CHAPTER TWO

You Must Have a Trust If …

Having a trust is advantageous for most people, and if they don't have one, the worst that can happen is that their estate gets probated, which takes a lot of time and costs the family a lot of money. A shame, but not the end of the world. However, for a lot of folks, a trust is an absolute necessity to protect their family's financial future. If any of the following applies to you, a trust is critical, and anyone who says you do not need one in any of these situations is flat-out wrong.

MINORS

If you do not have a trust and die while your children are still young, the inheritance will be given to them in a lump sum when they reach the "age of majority"—age eighteen in most states. In the meantime, the money is held in a court-supervised conservatorship account under the control of the minor's guardian or conservator. There are three things wrong with this.

First, in my experience turning over a lump sum of cash to an eighteen-year-old is a bad idea. I have seen it happen, and time and again, the money is wasted. In fact, leaving a large amount of money to an eighteen-year-old is actually a disincentive to getting an education. The child has never had any significant amount of money before, does not know how to manage it, and might think that going to college is not necessary with "all that money" in the bank. Unfortunately, the money soon disappears through bad management, poor decisions, and excessive spending on himself and his friends. I have seen a number of eighteen-year-olds inherit money that they no longer have at age nineteen or twenty. Then, when they do want to go to school, there is no way to pay for it.

The second problem is the court-supervised conservatorship. It sounds like a good idea to have a judge oversee the child's money, but in fact this can be a very complex and time-consuming process for the guardian who is acting as conservator of the money. Virtually every decision made by the conservator has to be approved by the judge. The money has to be put into restricted accounts over which the conservator has little investment control. In most jurisdictions, the conservator must prepare an annual accounting of income and expenses, prepare a written annual report, and appear in front of the judge for the judge's approval. Every year, and usually with a lawyer. True, we need oversight in some cases to be sure the conservator will not steal the money, but I find that the conservator is typically a grandparent, aunt, or uncle who would not steal from the child in a million years.

The third problem is that the guardian of the child is most often also the conservator of the money. Again, this seems logical, but often divorced parents tell me they want to be sure the other parent, the ex-spouse, does not end up in control of the child's money for one reason or another—usually because they do not trust the ex to use the money for the best interests of the child.

With a trust, you can set up rules as to when and how much money is given to a child and who will be in charge of that money.

Typical plans might include some of the following sorts of provisions:

1. All of the child's inheritance would be held in a trust fund under the control of a trustee chosen by the parent until the child reaches a certain age (for example, twenty-five). Until then, the trustee has the authority and the decision-making discretion to pay for such things as college tuition, books, transportation, medical expenses, or whatever the trustee believes to be a reasonable expense. The child does not decide what to spend the money on. The child can make requests, but the final decisions as to the appropriateness of the requests are those of the trustee.
2. Similar plans would give the child one-third the balance of the trust fund money at age twenty-five, one-third at age thirty, and one-third at

age thirty-five—or a similar pattern. There may be authority to make additional distributions to the trust beneficiary if the trustee believes these are appropriate.

3. Some parents put conditions on the distribution of money, such as requiring drug screening of the beneficiaries before they are eligible for a payout. Other conditions can be put in the trust and do not have to be approved by anyone. Some I have seen (but do not necessarily agree with) set up requirements such as attending a particular college, staying a member of a particular church, maintaining a certain grade point average, acting as a missionary for a certain period of time, getting married by a certain age, and even not getting married before a certain age. There are so many more, limited only by a person's imagination.

The point is that a trust is flexible and can be set up with whatever rules and regulations you want. There are no guidelines so long as the terms are legal. And the money is yours to leave in whatever fashion you choose, regardless of what anyone else thinks. It's your stuff, not theirs.

DISABLED BENEFICIARIES

As we know, there are millions of disabled people. Disabilities may exist from birth or may be inflicted later on as a result of accident or illness. The mental or physical problems of an heir may require that someone else take care of the special needs of the person so that assets are used in the heir's best interests. The disabled person may be perfectly capable of making financial decisions, but leaving that right to them may mean they are disqualified from certain governmental benefits to which they would otherwise be entitled.

Physical or mental disabilities create two needs for a trust. First, the disabled may not have the mental or physical capacity to handle the ongoing management of their money. Bills need to be paid, money invested, taxes prepared. They may be subject to coercion or undue influence by those who would take the money they rely on, or they may just make bad money-management decisions. Having their inheritance left to them in trust, under the control of an independent trustee, solves this problem.

Second, leaving money to a disabled beneficiary is often like leaving them nothing at all. The reason is that many disabled people rely on state or federal benefit programs for their medical care. Medical care is, of course, very expensive, and most of us would go broke fast having to pay for it without insurance. Nursing-home care, for example, can cost in excess of $100,000 per year. A day in the hospital may cost thousands. Certain drugs are unaffordable without help.

