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Revocable Trusts—To Fund or Not to Fund?

Many local estate planning practitioners (including lawyers at our firm) prepare estate plans that include both a will and a revocable trust.

By **Rebecca Rosenberger Smolen and Amy Neifeld Shkedy** | July 02, 2018

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Many local estate planning practitioners (including lawyers at our firm) prepare estate plans that include both a will and a revocable trust. This basic structure includes a bare bones will under which the executors of the estate and guardians of any minor children are appointed, but all of the assets of the probate estate are "poured into" the client's simultaneously executed revocable trust (sometimes known as a living trust) at the client's death. The revocable trust itself is structured to be a "will substitute." The revocable trust

(rather than the will) contains the meat of the estate plan after a decedent's death, whether that includes outright distributions to heirs or distributions in trust for the benefit of heirs.

Revocable trusts are used for multiple reasons, such as probate avoidance, privacy concerns (since, technically, a revocable trust is not a public document, unlike a will once probated) and ease of beneficiary designations.

It is important to understand that revocable trusts are not used for lifetime tax planning. We have found that many individuals are under the impression that funding a revocable trust will provide a tax planning opportunity, however that is simply not the case. As long as the creator (known as the settlor or grantor) of the revocable trust is living and has the ability to amend or revoke the revocable trust, there has been no shift of control or beneficial enjoyment of the trust assets. Therefore, there has been no transfer of the settlor's wealth for gift or estate tax planning purposes. The key provisions of the revocable trust for a settlor's intended beneficiaries do not take effect until after the settlor's death, and that is why it is referred to as a will substitute. Thus, there is no lifetime tax planning that can be accomplished by having a revocable trust.

One of the reasons that revocable trusts are utilized is for probate avoidance. Once a client has established a revocable trust, he always has the option of funding the revocable trust during his lifetime so that ultimately, when he dies, most or all of the estate assets will already be in the revocable trust, and, thus, avoid the need for a "probate." The term probate means the legal process of settling an estate after someone dies through the local court system. As part of that process, the executor or administrator (also referred to as a personal representative) of the estate is officially appointed by the probate court (i.e., the Register of Wills in Pennsylvania or Surrogates' Court in New Jersey). The probate court then validates the will (if one exists) and grants legal authority to

the executor or administrator to administer the decedent's estate by paying all creditors (including the taxing authorities) and distributing the remaining assets of the estate to the beneficiaries. Probate assets are all assets that were owned by a deceased person and that pass to beneficiaries named in the deceased person's will or, in the absence of a will, pass to the heirs in accordance with applicable state "intestacy" laws. Such assets do not have a survivorship feature (such as a jointly owned home or joint account, where assets pass automatically under applicable law to the surviving joint tenants) or beneficiary designation (such as life insurance policies or retirement accounts) to control who receives the property when one dies, so they must go through probate.

If a decedent re-titled individually owned assets to his or her revocable trust during his lifetime, then any such assets would be nonprobate assets and, therefore, not subject to probate. The question for each client is whether or not it is worth it to re-title assets (such as brokerage accounts, bank accounts, real estate, etc.) into a revocable trust during an individual's lifetime for the sole purpose of avoiding probate. The answer is not always yes, and often varies state by state.

The probate process varies significantly from state to state. In some states, such as New York, Florida and California, the probate process can be quite costly, slow and complicated. In many states, a good deal of an attorney's billable time is needed to navigate through the various probate issues and to prepare and file a petition with the probate court. In a few states, such as California, attorneys and personal representatives (i.e., executors/administrators) may charge a high statutory fee that is a percentage of the value of the assets that go through probate, regardless of how much work is involved. For example, if a decedent owned one piece of real estate in California that was worth $1 million (regardless of whether there is a mortgage on the real estate) and no other California probate assets, the attorney and the

personal representative would each be entitled to receive $23,000 (if they both take the fee, that would be double, or $46,000). There are also probate fees charged by the court system on top of this. Thus, it is customary and standard practice for individuals living in certain states to fund revocable trusts during their lifetimes in order to avoid the probate process.

Probate is not always so complicated or costly. In some states, like Pennsylvania and New Jersey, the probate process is straightforward and user-friendly, so probate avoidance is not necessarily imperative. Probate fees in Pennsylvania and New Jersey are not as costly as in other jurisdictions, although this varies from county to county. In Montgomery County, Pennsylvania, for example, the probate fee for a $1 million probate estate is around $550 and for a $5 million probate estate, it is under $2,000. In Philadelphia, however, the fees are a bit higher (about $1,300 for a $1 million probate estate or $5,500 for a $5 million estate). This fee is only on probate assets, so retirement accounts and life insurance policies, joint assets and other assets that are nonprobate by nature would not be included in this probate fee calculation. In New Jersey, the probate fees are much lower—they are set fees based on the number of pages of the will (e.g., $100 for a two-page will plus $5 per page for additional pages).

It is important to keep all of this in mind when deciding whether or not to fund a revocable trust simply for the purpose of avoiding probate. In some cases, it may be more costly and time consuming to go through the process of re-titling assets to fund a revocable trust than it would be to go through the probate process itself. Re-titling often involves deed preparation and recording fees for real estate as well as consultation with attorneys and brokers. The time and expense involved may not be worth it. That being said, for Pennsylvania and New Jersey decedents who have real property in other states (such as a Florida vacation home), it is generally advisable to transfer such individually owned real estate into a revocable trust to avoid the cost and hassle of an “ancillary

probate" in that other jurisdiction. Thus, it is helpful to have a revocable trust structure in place for this purpose, whether an out of state property is currently owned or may be acquired by a client in the future.

Even if probate avoidance is not a goal for a particular client, having the pour-over will/revocable trust structure in place adds value by providing flexibility in case there might be a reason to fund the revocable trust in the future. Even if the revocable trust is not funded during an individual's lifetime, at the very least the revocable trust will be funded at death from the assets pouring over from the will. Also, we have found that having a revocable trust document in place can be particularly helpful for implementing change of beneficiary designation forms, where trusts under the revocable trust may be named as primary or contingent beneficiaries for a life insurance policy, IRA, annuity or retirement plan. While a testamentary trust under a Will can be named as a beneficiary, it is generally easier under the applicable forms to designate a revocable trust as beneficiary.

Revocable trusts can be useful for multiple reasons. However, it's important to determine for each client whether there is value in "funding" a revocable trust during the client's lifetime. It is by no means one-size-fits-all for Pennsylvania and New Jersey residents.

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