CHAPTER ONE

Trusts and Wills Defined

Years ago, I started doing revocable trusts as a way of helping my clients avoid the long delays and high costs of probate. Now, after having done nearly four thousand trust-based estate plans, I can confidently assure you that a will is not the way to plan your estate.

Wills have to be probated.

Trusts don't.

Most people believe good estate planning is having a last will and testament made up by their local lawyer. Most people are wrong. The reason they believe wills are good is because the lawyer tells them so. It may be that the lawyer really believes that probate isn't so bad, but there are two other reasons for this advice. First is that many attorneys are not familiar with trusts and so do not recommend them. That is why I received many referrals from other attorneys whose clients wanted a trust and their lawyer didn't know enough about them to prepare one. The other reason frankly is that lawyers have a vested interest in seeing you go through probate. Most of the cost of probate is attorney fees. It is not, as they would have you believe, "court costs."

The actual cost of probate is unpredictable in most cases. It is usually based on the hourly rate of the lawyer—which may be hundreds of dollars per hour—multiplied by the total amount of time to complete the case. There can be a big incentive to "bill hours." Every telephone call, letter, meeting, and court appearance is recorded and billed. Since probate cases usually go on for one, two, or three years, the cost can be very high indeed. And attorney hourly rates vary widely. Hourly rates for probate work may run from $150 to $500 per hour, so it doesn't take long for the bill to get very large.

The family that hires the attorney rarely complains about the fees, thinking that there is nothing that can be done, and accepts whatever is billed to the estate. Here is a tip and something most people do not realize: attorney fees are negotiable in most cases, and you can also, even in a probate case, ask the attorney to allow family members to do as much of the nonlegal work as possible to keep the bill down. This is rarely done, and no one has ever asked me to do this. I typically give my clients homework—things they can do themselves to fund the trust rather than paying me.

Probate is, for the most part, pretty simple stuff. Except in contested cases or where litigation is needed, the probate process consists of filing a series of fill-in-the-blank forms in the right sequence and timeframe. It is not unusual for a legal assistant or secretary to fill out the forms. The attorney involvement in the process is typically very minimal, even though the case is often billed as if the attorney was hands-on every step of the way. The point is that you are paying a lot of money for what amounts to clerical work.

It's not always billable hours. Certain states set the attorney fee portion of the probate cost as a percentage of the gross estate. This may actually be even more unfair than the hourly rate method. In California, for example, the following are the maximum rates that attorneys can charge for probate (and you can bet that nearly everybody is going to charge the maximum).

4 percent on the first $15,000
3 percent on the next $85,000
2 percent on the next $900,000
1 percent on the next $9 million
0.5 percent on the next $15 million

So a typical $500,000 estate would have attorney fees of $13,000—a lot of money. However, the executor (also called the personal representative) would be entitled to an additional $13,000 fee. So now, we are up to $26,000 and have not included the cost of bonds, filing fees, inventory tax, and publication costs. This is, in my opinion, a very unfair way for costs to be assessed. It may take no more effort or time to probate a $150,000 estate than it does a $500,000 one, yet the fees are vastly different and not related to the effort expended or expertise needed. Most states have gotten away from the percentage fee because of this disparity—but an hourly rate may actually end up costing the estate more. Court costs are now being looked at as a source of revenue for the state. Filing fees are typically several hundred dollars. This is in addition, of course, to executor fees and attorney fees. Then there is the tax levied on the size of the probate case in some states. This is sometimes called an “inventory fee” and is a percentage of the total estate paid to the court or the county treasurer. Personally, whenever I write a check to the government, I think of it as a tax by another name. None of these costs are incurred in independent trust administration.

The time involved is another big problem with probate. The probate case may have a minimum time under state law that it must be “open” to allow potential creditors of the deceased to present claims against the estate. Even in a simple one-asset estate, the case may have to stay open for a minimum of six months. But because there are no firm deadlines in probate, many attorneys put off finishing it and concentrate on their cases that do have deadlines, like court trials and real estate closings. The probate estate can be kept on the bottom of the pile. I have read that the average time to close a probate case is fifteen to eighteen months. This will vary from state to state and attorney to attorney, with some estates being kept open for years. Fees continue to accumulate for “file reviews,” so why not keep it going?

