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Living Trusts

A living trust is a valuable estate-planning tool, in that it can avoid probate and reduce or eliminate estate taxes. In many cases, the living trust is the center of the estate plan.

To create a living trust, a person (called the "settlor") executes a trust agreement. After the trust is created, the settlor transfers his or her assets to the trust. The trust holds *title* to the assets. Although the settlor relinquishes title to the assets, the settlor still retains *control* of those assets. A trustee appointed by the settlor manages the trust assets. In most cases, the settlor is also the initial trustee. As the trustee of the trust, the settlor continues to have the same power to buy, sell, transfer, and otherwise control the trust assets.

ILLUSTRATION #1: John executes a trust agreement, thereby creating a living trust. John then transfers title to his house to himself, as the trustee of his trust. John is both the settlor and the initial trustee in this example. Although the trust now holds title to John's house, John still retains control of it.

The trust is *revocable*, which means that it can be modified or terminated by the settlor for so long as the settlor is alive and competent to make a contract. In some sophisticated estate plans, it may be desirable to create one

or more *irrevocable* trusts, such as an Irrevocable Life Insurance Trust (discussed in the companion article on the next page).

Parties to a Trust

The *trustee* is the person who handles the administration of the trust. When a trust is first created, the trustee is usually the same person as the settlor (the person who created the trust). When a married couple creates a trust, both spouses usually serve as the trustees. The *surviving trustee* is the person who continues to manage the trust after one of the original trustees has died. The surviving spouse is typically the primary *beneficiary* as well as the surviving trustee. A successor trustee is a person or entity that is named to succeed the surviving trustee upon death or incompetence. The *successor trustee* has the same powers as the original trustees.

For a trust to be effective in avoiding probate and minimizing taxation, the settlor's assets must be placed inside the trust.

Assets

Assets may include bank accounts, real estate, and motor vehicles. The process involves simply changing the title to the assets

to the trust. The person who controls the assets does not change; only the title to the assets does.

Transferring assets into the trust should have no or little cost. The settlor is the person who (with the assistance of counsel where necessary) places the assets into the trust and is the same person who has the right to also transfer those assets from the trust. Assets acquired after the trust is created should also be titled in the name of the trust.

ILLUSTRATION #2: John sells his house after it has been transferred into the trust, and he buys another. The new house should also be titled in the name of the trust.

Because the settlor owns nothing in his or her name (all of the assets were placed in the trust), there is nothing to probate upon the settlor's death. If the settlor is married, the surviving spouse typically becomes the surviving trustee and, as such, continues to have the same power to buy, sell, or transfer the assets. Upon the death of the surviving spouse, the same situation applies as before. Since no assets were in the name of the deceased, there is nothing to probate. The trust agreement will identify who is to act as the successor trustee upon the death of the surviving spouse.

Types of Trusts

The trust document can take one of several basic forms. The two basic forms discussed in this article are the A Trust and the A-B Trust. These are the most common. There are other forms of trusts (such as the A-B-C Trust), but they are best left to be explained by estate planning counsel retained for that purpose.

One important reason for having a trust is to avoid paying unnecessary estate taxes. The form that best suits a particular situation will depend on the person's marital status, the value of the estate, and the potential distribution desired for the heirs.



Living Trusts

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The A Trust can be used for single persons or married couples, but must always be used when only one person is involved. (The preceding illustrations assumed an A Trust). For estates valued at less than \$2,000,000 in 2008, the entire estate will flow down to the heirs without estate taxes. For estates valued at more than that amount, estate tax will be due. (The \$2,000,000 unified credit exemption amount, referenced in the second to last sentence, will increase to \$3,500,000 in 2009, before repeal in 2010.)

The A-B Trust is generally used for married couples. Couples whose combined estate now exceeds \$2,000,000 should consider the A-B Trust in order to take advantage of the unified credit exemption. Upon the death of one spouse, generally half of the assets will flow down into the B (or decedent's) Trust, and the other half will be passed down to the surviving spouse in the A (or survivor's) Trust. The entire estate will remain available to be used by the survivor, subject to certain restrictions imposed by the IRS.

ILLUSTRATION #3: John and Mary, a married couple, create an A-B Trust. Their combined estate is worth \$3,000,000. Assuming John dies, half of the assets, worth

\$1,500,000, will flow down into the B (or decedent's) Trust, and the other half of the assets, also worth \$1,500,000, pass down to Mary in the A (or survivor's) Trust. The entire estate will remain available to be used by Mary, subject to the restrictions discussed in the following paragraph. There will be no estate tax owed as a result of either John or Mary's death.

In most revocable trusts, the surviving spouse is named as the beneficiary of the B Trust (as in the above illustration) and, accordingly, has the right to all of the income of the B Trust; the right to use the principal in the B Trust for certain enumerated purposes; and the right to spend \$5,000 (or 5 percent of the assets—whichever is greater) in the B Trust each year, for any reason. The surviving spouse retains absolute control over the assets in the A Trust.

Because of the potential benefits of having a living trust in an estate plan, every person owning assets should consult estate planning counsel to consider whether a living trust is appropriate for him or her. ■

This article was excerpted from Estate Planning in Arizona: What You Need to Know, by Donald A. Loose (Wheatmark 2008), and edited for this publication. Reproduced with the author's permission.

