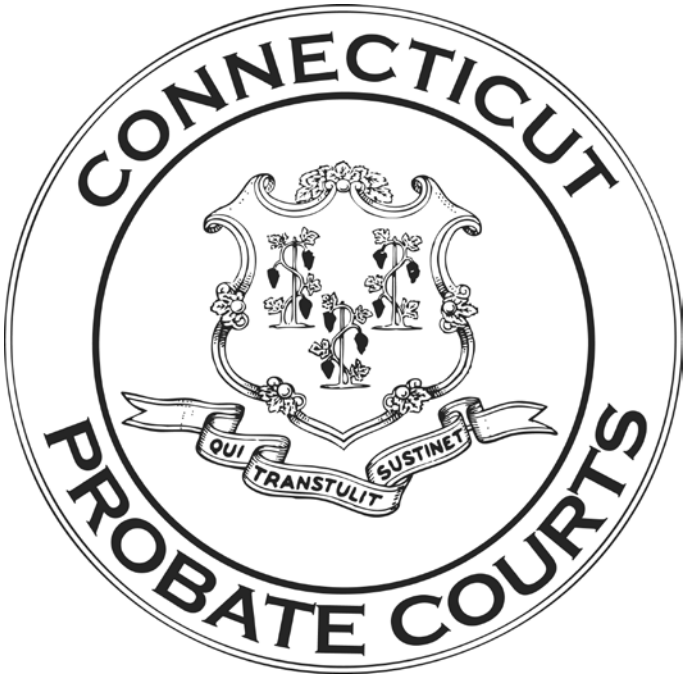
Probate Court User Guide

Understanding Trusts



Published by
OFFICE OF THE
PROBATE COURT ADMINISTRATOR
STATE OF CONNECTICUT

Compliments of your Local Probate Court

Introduction

This user guide is offered to give an elementary understanding of the complex subject of trusts. It is meant to answer some of the most basic questions about trusts and give the reader enough information to ask more detailed and probing questions of professionals in the field of trusts.

Consumers should be leery of marketers who offer incredible claims about what a trust can do, and they should be doubly leery when a hefty price is attached to the product the marketer is trying to sell. When in doubt, seek a second opinion from a trusted professional.

Forms for trusts and other probate matters are available online at ctprobate.gov. Click on “Forms.” Forms are also available at the Probate Courts.

Glossary of Terms

Account: A report of the trustee's financial transactions, including a list of receipts, disbursements, sales and purchases of assets and distributions to beneficiaries.

Beneficiary: A person or institution for whose benefit the trust was created. A beneficiary is frequently a close relative of the settlor but need not be. Other typical beneficiaries include charities, friends of the settlor and others whom the settlor wishes to benefit in some way.

Financial Report: A simplified version of an account.

Living (Inter Vivos) Trust: A trust created and activated while the person who established it (settlor) is still living. It should not be confused with a living will, which is another legal device incorporating a person’s wishes concerning the removal of life support systems under certain circumstances.

Medicaid: A federally-created program, which is administered by each state, which provides long-term nursing care and other benefits to those qualified to receive it. Medicaid is commonly referred to as “Title 19.”

Settlor: The person who creates a living trust, frequently the one funding it. This person may also be referred to as a grantor or donor.

Spendthrift Trust: A trust designed to be immune from the claims of the beneficiaries' creditors, often including the state or federal government.

Term: A trust may last for a short, fixed period of time or, if properly planned, for a longer period, even spanning generations. The most common type of trust is one designed to last during the life of the settlor's surviving spouse and beyond, usually until the settlor's children or other descendants reach a certain age of maturity. Charitable trusts often last indefinitely — for as long as there are assets to manage and distribute.

Testamentary Trust: A trust created within and as part of a person's will.

Testator: The person executing a will, with or without a testamentary trust.

Trust: Generally, a legal device designed to provide financial assistance to someone without giving that person total control over the trust assets. A trust may be revocable or irrevocable, express or implied. This user guide will deal only with express, *written* documents that become irrevocable upon the death of the person who created the trust.

