CHAPTER NINE

You Do Not Need a Trust If …

I know I stated earlier that nearly everyone needs a trust for one reason or another, but in certain very limited situations, a trust may not be needed for some people. Sometimes cost is a concern, as having an attorney prepare a trust can cost much more than will preparation and you may just not be able to afford the trust.

ALTERNATIVES TO WILLS AND TRUSTS

I typically prepare a handful of wills each year and hundreds of trusts. Sometimes I send potential clients away with neither. Below are some examples of reasons why.

No Probatable Assets

A person who owns no real estate or investments often will not go through probate, so probate avoidance would not be a reason to have a trust. Bank accounts can have co-owners on them or, in some cases, beneficiaries (sometimes called pay-on-death designees). If a person wants his limited assets to be given to particular people with no strings attached, assuming the people to whom the assets are to be given are adults not suffering from any disability, a beneficiary designation or co-owner on the account may be all he needs to meet his estate planning needs. (Even those who do not need a trust should still have a durable power of attorney and medical directive—more on this in chapter 11).

Small estates will not have to be probated. In most states, there is a threshold below which estates do not have to go through the whole probate process. Usually there is a simplified way to transfer small-sized estates to the beneficiaries. It may be by use of a notarized affidavit or by use of short forms filed with the appropriate court office.

The threshold varies from state to state. In California, for instance, estates under $100,000 do not have to go through probate. In Michigan, the amount is much lower, based on a formula that amounts to $20,000 after the deduction of funeral and burial expenses. There are also other deductions that can be made in specific circumstances—usually for married couples or those with minor children to increase the threshold amount. These may be called spousal allowances, homestead allowances, or exempt property, but the idea is that you may not have to go through full-blown probate, depending upon the nature and amount of the assets of the deceased.

Beneficiary Designations

Beneficiary designations can be a way of avoiding probate if there are no other probatable assets. Probatable assets are those that must go through the probate process in order to transfer the title to the heirs who are supposed to receive them. Some assets, though, are not subject to probate, because there is another way of transferring them. Joint ownership, described in the next section, is one way, and beneficiary designations are another. Keep in mind that a personal trust may be designated as a beneficiary of an account as described in chapter 7.

Examples of assets that may be transferred by way of a beneficiary designation follow.

Life Insurance. Everyone knows that life insurance is left to the policy owner's survivors by way of a written beneficiary designation. The beneficiary then is the person who receives the life insurance payoff at the insured's death. Suppose there is no named beneficiary who survives the insured. In most cases, the "estate" of the insured receives the death benefit.

"Estate of the insured" refers to the probate estate of the insured. So probate is necessary in this case to cash the check for the life insurance, provided that it exceeds the probate threshold in the state of residence of the deceased.

Insurance policy provisions can change this result by setting up default beneficiaries in the event a beneficiary dies. For example, the policy may provide that the money goes to the insured's next of kin. Talk to the lawyer.

If the deceased had a trust, then the trust would be named as the beneficiary. If not, then individuals would be named to get the death benefits. It is possible to leave beneficiaries different shares of a life insurance policy. For example, you may say your son is to get 40 percent of the life insurance as a beneficiary and your daughter to receive 60 percent. Beneficiaries do not have to be treated equally.

Retirement Accounts. Tax-deferred accounts come in many flavors, such as IRAs, 401(k)s, 403(b)s, SEP accounts, tax-deferred annuities, and many more. All of these can be left to an heir by naming that person as the beneficiary of the account. The beneficiary then steps into your shoes in a way, since he has the ability most of the time to make his own elections as to when and how much to withdraw from the account.