LBA Hires Estate Planner



Loose Brown & Associates is pleased to announce that Robert Hobkirk, an estate planning attorney, recently joined the firm. Rob attended Albany Law School, and is admitted to the

state bars of Arizona, New York, and Connecticut. He is also a member of the American Bar Association and Maricopa County Bar Association. Rob practices in the areas of trusts and estates, estate planning, probate, business law, and real estate.

Gina Horn Becomes Certified Paralegal



We are pleased to announce that our paralegal, Gina Horn, successfully completed the two-day CLA/CP examination given by the National Association of Legal

Assistants. By successfully completing the exam, Gina joins the select rank of paralegal professionals qualified to be called "Certified Paralegals." Congratulations to Gina on her accomplishment!



Special-Purpose Trusts

The use of a special trust may be desirable to meet the unique challenges presented by a blended-family situation (where the family structure has changed because of divorce, separation or remarriage), or to avoid payment of estate taxes. Here are two common forms of special trusts:

Qualified Terminable Interest Property (QTIP) Trust

The QTIP trust is often used by individuals who have children from another marriage. It is a special trust that lets the maker of the trust (the "settlor") use the unlimited marriage deduction, provide for his or her spouse after death, and defer potential estate taxes until the second death while retaining ultimate control over the distribution of his or her property. In using a

QTIP trust, a certain portion of the settlor's estate is transferred upon death into a trust that pays income (and potentially principal) to the settlor's spouse for his or her lifetime. At the spouse's death, the principal passes to the beneficiaries that the settlor has designated, typically the children from the settlor's first marriage.

Irrevocable Life Insurance Trust (ILIT)

The ILIT trust allows an insurance policy to be held in a trust so that it will not be included in the settlor's taxable estate. In order for the settlor to receive full tax advantages offered by an ILIT, the settlor cannot name himself or herself, or his or her spouse as the trustee. Currently, an individual can contribute \$12,000 annually (\$24,000 if married) per beneficiary to pay the premiums on the life insurance policy held in the trust. Upon the death of the settlor, or the settlor and spouse, the life insurance policy's proceeds are paid to the trust. The trustee then distributes that money to the beneficiaries as outlined by the terms of the trust.

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Ten Common Misconceptions About Wills

- 1 If I don't have a will, my property will go to the state.** False. If you don't have a will, your property will go to your heirs under the law of descent and distribution in Arizona. Your property will go to the state only if you die without a will and you have no living relative to inherit it.
- 2 If I have a will, all of my property will automatically pass under it.** False. Some or all of your property may pass outside your will by reason of survivorship provisions, joint title, pay-on-death clauses, and beneficiary designations in deeds and contracts. For instance, life insurance proceeds will be payable to the beneficiaries that you have designated in the insurance contract, regardless of the terms of your will.
- 3 The will that I executed before I moved to Arizona is invalid.** False. If your will was valid in the state or country in which it was executed, it is valid in Arizona. (Yet it is a good idea to update your will in your new state.)
- 4 I have to execute a living trust to avoid taxes on my estate.** False. Most estates will not be subject to taxation with or without a living trust. In 2008, up to \$2,000,000 is exempt from estate taxes (assuming no lifetime transfers). The unified credit exemption is scheduled to increase to \$3,500,000 in 2009, before repeal in 2010. If you are married, you can leave an unlimited amount to your spouse without payment of any estate taxes.
- 5 If I execute a will, my estate will be subjected to costly attorney fees and probate charges when I die.** False. It is not inherently expensive to probate a will in Arizona. An informal and inexpensive probate process is available in most cases. There are no separate probate fees, other than a small filing fee to start the case.
- 6 It is always less expensive to leave my property under a living trust than a will.** False. In some cases, it is actually more expensive to create a living trust than to informally probate an estate. It depends on the nature and value of your assets.
- 7 If I execute a will, I will be unable to create a trust for my children.** False. One or more trusts can be created in a will. These are known as "testamentary trusts," and take effect upon the death of the person executing the will. By use of a testamentary trust, you can set aside money or property for the future benefit of your children. The testamentary trust will be administered by the trustee you appoint in your will.
- 8 If my estate is probated under a will, my assets will be tied up for years in the courts.** False. Informal probate can be started almost immediately after your death, allows the personal representative immediate access to your assets, and, in most cases, can be completed in nine months or less.
- 9 My will must be filed after it is executed.** False. There is no provision for the filing of a will in Arizona, until after the death of the testator. The original stays with the testator after execution.
- 10 It is better to keep my will in a safe deposit box than at home.** False. Accessing a safe deposit box is often difficult and time consuming after the death of the person renting the box. A better place to keep your will is at home with your other important papers, where family members can easily access it.

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Estate Planning in Arizona

What You Need to Know

Are you interested in paying the minimum amount of estate and gift taxes? Would you like to avoid probate and keep your financial affairs private? Estate Planning in Arizona is the reference you need. Written for Arizonans with little or no legal experience, this book tells you what you need to know:

- The basics of wills and trusts
- Protecting your assets
- Appointing guardians for your children
- Taking title to real estate
... and much more!

Providing you with a better understanding of the laws and issues involved in estate planning, this comprehensive, easy-to-understand book will help you to preserve wealth, protect your family, and create a winning succession plan.

Praise for *Arizona Laws 101: A Handbook for Non-Lawyers*, by Donald A. Loose

"Interpreting the legal jargon and navigating the various laws can be a daunting task for even a trained professional. That's why Arizona Laws 101: A Handbook for Non-Lawyers is so helpful."

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