Programs like Medicaid are what we call "need based." This means that the person needing help must qualify based on his or her income and assets. This varies by state because even though Medicaid is a federal program, each state administers the payout based on its own eligibility rules. Online you can find Medicaid eligibility for your state. One site is *http://www.medicaidoffice.net/medicaid-eligibility*. So if you leave money to a person who is receiving Medicaid, he may no longer qualify because of the amount of inherited money and must spend down the inheritance to the threshold level by paying for his own medical care. Then, when the money is gone, he has to go through the sometimes lengthy process of reapplying for the medical benefits.

I am not making a judgment of right or wrong here, but I can tell you that most people would prefer to leave money to their disabled beneficiaries in such as way as to not disqualify them from aid programs and still let them benefit from the inherited assets. A properly arranged "special needs" provision in your trust can do just that. This provision allows the money to be used for things that benefit them during their lifetime and then have the remainder go to some other beneficiary after death. The special-needs provisions have to be carefully written, since the wrong wording can completely throw out the intent of the provisions and make the inheritance subject to spend-down. Also, the beneficiary cannot be his or her own trustee.

SPENDTHRIFTS

We all know people who just cannot hold onto money. If they have it, they spend it. If they can borrow it, they will spend it. Their credit cards are maxed out. They may have declared bankruptcy, had repossessions, or even been sued for nonpayment of bills. These people are spendthrifts and will spend their inheritance very quickly if it is not protected for them. There are several ways to handle this, and a trust is ideal for managing their money. A trust can structure their inheritance in the following (and many other) ways:

1. **Allowance.** Leave them a share of the trust assets but have it given to them in a certain amount per month so they do not get a lump sum to waste. Another provision could say where the remainder of the trust

funds will go if they die before it is all given to them. A variation on this is to pay out only the interest on the trust funds, with the principal going to someone else—perhaps the grandchildren—at the death of the beneficiary.

2. **Set number of years.** A common method is to have an inheritance paid out in annual installments over five, ten, fifteen, or twenty years. The rationale here is that if the beneficiary makes a mistake with one installment, he will have time to think about it before the next installment comes along. It also solves the problem of someone entering a bad marriage or investing in a failing business and losing the inherited money along the way.
3. **Retirement accounts.** I see clients who have adult children who are not necessarily bad with money but have low-paying jobs with no retirement plans, have no savings, and therefore have no money for the future. The parents can set up a plan that pays out a percentage at their death with the balance held in trust and invested for them until the beneficiary reaches retirement age—say, sixty-five or sixty-six. Alternatively, if they should become permanently disabled, the trust could be paid out as an annuity for life.

There are many other variations on distributions to spendthrifts that basically manage money for someone who cannot effectively manage it for herself. If you can put together a plan, your attorney can put it in the right legal language.

Similar considerations and plans need to be made for heirs who have substance abuse problems or who are incarcerated. Some states now will go after the assets of an inmate to pay for care.

GAY COUPLES/UNMARRIED COUPLES

An unmarried couple, whether gay or not, needs the protection only a trust can offer. Unmarried couples do not have the legal rights afforded to those who are married in most states. Here’s an example: Allen came to see me after his partner William died. They had been together for eighteen years. William had three adult children who seemed to get along with Allen—in fact, they exchanged presents for birthdays and Christmas. Now that William was dead, the relationship had changed and the children were no longer so fond of Allen. It seems the house they lived in was originally William’s.

They had both paid their share of the mortgage and shared all the other expenses of the house, but Allen's name had never been put on the title. Now that William was gone, the kids wanted the house. Neither Allen nor William had made out a will or a trust. Allen had no legal rights to live in his own home any longer. This meant that the kids could (and did) rightfully and legally evict Allen. I have also seen the same thing happen several times in heterosexual relationships. While mom or dad is alive, everything is fine, but once death removes them, the family relationship quickly turns into a matter of money. The moral is to get some written protection for your partner in your trust documents.

With a trust, you can provide your partner with the right to live in the house for his or her lifetime—what we call a life estate or life lease. At your partner's death, the kids can sell the house. Or you can provide that the partner has a right to live there for a set period of time, such as one or two years. Often there is a requirement that the bills have to be paid, such as mortgage, taxes, insurance, and maintenance, in order to have the right to stay in the house. Sometimes provisions are put in that would not allow the surviving partner to rent the house or share it with others. The choice of restrictions and requirements is yours.

Other issues arise such as determining ownership of furniture and other personal property items, and provisions for these should be specifically set out in the trust language. Either partner could make a list of individual items to be given immediately at death to particular people, with the rest of the household goods and furniture going to the survivor. One of the purposes and goals of a well-written trust is to avoid problems for surviving partners and beneficiaries. We do this by having an answer to the "what if " questions and making the trust provisions totally unambiguous.

