

## 13. THE REVOCABLE TRUST

### Creation of Trust

A trust is created when one party transfers legal ownership of property to another party for the benefit of a third party, but retains the right to specify, in writing or otherwise, what the responsibilities of the trustee will be.

A trust may be created by will (a testamentary trust), between parties during life (an *inter vivos* trust), or by declaration. The terms *inter vivos* trust and living trust are synonymous. A declaration of trust occurs when the trust creator declares the intention to own property in trust and names him/herself as the initial trustee.

### Essential Trust Elements

#### 1. Creator

The creator of a trust is known by several synonymous terms: grantor, trustor, or settler. The creator transfers owned property to another to hold for a specified purpose. (While the focus of this chapter is personal trusts, recognize that trusts can also be created by other legal entities such as corporations or governmental entities.) The grantor may or may not retain powers over the management of the trust and may or may not continue to be involved as a trustee or beneficiary. Lacking retained powers or rights the grantor's continuing relationship to the trust is nominal.

Generally, anyone who is an adult under state law (usually eighteen or older) can create a trust. The grantor is required to have mental capacity sufficient to understand the implications of the document. This would include the ability to know generally the nature and situation of the subject property, the persons who would have a claim on the trustor's remembrance and the ability and freedom to act independently in creating the trust. Generally, if the trustor has the mental capacity to create a will, the trustor has the mental capacity to create a revocable *inter vivos* trust.

#### 2. Trustee

The trustee is a fiduciary who manages trust assets pursuant to the directions set forth in the trust agreement and applicable law. The trustee is the one who is trusted to care for the trust property and to do what the trust document instructs. Implicit in the role of trustee is the requirement for the trustee to act solely for the benefit of trust beneficiaries with undivided loyalty. It has been written of the trustee's duty, "The first and most important duty of the trustee is to study and become thoroughly familiar with the provisions of the trust instrument and thereafter to follow them implicitly" (Charles Rounds, Jr. quoting Augustus P. Loring in *Loring: a Trustee's Handbook*, 2001).

The trustee may be a person, a bank, another corporate trustee, or a charitable corporation (if the corporation's articles of incorporation and state law so allow), or a combination of these. During the formative years of Seventh-day Adventist Planned Giving & Trust Services it was common for the church member grantor to name the church organization corporation or association as the trustee. However, it is becoming increasingly common for the church

member grantor to name himself or herself as the initial trustee with another person, bank or corporate trustee, or the church organization corporation as successor trustee to assume office upon the death or disability of the grantor. In this case, the revocable trust is commonly referred to as a *self-trusteed* or *self-administered* trust.

Legal capacity to serve hold and manage property in trust is one thing; fitness to serve as trustee is another. A person or entity with legal capacity to take title or hold property for oneself can generally do so as trustee. A natural person must be of majority age to serve as trustee. Some states may require residence in the state. Fitness to serve as trustee includes adequate mental capacity. Fitness also includes the ability to properly and honestly safeguard assets, handle financial transactions, engage in investment functions, and perform accounting and tax reporting duties. Fitness also includes the commitment of time, monetary and staffing resources to assure that trustee duties are properly performed. The trustee must also possess ability to manage a set of potentially complex relationships among lifetime and remainder beneficiaries.

### **3. Property**

The third essential element of a trust is the trust property. The transferred property is usually called the trust corpus or principal. Generally, a trust cannot exist without property, although in some jurisdictions a trust created during life (*inter vivos trust*) can be initially funded with a transfer at death either through will or beneficiary designation. The transferred property can generally be any type of property capable of ownership transfer (such as cash, securities, bank accounts, real estate, tangible personal property, contract ownership etc.). Even though a wide variety of property can be transferred to the trust does not mean that all assets are suitable trust assets.

The trust represents a split ownership of property. The trustor retains the “equitable” right to the transferred property, while the trustee holds the legal title. Equitable rights involve the right to use, enjoy and benefit from trust assets. For example, the grantor may retain the right to receive trust income and occupy trust real estate. Somewhat simplistically, the trustee has all rights to trust property except the right to its benefit; that right is given to the beneficiary.

In some jurisdictions, legal title may be held in the name of the trustee without reference to the trust (e.g. General Conference Corporation of Seventh-day Adventists), but it is generally preferred for title to be held in the name of the trustee, as trustee for a specifically named trust (e.g. General Conference Corporation of Seventh-day Adventists, trustee of the John and Mary Doe Trust). Legal title includes possession and control of the asset or title document. Legal title also includes the right to transfer ownership. In many revocable living trusts for which a church organizations serves as trustee, the trustee’s right and obligation as to property is to hold bare legal title and rely on grantor written instructions for investment and lifetime disposition of trust assets.