Trustee: The person or institution entrusted with administering the trust. The term should be distinguished from an executor or administrator, who is responsible for settling a decedent's estate regardless of whether a trust is involved. The common characteristic that trustees, executors, and administrators share is that they are all *fiduciaries*, meaning that they have been entrusted with other people's assets, and they are legally responsible to manage them properly.

Why Trusts may be of Value

Trusts have generally been used to help people who fall into two basic categories: people who need financial assistance and people who are unable to manage their own money properly. Trusts have been used to benefit children, those over the age of 18 who are unable to manage large sums of money, those with disabilities who aren't able to manage their own affairs and those with substantial creditors.

In addition, trusts are commonly employed as devices to shield a person's assets from unnecessary taxation or court supervision. The trustee is normally directed to pay income to one or more beneficiaries and is given discretion to distribute principal, usually subject to certain stated standards. The payment of income may also be discretionary. The trust, therefore, allows the settlor (even after his or her death) to distribute assets to favored parties and to control those assets “from the grave” through the trustee whom he or she has appointed. For example, an individual who has children from a prior marriage might establish a trust for his or her spouse to ensure that the individual's children receive the trust property after the spouse's death. If properly created, a “spendthrift trust” (see definition in “Glossary of Terms”) may be crafted to shelter assets from the reach of the beneficiaries' creditors, including the government.

Tax benefits

Another advantage of the trust is its ability to shelter certain assets from estate taxes at the time of the settlor's death. Both the state and federal governments tax lifetime gifts and property passing after death, if certain exemptions are exceeded. The subject is a complicated one, but the reader should be aware of the fact that gifts or bequests between spouses are normally exempt from the estate tax. The proper use of a trust may shelter assets from taxation when the surviving spouse dies. In 2016, an estate of $2 million or less is exempt from the Connecticut estate tax. The federal estate tax exemption is more than $5 million. It does not matter whether the trust is a testamentary or living trust – *the potential tax benefits are identical.* The use of an irrevocable life insurance trust or a charitable remainder trust may also offer potentially attractive tax benefits.

Comparison of Testamentary and Living Trusts

Both testamentary and living trusts can play a valuable role in professional estate planning. Each device should be analyzed to determine the best course for an individual. What follows is a summary of the most common benefits and detriments mentioned by objective practitioners in the field.

May a testamentary or living trust be modified or revoked?

A testamentary trust is *always* revocable and modifiable as long as the testator is living and competent. Naturally, it becomes irrevocable when the testator dies. A living trust, as the term is commonly used, is ordinarily revocable, although certain types of trusts established during the settlor's life may be irrevocable, usually for tax reasons. For

example, a typical life insurance trust (and often a charitable remainder trust) is irrevocable upon formation.

Does the person creating the trust lose control of his assets?

Since a testamentary trust does not spring into use until the testator's death, the testator retains full control and use of his or her assets *in the testator's own name, without transferring them to the trust.* In a *revocable* living trust, the settlor (who normally appoints himself or herself as the initial trustee) usually remains in control of the assets as long as he or she is alive and competent. The settlor normally must transfer all of his or her assets to the trust and thereafter controls their use as his or her own self-appointed trustee. Therefore, any entities holding assets (such as banks, brokerage houses, etc.) must be notified of the transfers, and the correct forms must be completed to transfer the assets properly. Without completing these transfers, the living trust may be of virtually no value, since the trustee of a living trust cannot control assets that have not been properly transferred to the trust. It is somewhat cumbersome to transfer assets in and out of a living trust, and sometimes the result is that assets that were intended to be made part of the trust fall outside of the trust because they were not properly transferred to it.

How is real estate transferred to a living trust?