So avoiding probate is a big deal, no matter what your lawyer tells you. And the living trust is the best way to do it.

According to the National Association of Estate Planning Councils, only about 5 percent of people with an estate have done any estate planning at all. And most of those have done a will rather than a trust. For those who die without a will, most folks rely on state law to determine what happens to their estate at death. A will may be better than nothing at all, but it pales in comparison to the value of a trust.

Before we go too far, let’s define our terms. What exactly is the difference between a will and a trust?

WHAT IS A WILL?

A will is really just a written document telling who gets what part of your stuff at your death, when they get it, and who is in charge of getting the assets to the people who are supposed to get them. You can write your own will in your own handwriting (what lawyers call a holographic will) or it can be typed up, usually by a lawyer, and ceremonially witnessed and/or notarized. You can buy a will online or even get a fill-in-the-blank one at the office supply store. Some states even have a state-promulgated “statutory will,” which is another fill-in-the-blank form. Wills are pretty easy to make and are usually less expensive to create than a trust. The big cost of a will comes later when the probate fees are counted in.

The executor (also called the personal representative or sometimes the administrator) is the one who is in charge of seeing that these written instructions in the will are carried out under the supervision of the court.

The instructions in the will are really instructions to the probate court—who gets what, when they get it, and who’s in charge. After your death, if there is anything left in your name to be probated, it is necessary to file the will in probate court because a court order is the only way your heirs can get your stuff turned over to them legally. You can’t just take the will to the bank, show it to them, and walk out with your inheritance. There are a number of ways to avoid having things in your own name that have to be probated, such as giving everything away before you die or having everything in joint ownership, but these methods have problems of their own, which will be explained later in this book.

For example, I had a client who married a woman who owned a house in her name only. They lived in her house together for years, and he even signed on to the mortgage when it was refinanced. She then died suddenly. The house was in her name alone and his name was never added to the deed. Her husband was very upset when I explained that the house was not his until the probate court said so. She had made a will which left everything to him, but that was not in itself enough—which was a big surprise to him. He could not get full title to the house transferred to him until the probate court process was completed and all the expenses were paid. That case cost thousands of dollars in probate costs because of poor planning.

Here’s another example: Dad dies, leaving no wife but three adult children. He has a house and some bank accounts and other investments. He has a will that says everything goes equally to his children. In order for those children to sell the house, they need to prove they own it. Unfortunately, in most cases, the will in itself is not sufficient proof for a land title company or a real estate mortgage company that the house now belongs to the children—they want a court order that says the will is valid and that the property belongs to the children. The will has to be probated to get that order and clear the title.

Interestingly, in most states the will in the above example is totally useless and was a waste of money for Dad. The reason is that if a person dies without a will, then state law determines who are a person’s heirs. These laws are called the laws of descent and distribution in case of intestacy (who gets what when somebody dies without a will). In the Dad-and-three-kids example, most state laws say that children whose parent dies without a spouse share his estate equally. A will adds nothing to that. The probate process is virtually identical with or without a will, so whoever charged Dad for that will did nothing for the money. Dad should have had a trust.

WHAT IS A TRUST?

A trust is also just a written document. It also says who gets what, when they get it, and who is in charge of seeing that that happens. The person in charge is the trustee. The difference between it and a will is that a trust does not have to go through the probate court.

The reason a trust is not probated is that when a trust is signed, it becomes a legal entity that has the ability to own things. I often analogize it to the hardware store down the street. Smith’s Hardware is a corporation. The corporation owns the building, the inventory, the delivery truck, the hardware bank account, the money in the cash register—all the hardware store assets. The Smiths own the corporation. If they die, the corporation is in a sense still alive and will keep selling hardware. New owners come in and take over the business operation.

A trust is similar. In a trust, the trust owners (called variously the grantors, trustors, or settlors) transfer their assets into the name of the trust. Let’s call it the Smith Trust. After they sign the trust document, the Smiths then “fund” the trust. In other words, they transfer their assets into the trust name. This is done in a few ways, but typically real estate is deeded into the name of the trust by using a quitclaim deed. Bank accounts may either be put into the name of the Smith Trust or may pay on death (POD) to the trust (kind of like a beneficiary designation). Life insurance is transferred by naming the trust as the beneficiary. Tax-deferred accounts like IRAs and 401(k)s may have the trust as the primary or contingent beneficiary.

