

Chapter IX

Lifetime and Testamentary Trusts Commonly Used in Estate Planning

A. Overview and Purpose

In this chapter we will examine the legal concept of a trust and explore its use in typical estate planning situations. The discussion starts with a description of trust terms and concepts. The next area of focus is to examine the use of trusts in typical estate planning settings. A brief review of the inheritance, estate, and gift tax aspects involving trusts will be included in the next discussion. The final area of consideration will look to the application of a trust to woodland estate planning situations specifically.

B. Lesson Objectives

After successfully completing this chapter you will be able to accomplish the following objectives:

1. Understand the meaning of basic trust terms and terminology.
2. Explain the nature of a trust relationship in comparison to other types of property ownership.
3. Explain the application of trust concepts in estate planning.
4. Review and consider the application of the trust concept to an estate plan in which an active farm is included.

C. The Concept of a Trust

A trust is a special legal relationship that the law describes as a "fiduciary" relationship. A person who undertakes the responsibility to act in a fiduciary relationship accepts the duty to act primarily for another's benefit in carrying out the task that he or she assumed. If property is transferred to a person or entity acting as a fiduciary, legal title to the property is held by the trustee, but title is held for the benefit of another and not for the benefit of the fiduciary. The relationship of a trust creates legal ownership in the hands of the trustee and an accompanying obligation on the part of the trustee to maintain ownership of the property for the benefit of another.

1. Elements of a Trust

A trust has several elements. *First*, someone or some entity must be designated to act as the **fiduciary**. A fiduciary can be either an individual or a corporation that has legal authority to act as a fiduciary built into its charter. In common practice such powers are part of banking company charters, but all financial institutions do not have such powers. The person or entity who acts as the fiduciary is the **trustee** in the trust relationship. The person who creates this relationship and establishes the trustee as a fiduciary is the **grantor or settlor**. *Second*, for a

trust to come into existence, the grantor must transfer property to the trustee with the intention to create a trust. *Third*, the trust relationship is created for a specific purpose that does not involve committing a crime, violating a person's personal or property rights, or violating a rule of conduct supported by a clear public policy. *Fourth*, the trust must designate the person or persons benefitted by this relationship. **Beneficiaries** can be individuals or organizations, such as corporations or associations. *Fifth*, the trustee takes title to some item of real property or tangible or intangible personal property under the trust relationship. This property is known as the **trust res or corpus**. Without property to manage, the trust relationship does not exist. Although a trust requires that property be managed for the trust to come into existence, a grantor can describe the trust organization and structure in advance of actually transferring property to the trust. When property is transferred to the trust at some future time, the structure and organization of the trust and the roles of major participants are already identified.

2. Trust Compared to Other Forms of Ownership

A trust relationship is fundamentally different from several other common relationships affecting individuals and their property. Unlike a debtor-creditor relationship, a trustee has an affirmative obligation to avoid combining trust property with personal property. Property held in trust, although titled in the name of the trustee, is not subject to the claims of the trustee's creditors or otherwise subject to the trustee's obligations. If the trustee combines trust assets with personal assets, the trustee violates the duty owed to beneficiaries and faces personal liability for any loss or damage suffered by them.

The position of trustee is one that is subject to numerous requirements that recognize its special relationship to beneficiaries. Actions that are detrimental to beneficiaries, that expose the trustee to conflicts of interest, or that reflect the trustee's inability to act, are grounds for removal of the trustee, by court order if necessary. If such action is taken, the trustee is personally liable for any loss that occurs as a result of the conduct. Personal liability places the trustee's personal assets at risk to pay claims from beneficiaries. In deciding whether to accept appointment as a trustee or any other form of fiduciary, exposure to potential personal liability is an important consideration.