If real estate is part of a living trust, a proper deed must be drafted, executed and placed on the public land records to properly transfer the real estate to the trust. If the settlor subsequently wants the real estate back in his or her name, another deed will have to be employed to reverse the process. The transfer may also necessitate notifying the mortgage holder and obtaining its approval. In addition, the homeowner's insurance company should be notified. An attorney should always be consulted before making real estate transfers, since important tax and other implications are involved. Property tax ramifications should also be carefully weighed and considered before making such a transfer, because the transfer may invalidate an existing tax exemption. With a testamentary trust, the settlor retains direct ownership of the real estate, so deeding it to the trust is not necessary.

What do attorneys charge for testamentary and living trusts?

There is no fixed rule about what attorneys may charge for either kind of trust. It is normally part of an overall estate plan. Traditionally, fees will depend on the complexity of the estate, the complexity of the legal document and the amount of time expended. Some attorneys charge substantially more to draft a living trust than a testamentary trust, even though the legal work may be very similar. It is always a good idea to obtain a fee quotation *in advance* for both kinds of trusts and to weigh the pros and cons of the work performed against the fees charged. When in doubt, get a second opinion.

Are trusts confidential?

A testamentary trust remains confidential until the settlor dies. At that time, the entire will, including the trust is submitted to the Probate Court and becomes a matter of public

record, although few people bother to look at other people's wills. A living trust may remain confidential to uninterested parties. Interested parties have a right to know the contents of the trust instrument. Contrary to the assertions of some, it is not proper to prevent a beneficiary with a legitimate interest in the trust from receiving a copy of at least the portion of the trust applicable to that beneficiary. The intervention of a court may be required if the trustee fails to provide it. For example, a beneficiary has the right to petition the Probate Court for a copy of the instrument as part of a request for an account from the trustee.

Can a testamentary or living trust protect trust assets from creditors?

While some may argue that the assets in a living trust can be insulated from the claims of the settlor's creditors, there are important exceptions. The creditors of a settlor who has created a revocable, funded living trust (the most common of all) and named himself or herself as trustee **can and do** reach the settlor's assets. That applies also to a settlor *or his or her spouse* who needs long term care (whether at home or in a nursing home) and submits an application for Title 19 Medicaid assistance. Under current federal and state law, the revocable trust assets will be deemed available to the settlor or his or her spouse and could result in denial of Title 19 benefits.

On the other hand, properly drafted spendthrift trusts, whether testamentary or inter vivos, can shield trust assets from the creditors of *beneficiaries.* In addition, the beneficiary of a properly drafted *special needs* trust **would** be eligible for Title 19 assistance, since the assets within such a trust would not be deemed available to the beneficiary. This area of the law is extremely technical and fraught with potential pitfalls. An attorney with expertise in Title 19 law should always be consulted beforehand.

What are the legal and other fees in administering a trust?

The legal and other professional fees in *administering* (as opposed to *creating*) either kind of trust may vary, but it is common for attorneys to charge clients on the basis of time and effort expended and not on the size of the estate. Ordinarily, accountants do the same. In that regard, there should be little difference between the legal or accounting fees incurred in handling one trust over another. The work is virtually identical:

(1) A list of the assets of the trust must be compiled, together with date of death values (and alternate valuation dates with larger estates).

(2) Creditors’ claims must be reviewed.

(3) Appropriate tax returns must be filed with virtually identical tax results.

(4) Information should be provided to interested beneficiaries as reasonably requested.

(5) Finally, some kind of an overall account or financial report should be provided to the beneficiaries.

Any suggestion that the administration of a living trust does not entail this work, especially in larger estates, is misleading. The trustee of a living trust who did not perform this elementary work would violate his or her fiduciary duty to the beneficiaries.

Some states have statutory schedules for the payment of testamentary trustees, executors and administrators. Connecticut is not such a state. On occasion, fees allowed in other states are offered as examples of the kinds of fees charged in Connecticut Probate Courts. It is important to note that, in Connecticut, *all* fees are subject to probate review for reasonableness in any matter before a Probate Court. Any party may challenge the fees charged by a trustee or any other fiduciary, and the *fiduciary has the burden of proving their reasonableness.* The court can and will reduce fees if the court considers the fees unjustifiable and excessive.