It is absolutely essential that the assets of any trust be kept separate from the trustee’s personal or corporation owned assets. Mingling the trust funds with funds belonging to the trustee generally is held to be a breach of trust. Many states prohibit co-mingling by statute; some states consider it to be a criminal act. A trustee who co-mingles trust funds with other owned funds exposes trust assets to the trustee’s creditor’s and invites personal responsibility

for loss. A trustee is held strictly accountable for co-mingled funds and any doubt will be resolved against the trustee.

#### **4. Beneficiaries**

The fourth essential part of a trust is the beneficiaries. Without a beneficiary there is no trust. The beneficiary is the person or class of persons for whose benefit the trust exists. The beneficiary must be specific, either named individually or described sufficiently to be definite (such as “the children of the grantor then living”), and must be identifiable before the termination of the trust.

There are two kinds of beneficiaries: income and remainder.

One type of income beneficiary has a *mandatory* interest; meaning that under the trust terms all income must be regularly paid out. Such income distributions are mandated at least annually or at a more frequent interval as the beneficiary and trustee agree. A trust might also make the income distribution *discretionary*, which leaves the decision to the trustee to pay out all or part of trust income in a given period. Income retained in the trust is usually added to trust principal and re-invested.

It is common in *inter vivos* trusts and declarations of trust for the grantor to retain the right to income during life, thus being the primary trust beneficiary. A trust could also name another individual or class or organization to receive trust income. Some income beneficiaries also receive or retain the right to withdraw trust principal from time to time or upon the occurrence of certain events.

A second type of beneficiary is the remainder beneficiary or remainderman. The remainder beneficiary takes the trust principal and accrued income, if any, remaining when the trust terminates.

#### **5. Trust Agreement**

The written terms and conditions of the trust are the final element of a trust. The trust agreement defines the rights, duties, and obligations of all parties to the trust. The terms of a trust will ordinarily govern the authority and duties of a trustee, to the extent those terms are possible and legal. The terms can be restrictive, forbidding an otherwise proper activity of the trustee, or they can expand the trustee’s authority, permitting actions that may be generally improper for a trustee.

Typical provisions in a revocable living trust agreement or declaration of trust for an individual or married couple may include the following:

- a. the name(s) of the trust creator (grantor) and that of the initial trustee,
- b. the grantor’s expression of intent to create a trust,
- c. a statement of grantor’s intent to transfer property to trustee and agreement by trustee to accept such property,
- d. whether the grantor, or anyone else, may amend or revoke the trust, add or withdraw assets,

- e. identity of successor trustee(s), conditions under which and in what order the successor trustee would serve,
- f. what powers the trustee should have, in terms of investment and management, and what discretion the trustee is to have in terms of releasing money or other trust property to beneficiaries,
- g. identity of the primary trust beneficiaries,
- h. who is to receive distribution of the trust estate upon the death of the grantor (remainder beneficiary, and
- i. when the beneficiaries would be entitled to receive the distributions.
- j. statement of governing state law

### **Benefits of a Revocable Trust**

1. Generally, properly titled trust assets do not become part of the probate assets of the decedent. Avoidance of probate may result in some cost savings as well as a timelier disposition of the trust assets. It must be kept in mind, however, that some trustee duties, like those of an executor/personal representative, take time to complete. These activities include, but are not limited to liquidating assets, determining and paying final expenses, filing tax returns, paying creditors, locating beneficiaries, and making distribution.
2. The trust is not normally filed with a court or made a part of any public record; and it is, therefore, more likely that it will remain a private document. It is likely however, if the trustee sells real estate, that recordation of a Memorandum of Trust Existence and Authority or similar document will be required. In those jurisdictions which assess an inheritance tax disclosure to taxing authorities of the names of trust beneficiaries, their relationship to the deceased grantors and their interests under the trust may be required.
3. A trust can generally avoid the necessity of a court appointed guardian and/or conservator by providing uninterrupted administration through any period of grantor disability or incapacity.
4. A trust may provide an increased certainty of result. The probate process offers an opportunity for interested parties to challenge the validity of the will. The revocable trust is not subject to the rules of probate and any attack must be based upon the more difficult showing that the grantor acted under duress or undue influence. This would be difficult to establish if the trust has been in operation for a significant period prior to the grantor's death.

### **Tax Consequences of the Revocable Trust**

For virtually all purposes the property in an *inter vivos* revocable trust remains the property of the grantor. Thus the grantor remains liable for all income taxes on income earned by trust property. Moreover, there are no gift taxes payable on the amounts placed in the trust because, due to the grantor's retained power of revocation, the transfer to trust is incomplete for gift tax purposes. Finally, when the grantor dies, the trust property is included in the grantor's taxable

estate for federal estate tax purposes. Despite common perception, there are no tax savings realized through *inter vivos* revocable trusts.