BLENDED FAMILIES

In the typical family unit today, one or both partners may have been previously married and they may both have children from those prior marriages. Estate planning is an absolute must in these situations. Otherwise, everything may end up in the hands of the children of the spouse who lives the longest when that may not have been the intent of the couple.

The first consideration is to be sure your current spouse is protected by the trust provisions. Often, the marital home was owned before the marriage by one spouse or the other. It is not unusual to find the new spouse's name was never put on the title to the property—a big problem, since the new spouse may have to probate the house in order to continue to live in it and may even find that the stepchildren own all or part of it. Having the house in the name of the marital trust assures that the surviving spouse will be able to continue to live in the house without interference from the family.

The second factor is survival. Without a trust or will, the assets will, in most cases, belong to the surviving spouse. At her death, those assets would by law go to her children. So without a trust, it could become a gamble—a matter of who lives the longest—to determine whose children get the joint assets.

A trust can contain very flexible provisions to meet your intentions. For example:

1. At the death of one spouse, an immediate distribution of certain assets or money is made to that person's children, with the rest staying in trust for the benefit of the survivor.
2. At the death of one spouse, the income from the marital trust assets could be paid out to the survivor as they are earned, with the remainder at death paid out to all the children of both spouses.
3. The trust could become unchangeable at the death of one spouse to insure that the children of the first spouse to die are not disinherited by the survivor. This means, in effect, that the trust becomes irrevocable at the first death.
4. Most commonly the surviving spouse gets the use and ownership of all the trust assets but cannot change the trust to effectively disinherit the children of the first spouse to die.

Any rules that you think are fair and both agree on can be put into the trust rules and regulations. The above are just a few examples. The point is that if you do not decide now, then state law will decide for you—and you may not like what the law would do. Keep in mind that if you and your spouse have a premarital agreement, the terms of that agreement may have to be modified to fit the above examples.

SEPARATED COUPLES OR SEPARATE TRUSTS

Sometimes both spouses don't agree on what would go into a joint trust and want separate plans funded with their own separate assets. Especially if a couple is separated, each would want to be certain that the trust is not going to be invaded after the death of the first by the survivor. In most states, if both parties agree, the trust assets in separate trusts are not reachable by the survivor except as specifically spelled out in the trust documents. The trust becomes in effect a postnuptial agreement.

With a will, a surviving spouse has rights over and above what the will of the deceased partner set out. In Michigan, for example, there are rights of election, homestead allowances, and exempt property rights—all of which allow a surviving spouse to “break” the will. So, in effect, you cannot disinherit a spouse with a will. You may write a will that says your spouse is supposed to get a certain amount, but the spouse has the right, through probate court, to take what the state would give instead of what the will provides.

A trust does not have that problem in many states, particularly if both spouses agree in writing to abide by the trust terms. This can be done by including the right language in the trust and then having the trust signed by both parties. Beware, however, of one partner fraudulently misrepresenting the nature and extent of his assets to get the other to agree. A court may then set aside the agreement.

In Michigan and some other states, at least under current law, a surviving spouse cannot elect against a trust and is stuck with whatever he or she is given under the terms of the trust. There are no other options. A trust is a much safer way of assuring that your instructions will be followed.

LARGE ESTATES

Trusts can eliminate or dramatically reduce estate and inheritance taxes. You might think you do not need to worry about estate tax since the threshold at the time of this writing is $5.45 million, but keep in mind that the IRS considers all assets taxable. So life insurance, retirement plans, and real estate, as well as traditional investments, are considered taxable. I have seen young parents with very little in the way of liquid assets who have multimillion-dollar life insurance policies (which are taxable for estate tax purposes at their deaths) and who ended up paying a huge estate tax bill that could have been avoided with a trust.

This is important because it is a big tax. The tax rate is effectively forty percent of everything over the threshold (though the rate is also subject to legislative change). So a $6 million estate could have a tax bill of $220,000.

A typical marital trust can have provisions that double the estate tax exemption amount, effectively preserving two exemptions. Under the current rules, a joint trust (or reciprocal trusts) would be nontaxable up to $10.9 million. This is a very inexpensive way of saving potentially huge amounts of tax, without complicating things while you are alive. Some estate planning attorneys are unaware of the type of joint trust that can preserve two estate tax exemptions. Warning: if you have just over $5.45 million and your attorney pushes the complex two-trust plan while being unable to explain why the joint trust with tax exemption doubling alternatives is unavailable to you, perhaps you are speaking to the wrong attorney.

Also keep in mind that this is not a tax advice book. Taxes are complex and often change. State laws may allow taxation of your estate even though there is no federal tax, so get good advice.

Large estates can also achieve significant estate and income tax savings using the more sophisticated types of trusts, such as charitable remainder trusts, as well as family limited partnerships, limited liability companies, and other complex estate planning techniques. Consult an estate planning expert to develop a plan for you.