The fees charged by the trustee of a living trust are generally not screened by anyone but the parties themselves. Even if they are excessive, the parties may not be aware of that fact and may be reluctant to question or object to them. A beneficiary may challenge the fees by invoking the jurisdiction of the Probate Court or bringing an action in the Superior Court.

What delays are involved in trust administration?

Delays in the probate process are sometimes offered as a reason for using a living trust. Delays in administering testamentary trusts are virtually *always* related to the actions of the trustee. Common causes of delays include time needed for federal or state tax audits, litigation involving the estate or trust or simply the reluctance or inability of the trustee to perform the necessary duties in a timely fashion. It is almost never the probate process itself that causes a delay in the administration or distribution of trust assets. On the contrary, it is often the prodding of the Probate Court that prompts the trustee to complete his or her duties more expeditiously. With a living trust, there is no apparatus to "move the trustee along," except for the informal prodding of other family members. The problem is often compounded when the trustee and the beneficiaries do not enjoy a good working relationship.

What is the truth about "avoiding probate"?

Perhaps the most advertised "benefit" of the living trust is that it "avoids probate." What that often-misunderstood phrase means is that it avoids the supervision of the Probate Court. Avoiding probate does *not* avoid estate or inheritance taxes. Those taxes apply equally to assets held in a living trust or a testamentary trust, and the opportunity of minimizing those taxes applies equally to both kinds of trusts.

An often misunderstood fact is that a living trust does *not* avoid the statutory fees charged by the Probate Court. These fees are established by the state legislature. Additional information about probate fees may be found in the Probate Court user guide entitled *User Guide for Administration of Decedents' Estates* and on the Probate Court website at www.ctprobate.gov. For example, a $250,000 estate passing to a non-spouse would result in a $990 probate fee, while the fee to a surviving spouse would be $553, since there is a special exemption for spouses. Many experienced probate

practitioners do not find these fees excessive, and most lay people, when they discover what they are, find them reasonable as well.

In deciding whether to use a living trust, it should be kept in mind that these probate fees are charged on the basis of the gross taxable estate as shown on the Connecticut estate tax return, which must be filed in the Probate Court **even if all the decedent's property is passing through a living trust.** Therefore, the same fees will generally be charged whether or not a living trust is used.

What are the advantages of Probate Court supervision?

The Probate Court offers a speedy and inexpensive mechanism for resolving questions or disputes concerning the administration of a trust. This includes the availability of informal conferences that often resolve problems without the need for formal litigation, thereby saving the parties a great deal of time and money. This is just one reason why many people consider the supervision of the Probate Court to be a positive feature. The role of the court is not to interfere in the management of the estate, but to *expedite it.* Here are two other examples:

(1) When executors, administrators or trustees are not acting properly or promptly, the court can and will spur them on to complete their duties.
(2) Probate proceedings can be very simple and informal. Many Connecticut estates are administered by family members without the assistance of an attorney. These family members often forego the payment of a fiduciary's fee or charge less than a professional.

Finally, experience has shown that *some* fiduciaries act dishonestly. While the vast majority of trustees perform their duties with integrity, one cannot ignore those incidents in which funds have been misappropriated, sometimes for years, without anyone being aware of it. The supervision of the Probate Court, including the requirement that the trustee file periodic accounts, can provide an excellent deterrent to such problems. In the event that a problem arises, it offers an effective and inexpensive mechanism to effect a remedy.

What can happen when the settlor of a living trust becomes incapable?

A currently funded living trust provides a seamless mechanism for meeting the needs of a settlor who becomes incapacitated after creating the trust. What typically happens is this: the settlor, in the living trust instrument, provides that if he or she becomes incapacitated, a new trustee (named by the settlor) will take over management of the trust assets and provide for the settlor's care for the remainder of his or her life. Then, upon the settlor's death, the trustee would continue to manage the trust assets for the benefit of the settlor's beneficiaries. Advocates of this arrangement argue that this procedure avoids the appointment of a conservator for the incapacitated individual by the Probate Court, and they are right. It does. But whether or not that is a good thing is something for the settlor to consider carefully.