Joint Ownership. One of the traditional ways of avoiding probate, often recommended by lawyers, was to add someone's name on an account or a parcel of real estate. At the death of the original owner, all that had to be shown was the death certificate, and the property belonged to the survivor. It does work to avoid probate. Unfortunately, joint ownership, if not set up correctly, can lead to unanticipated problems. For example, putting someone else's name on your property can mean that you now need the co-owner's permission (and in some states if he is married, his wife's) to mortgage or sell the property. If he refuses, there may be nothing you can do about it. So be cautious using this approach. It can also lead to loss of the "stepped-up tax basis" causing the new owner expensive capital gains taxes at the time of your death. Merely putting the property in a trust or in a special type of joint deed (such as the ladybird deed explained later in this chapter) gives you the stepped-up tax basis at death and minimizes any capital gains tax.

Gifts. Putting someone else's name on your account or property with the intention that they receive it at your death is a gift to them. The gift is subject to federal gift tax laws, and if the value of the gift exceeds the annual exclusion amount ($14,000 at the time of this writing), a gift tax return is supposed to be filed to give that information to the IRS. The annual exclusion amount applies to each person to whom you give a gift. No gift tax is due unless the total value of all gifts in excess of the annual exclusions is greater than $5.45 million during your lifetime.

Also, the making of the gift means that the assets are now assets of the new owner and subject to the claims of the new owner's creditors, including being reachable in bankruptcy proceedings, and may become marital property for divorce property division purposes. Do you want your property tied up in this manner? Probably not, which is why a trust is the best way to handle your estate plan.

Tax Basis

The whole area of tax basis, carryover tax basis, and stepped-up tax basis is in flux right now. Under current law, making a gift of property to a person by putting his name on it as a way of avoiding probate may result in a much lower tax basis for that person (meaning higher capital gains taxes) than would putting it into a trust where he could elect to get a stepped-up tax basis (meaning lower capital gains taxes).

Loss of Control

Once you put someone's name on your real estate, you now need his permission (and the permission of the wife of a male co-owner in most states) to sell, mortgage, or give away the property. Most people do not want to give up the control of their own real estate. I once had a two-year court battle representing a mother who wanted to get her children's names off her deeds—something she did on the advice of her not-so-smart attorney.

Probate Not Avoided

Probate is not avoided; it is merely postponed. While probate is avoided on the death of one person, at the death of the survivor, the property would have to be probated to go to the heirs of the survivor. The survivor would need to make his or her own estate plan to cover this problem.

Transfer on Death Deeds (Ladybird Deeds)

There are many people who have very little in assets other than their home and a very simple plan for those assets at death. A full-blown trust-based estate plan may be too expensive for them. In those situations, there is a simple alternative. It does involve a type of joint deed, which I have just warned about, but by setting it up properly, you can avoid most of the pitfalls of joint deeds and still avoid probate. This type of deed is sometimes called a “ladybird deed” after the former first lady, wife of President Lyndon B. Johnson, part of whose estate was handled in this manner.

The deed says that the grantor of the property is adding one or more names to the deed, but until the grantor’s death, she still retains the right to sell, mortgage, or transfer the property without the permission of the new co-owners. In effect, a gift is made, but it is a contingent gift (what lawyers call a gift of a future interest), which may or may not come to fruition. If the grantor sells the property, the interests of the newly added people are revoked. Because the gift is contingent, the new people cannot exercise any rights of ownership, the property is not reachable by their creditors, and the grantor does not need their permission to mortgage or sell the property. It becomes like a mini-trust.

Some attorneys are now drafting the ladybird deed even for people with regular trusts, naming the trust as the contingent joint owner in answer to some court decisions that put into question the availability of title insurance for trust property or of Medicaid qualification. Medicaid is the federal program providing medical care for indigents. It is administered by the states, and each state has its own requirements for qualifying for this benefit. The common requirements are meeting certain minimum asset and income limitations. So a person who does not qualify because she exceeds the asset threshold may be able to change the ownership status of some of the assets to fit into the program.

The rest of the assets of the grantor should either be handled with beneficiary or transfer-on-death provisions; if they are small enough in value to fall below the threshold for requiring formal probate in that state, they may qualify for an expedited or affidavit probate process.

The grantor still should have a durable power of attorney, medical power of attorney, and living will, as explained in chapter 12.