Remember that Congress changes the tax laws frequently, so you should keep track of the exemption amount as it may be significantly different from what it was when this book went to press. (There is a good chance that the federal estate tax will be eliminated entirely, which would be a big loss of business for tax planning attorneys—stay tuned.) Having the joint trust with the tax provisions would, however, give you twice the then-current exemption amount, so it is the safest way to go, even if you think you are likely to fall under the single exemption amount.

SMALL ESTATES

Even some very small estates benefit from having a trust. You should refer to chapter 9, where I discuss small estates, but in some cases a trust is called for even if non-trust alternatives are available. For example, you may have only your house, a small savings account, and a life insurance policy to leave your children at your death. These could be handled without a trust and without probate by devices such as joint ownership and beneficiary designations.

But suppose you have one of the categories of concerns I covered earlier, such as a disabled child, an unmarried partner, an unequal distribution plan among children, or spendthrift heirs? You can, by using a trust, see that the money available is used for specific purposes, like paying off a child's education loans or tuition or holding it for them until they meet certain conditions you set up. And remember the problem with a person receiving assets that may disqualify him or her from receiving Medicaid or other need-based benefits. I have had a number of clients who were estranged from their children and even some who have children in prison. They may not want these children to share in the estate, and a trust can easily accomplish this intent. Trusts can be a way of making maximum use of a limited amount of money.

I have had people tell me that they are concerned about the cost of probate in their small estate because of the amount of cost relative to the size of the estate. Paying three or four thousand dollars for probate may be affordable for a $500,000 estate but may seem like a large share of a $100,000 one—especially if there are a lot of heirs. I have seen cases where the attorney got a bigger share of the estate than did the individual beneficiaries after all the probate costs were figured. This should not happen with a trust.

DISABILITY

A trust and its related documents avoid the need for court-ordered adult guardianship and conservatorship. A legal guardian is the person who is in charge of caring for a disabled adult, whether due to mental or physical disability, to the point that the person cannot take care of himself. This is done under the authority of the probate or family court and requires a fairly complex legal process. A petition is filed either by a social agency or family member stating the need for the guardianship. The court appoints an independent lawyer, a "guardian ad litem" (GAL) for the allegedly incapacitated individual—the ward. This procedure and the terminology will vary state by state, but the process is similar.

The GAL interviews the ward and others who have knowledge about the ward, reports back to the court in writing, and usually appears in person at a court hearing. All relatives are notified and can attend the hearing or bring their own attorneys. The judge then decides whether the guardianship is needed and, if so, appoints a guardian who from then on has to report to the court in writing and in person on how the ward is doing. The estate of the ward has to pay the guardianship fees.

A conservator—a person appointed by a court to manage the money of another person—is usually appointed at the same time. Minor children may have conservators. Disabled adults may also have conservators. The purpose of the conservatorship is to be sure that the ward's (the person who is in need of the conservatorship) money is being honestly and effectively managed. This is a valuable service for the ward, but it comes at a high cost to the family. Often the guardian and the conservator are different people, not family members, and both are paid from the assets of the ward.

In order to establish a conservatorship for an adult, an interested party petitions the court. This may be a family member, a state agency such as Adult Protective Services, or even a concerned nonfamily member. This person or agency states in writing why he or she believes the ward needs a conservator. The court then appoints a GAL, typically an attorney or county agency, who visits the ward, investigates the situation, then reports back to the court with a recommendation on whether a conservatorship is needed. Then there is usually a court hearing. Family members and others can testify under oath as to the facts they know relating to the mental state of the ward, giving examples of what the ward may be doing to cause the need for someone else to take over.

This is often a humiliating experience for the ward and embarrassing to the family. The expense is high because the ward has to pay the GAL even if the conservatorship is found to be unnecessary, and the family may have to hire one or more other attorneys to promote their view of the conservatorship.

It doesn't stop there. If the conservatorship is granted, the conservator charges additional annual fees for acting as conservator. Further, the assets of the ward may have to be placed in restricted accounts with little opportunity for the best investment management. The conservator has to account to the court annually for everything financial that is done and may even need individual permission for extraordinary expenses of the ward.

All this is avoided with a trust. The trust has language that defines when a person is to be considered incapacitated, and when that occurs, the alternate or successor trustee immediately steps in and begins managing the assets of the trust owner. When combined with the medical directives and power of attorney that are part of the trust-based estate plan (see chapter 12), there is no need for a court-supervised guardianship and conservatorship. In fact, I have defeated petitions for guardianship in court merely by showing the judge that the proposed ward already had a durable power of attorney and medical power of attorney, as well as a revocable trust with a trustee in place managing the assets.

If you have any of the concerns outlined above, you absolutely must have a trust or the inherited assets are likely to be wasted or misused.