The idea is to have the Smith Trust own all the Smiths’ assets. That way, at the death of the Smiths, there is nothing left in their individual names for the probate court to administer. The trust owns their stuff, but they own the trust. They die and the trust still owns their stuff, but the trust document instructions then kick in. The trust says who takes over at their death to carry out their instructions as to who gets what and when.

The great thing is that there is no court order needed for the trustee to take over after the Smiths die. The trustee merely has to show proof that they are dead and show the trust to prove who is the trustee. Then, literally the day after they die and without any fees, the trustee can begin carrying out the Smiths' instructions on distributing the trust assets. (How the trustee does all this step by step is explained in simple language later in this book.)

Now, of course, the trustee still has to do the normal things that need to be done when a person dies. The garage has to be cleaned out, the credit card bills and funeral and burial expenses need to be paid, and the last year's income tax must be filed, but the trustee just goes ahead and does these things. No lawyer is needed and no legal or court fees are due.

People worry that a trust will tie up their property or complicate things during their lifetime. Not true. In a revocable trust, the trust owners (grantors) have full rights to all trust assets during their lifetime. They can sell these, give them away, mortgage them, or even burn them up or gamble them away if they want without anyone's permission or any special paperwork. A trust is a death-planning device and does not complicate the owner's life—if it is put together properly.

After the death or disability of the grantors the named trustee is in charge but does not have the same powers that the trust grantor had. We call a trustee that name because this is someone the grantor picks who is trustworthy. Trustees have legal responsibilities to the trust beneficiaries. Trustees cannot, in most cases, change the terms of the trust in the way the grantors can. They can only follow the instructions of the grantors. And the trustee cannot do anything risky with the trust assets. State law requires a trustee to be very conservative in investing and dealing with trust assets. A trustee is called a "fiduciary" because they have a special responsibility to the beneficiaries to safeguard the trust assets for the benefit of the beneficiaries until all the trust assets are ultimately distributed as the grantors have instructed.

Bottom line? It is infinitely faster and cheaper to settle an estate with a trust rather than with a court-supervised probate of a will.

Your own lawyer may tell you that a simple will is all you need and that you do not have enough assets to consider a trust. Your lawyer is either lying to you or is uninformed of the facts about trusts. Many lawyers have been minimally trained in trust law and believe that the only reason to have a trust is for wealthy people to avoid estate taxes. Wrong.

The fact is that nearly everyone would be better off with a trust than with a will. In most cases, the only person who benefits from your having a will instead of a trust is your lawyer. Attorney fees for making the will and probating the estate are an estate lawyer's bread and butter.

Of course, sometimes a lawyer can arrange it so a trust is no better or cheaper than a will. Some attorneys charge what they call a "settlement fee" to help the family wrap up the trust after death. This may be a percentage of the trust assets. The services provided by the lawyers are not, for the most part, legal services, but they are charged just as if they were. They may also charge outrageous fees to prepare a trust, or prepare a complex trust when a simple one would work just fine. I will speak more to the issue of attorney fees and trust settlement later.

I have been talking so far about a simple trust for the normal family situation—what the IRS calls a revocable grantor trust and which is often called a living trust. There are a lot of kinds of trusts with a lot of functions, including estate tax avoidance and charitable purposes, but most of the situations normal people find themselves in are easily handled using a simple revocable trust. In the next chapter, I will explain who absolutely should have a trust and what it will do for them.

One more note: it is possible to put the provisions for a trust in the language of the last will and testament. A trust of this kind is called a testamentary trust. It may contain all the provisions of a stand-alone trust document and accomplish the same things. But because it is in a will, the trust is not created until probate is finished. It is then funded with some or all of the assets left after the probate process is completed and all the costs deducted.

Anyone with this type of trust is losing the major benefit of probate avoidance. This is not the type of trust you want. The testamentary trust is a great deal for the lawyer, because he gets paid for preparing the trust as well as probating the estate. Good estate planners no longer use testamentary trusts. If one is recommended to you, be sure you ask why a revocable living trust is not being prepared instead. If your lawyer can't explain the costs and benefits of wills and trusts, then you have the wrong lawyer.