances and assets, such as accounts in financial institutions, real estate, motor vehicles, and other assets. Once assets are placed into the trust (known as funding the trust), it's highly unlikely court intervention will be needed to manage those assets during my client's incapacity and after her or his death.

In this regard, trusts are much more reliable than a power of attorney. Wills have no effect on management of assets while the person who created the will is alive. Beneficiary or survivorship designations likewise do not provide for management of the asset while the owner is alive.

What is a Trust?

A trust is a contract between the person creating the trust (referred to as the trustor, grantor, or settlor) and the trustee. A trust must also have one or more beneficiaries. For revocable living trusts, the grantor, initial trustee, and beneficiary may be the same person or persons. For Florida trusts, Florida law prohibits the same person from being the sole trustee and sole beneficiary of a trust. This requirement must be addressed in the trust document, and is one of many reasons why anyone considering using a trust should have an experienced trust attorney prepare the it.

Trustee is in Control: High Standards

In a "living trust" – the type of trust that's the focus of this article series - the person or persons who create the trust, such as a married couple, are also the initial trustees and beneficiaries of the trust. They have a high level of control in using trust assets that successor trustees will not have.

A trustee is the fiduciary (a person, persons, or qualified financial institution) with the responsibility and authority to administer the trust. The trustee must be very careful to not exceed the authority the trust gives them. A trustee has important legal responsibilities that constitute one of the highest

legal standards in American law. These responsibilities include placing the interest of the trust beneficiaries above that of the trustee's own interests. A trustee is prohibited from using their position for their personal gain (known as self-dealing). The trustee may not exercise their authority to the advantage of anyone other than trust beneficiaries (the duty of loyalty). A trustee must also manage trust assets in a responsible manner (the Prudent Investor Rule), and avoid wasting trust assets. Trustees have other responsibilities as well.

When considering who to name as a trustee, only persons or institutions in whom the grantor has total confidence should be considered. Any potential trustee must be very organized and administer the trust with a sense of urgency. Those who are disorganized or have a habit of procrastination should not be considered as potential trustees or successor trustees.

Revocable Living Trust

In this kind of trust, assets in the trust may only be used for the grantor's or grantors' support while they are alive.

For these types of trusts, the person or persons creating the trust is/are usually both the grantor and initial trustee. The practical effect of this is that the person creating the trust has full control over the use of trust assets. Once they place an asset, such as a checking account, into the trust, they continue to use the checking account in the same manner they did before the checking account was placed into the trust. They are free to move assets into and out of the trust as they please. There are no tax consequences to transfers.

Example: John and Mary Jones, husband and wife, create the Jones Family Trust. John and Mary are the grantors, initial co-trustees, and beneficiaries of the trust. While either or both of them are alive, the sole purpose of the trust is for the benefit of John and Mary.

As the term "revocable" implies, the grantor may, at any time, change the trust, terminate or revoke the trust, place assets into the trust, and take assets out of the trust. The grantor is in no way limited in how they may use trust assets.

Example: John and Mary Jones from the example above decide that they want to make changes to the Jones Family Trust so that a disabled beneficiary (their new grandson) may have access to trust assets without jeopardizing his eligibility for public or private benefits. John and Mary have their attorney make changes to the Jones Family Trust to provide for their grandson.

Example: John and Mary Jones place their brokerage account into the Jones Family Trust. They are still able to buy and sell stocks, bonds, and options in the brokerage account. John and Mary may also make gifts from the account to their grandchildren, or use cash in the account to pay tuition for their children or grandchildren, for vacations, expenses, or any other purpose. John and Mary may use trust assets to pay for their groceries, insurance, utilities, taxes, credit card bills, and any other purpose.

Once someone other than the grantor becomes the trustee, the new trustee (known as the successor trustee) must adhere very closely to the terms of the trust. The example below illustrates how this might work.

Example: John and Mary Jones, as the initial co-trustees of the Jones Family Trust are not bound by the terms of the trust while both of them are alive. If they want to transfer an asset out of the trust, they may do so at their pleasure. If they want to change the trust in any way, or terminate it, they may do so. Once either John or Mary passes away, the use of the trust must carefully comply with the terms of the trust. This is to protect the surviving spouse, who may get full access to trust principal and income. The surviving spouse may not change or terminate the trust, except as allowed in the trust instrument.

Taxing authorities treat assets in the trust the same as assets outside the trust owned by the grantor. Once the grantor passes away, all of that changes. The trust becomes its own taxpayer and will need a separate tax identification number from the Internal Revenue Service.

Example: Abigail DeFeo creates and funds a revocable trust for her benefit. She is the initial trustee. During her lifetime, assets in the trust – such as income, interest, and dividends – are taxed as Abigail's own property. Upon Abigail's death, the successor trustee who Abigail named in her trust automatically becomes the trustee. At that point, the trust becomes a separate taxpayer and annual trust tax returns must be filed until the trust is terminated.

<u>About the Author</u>

A Connecticut Probate Judge since 2003, and a trusts and estates attorney since 1995, Dom Calabrese is admitted to the practice of law in Connecticut, Florida, and New York. Judge Calabrese has given hundreds of presentations on probate and estate planning to the general public, bar associations, the University of Connecticut Income Tax School, the Connecticut Society of Certified Public Accountants, and the Connecticut Probate Assembly. Calabrese Law PLLC has offices in Palm Beach Gardens, Florida, and Watertown and Stamford, Connecticut devoted to estate planning, asset protection, and business counsel.

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