First, such trusts frequently provide that someone other than the settlor will determine whether the settlor has become incapacitated. If that determination is made, the settlor may lose control over his or her own property *without any impartial court determination whatsoever.*
Secondly, the trustee will be managing the trust assets for the incapacitated settlor without any oversight to insure that the settlor is treated fairly.

Conversely, if the living trust did not provide this kind of power, the trustee or other family member *would* probably need to seek the appointment of a conservator through the Probate Court. That procedure includes important safeguards to insure that due process rights are guaranteed to the alleged incapable person:

(1) A copy of the petition is given to the person so that he or she knows exactly what is being alleged and can challenge those allegations if he or she disagrees with them.

(2) An attorney must be appointed for the person if he or she cannot request one, so that his or her legal interests are adequately protected.

(3) A hearing is held before the judge in an informal atmosphere, which may occur within the person's own home or hospital room if he or she cannot attend the hearing in court.

(4) The person is invited to participate fully in the process, and his or her wishes are carefully considered by the court, including the identity of the person who might become the conservator.

(5) The conservator's actions can be controlled by the court, so that an inappropriate admission to a nursing home or the premature sale of the person's home can be avoided.

(6) The conservator must periodically account to the court for the actions taken, so as to avoid self-dealing, improper use of assets and the taking of excessive fees.
(7) If any interested party is dissatisfied with the actions taken by the Probate Court, an appeal can be made to a higher court.

The protection of beneficiaries' fundamental rights is an inherent part of the probate process. In the case of a living trust that is not within the court's jurisdiction, legal remedies are available, but it falls upon the settlor or beneficiary to seek them out, a process that may be cumbersome and costly. With basic rights at stake, the choice of a living trust should be made only after careful consideration and sound professional advice.

Can an unsatisfied family member attack a trust?

Some argue that it is easier for unsatisfied heirs to attack a person's will than a living trust. The fact is that either device may be challenged in court by a person with proper standing. Any competent attorney will take the necessary precautions to buttress the

relevant instrument against attack, whether it is a will or a living trust. That is why great care should be exercised in selecting the proper attorney to advise about the appropriateness of each device.

If I have a living trust, do I still need a will?

Most lawyers will recommend to clients who choose to have a living trust that they also execute what is called a "pour-over" will, simply because a living trust is ineffective as to any asset not transferred to the trust. For example, if the settlor neglects to transfer his or her house to the trust, that asset must pass through the probate process. If the settlor didn't execute a will leaving his or her assets to the trust or some other person, those assets may pass by law to persons the settlor never wanted to inherit from the other person. It is *always* a good idea to execute a will *in addition to a living trust.*

Do I need a living trust or not?

There is no one answer to the question, “Should I have a living trust?” Living trusts, wills (with or without testamentary trusts), the utilization of jointly held assets and other devices are all potentially useful and desirable estate planning tools to consider *with proper legal advice.* Embarking upon a sophisticated estate plan without proper professional guidance is not recommended and can have negative results. Similarly, small estates with typical family beneficiaries do not usually warrant the cost or complexity of a living trust. For example, *in general*, a married couple with combined assets (including potential life insurance proceeds) below the federal estate tax exemption will not need a trust *to save taxes.* Also, those with modest estates consisting of a jointly held home and cash or securities under a few hundred thousand dollars may find little benefit in using a living trust. A cost/benefit analysis should be undertaken to determine if the added costs warrant such a device. Therefore, great care should be exercised in locating a competent estate planning attorney to discuss the pros and cons of a living trust and any other estate planning device. If assistance is needed, contact your local or state bar association or obtain a referral from some other knowledgeable authority.

Rights as the Beneficiary of a Testamentary or Living Trust

The right to information and an account

The trustee of either a testamentary or living trust should communicate periodically and regularly with the trust beneficiaries as the trust or circumstances dictate. Beneficiaries should normally be kept informed of major decisions affecting the trust: for example, the sale or exchange of a major asset of the trust, a major expense, the fees of the trustee and any other professional hired by the trustee, amounts distributed to beneficiaries and other matters of direct concern. If the trustee *does not* communicate, or if any beneficiary believes he or she is being kept “in the dark” by the trustee, the beneficiary has the right to petition the appropriate Probate Court for relief.

Unlike testamentary trusts, living trusts are not under the continuing jurisdiction of the Probate Courts. However, C.G.S. section 45a-175 (c) permits the Probate Court to order an account from the trustee *of a living trust*, if the court finds:

(1) the beneficiary has a sufficient interest in the trust,

(2) cause has been shown that an account is necessary, and

(3) the request for an account is not for the purpose of harassment.

The location and identity of the specific Probate Court is determined by C.G.S. section 45a-175 (c) (2), which allows the matter to be brought to that Probate Court:

(1) which is the residence of the trustee, or if a corporate trustee, in which it has an office, or

(2) in which the trust assets are maintained, or

(3) in which the settlor presently resides or resided immediately prior to his death.

Testamentary trusts *are* under the continuing jurisdiction of the Probate Court, and trustees are required to file financial reports or accounts at least every three years, without the need for a request. Nonetheless, a beneficiary of a *testamentary trust* may ask the court to require a financial report or account at any time upon a proper showing of cause.

The right to a copy of the trust instrument

Any person may obtain copies of any non-confidential file in the Probate Court upon the payment of a reasonable copy charge. Testamentary trusts and wills are not considered confidential and are therefore available for copying.

If the beneficiary of a living trust or other interested party requested the trustee to supply a copy of the trust but was refused, that person may apply to either the Probate Court or the appropriate Superior Court for an order compelling that disclosure as part of an action for an account. It is within the discretion of either court to grant the request or not. Normally, the court would be inclined to do so if the party could prove sufficient economic interest in the trust that might be jeopardized without direct knowledge of the terms of the trust.

The right to compel the distribution of income or principal from the trust

Whether a beneficiary of either a living or testamentary trust has the right to *compel* the trustee to make a distribution of principal and/or income to that beneficiary (or any other beneficiary) depends on the circumstances of each case, most importantly the provisions of the trust itself. For example, it is common for family trusts to provide for the mandatory payment of *income only* to a surviving spouse and such amounts of principal as the trustee, in the trustee's discretion, determines are appropriate and reasonable. A surviving spouse who did not receive the mandatory payments of income would have a

right to seek a court order compelling those income payments. However, with respect to the discretionary payment of principal, the court could interfere with the trustee's decision only if it concluded, after hearing all of the relevant facts, that it constituted an abuse of the trustee's discretion. It is always a good idea to consult with a knowledgeable attorney before attempting to file a petition with the court to compel such a payment.

Probate Appeals

Any order of a Probate Court may be appealed by an aggrieved person. Generally, a person is considered to be aggrieved if he or she has a legally protected interest in the matter. Probate appeals are taken to the Superior Court. It is important to note that appeals must generally be taken within 30 days of the date that the decree was mailed. Failure to meet the statutory time frame may result in the loss of the right of appeal. Therefore, prompt action is required.

It should also be noted that a probate appeal in the Superior Court is a more formal and legally technical proceeding than is typically the case in the Probate Court. It is strongly recommended that any party considering appeal immediately seek professional legal advice.

Conclusion

It is not easy to decide whether or not to have a testamentary or living trust. The final decision depends upon the needs of the settlor and those of the family or others the settlor wants to benefit. Tax considerations, potential Title 19 issues and a host of other critical factors must be carefully weighed in making the final decision. Both testamentary and living trusts can play a legitimate role in proper estate planning. Ask your attorney what makes the most sense for you.