D. Creation of Trust and Trust Terminology

Creation of a trust can be done in a will where property passes from the personal representative of a deceased owner's estate to the trustee for management, during lifetime by the execution of a declaration of trust under which the grantor transfers property to the trustee, by a trustee's declaration that property held by the trustee is held in trust, or by the exercise of a power of appointment which creates the trust. In each of these cases a written document describes the essential elements of a trust, such as the grantor's intent, identification of the trustee and successor trustees, the trust purpose, identification of beneficiaries, and any special duties or instructions that the trustee is to follow in carrying out the terms of the trust responsibility. If a trust is to involve a parcel of real property, a written document must evidence the creation and administration of the trust. This is to ensure that the intent to create the trust relation and the authority of the trustee to deal with the land are clearly stated. If a trust involves management of personal property, a written document is not required for the creation of the trust, but the

importance of the relationship would favor preparation of a written document in all cases where a trust is created.

Trust terms and terminology reflect the special characteristics surrounding its creation.

*Example: A trust created in a will is referred to as a **testamentary trust**. If the terms of the will provide that a transfer of property be made from the estate to the trust, the provisions of the will that describe the transfer are referred to as **pour-over provisions** since they pour over funds from the estate to the trust. In contrast to a testamentary trust, a trust created during a person's life is referred to as a **living trust** or **inter-vivos trust**.*

*A trust created during lifetime and in which the grantor reserves the right to cancel the trust is referred to as a **revocable trust**. A common example of such a trust is a **revocable living trust** or **living trust**. Living refers to the fact that the trust was created during a person's lifetime. Revocable refers to the fact that the person creating the trust retained certain interests or rights in the trust, including the right to revoke it. If the grantor wants to create a trust and give up the right to revoke it in the future, the trust is referred to as an **irrevocable trust**. In such situations, the property owner intends to give up ownership and control of the property to avoid the property being included in the owners estate at his or her death. A common example of such a trust is an irrevocable life insurance trust. In the Chapter X discussion of how life insurance is treated under federal estate tax, a key issue is who owns the policy or has "incidents of ownership" in the policy. In an irrevocable life insurance trust, a policy of insurance is transferred to the trustee who is considered to be the owner of it. The trust agreement designates the trust as the beneficiary of the policy. Once the policy proceeds are paid to the trust, the trustee's obligations to the beneficiary will take control to manage and distribute the policy proceeds. This concept is discussed in more detail in Chapter X.*

*Trusts are also referred to by the purpose they serve, such as a **marital deduction trust**, which is a trust created to manage property passing to a surviving spouse which qualifies for the marital deduction under the federal estate tax law. Likewise, a **credit shelter trust** is a trust under which the grantor designates property to pass to the trustee in an amount equivalent to the amount of the grantor's unified credit for federal estate tax. Property which qualifies for marital deduction treatment as qualified terminable interest property (see earlier discussion in chapter VI), or Q-TIP property, may pass under a **Q-TIP trust**. In making gifts of certain property, an owner can separate ownership during lifetime from ownership that follows after the owner's death. This creates a life interest, or life estate, and a follow-on interest, or remainder interest. A transfer in trust of a remainder interest in property to a charity may be made in the form of a **charitable remainder annuity trust** or a **charitable remainder unitrust** to qualify for the gift tax charitable deduction.*

A popular estate planning use of trusts is to invest income-producing property in a manner that provides lifetime financial security to the beneficiary without causing an undesired federal estate tax problem for any of the beneficiaries of the trust. This technique is often referred to as an **A-B trust**, or a **marital trust and a by-pass trust**. In this technique an amount of property passes to a surviving spouse in a way that qualifies it for the marital deduction from federal estate taxes. The amount of property that passes to the spouse should be sufficient to provide financial security for the spouse. If this property passes to the spouse in trust, the trust is known as the **A-trust**, or **marital trust**, since the trust qualifies for the marital deduction.

The **b-trust**, or **by-pass trust**, is funded in an amount tied to the exemption equivalent of the grantor's unified credit against federal estate tax. Chapter VI discusses this concept. Income from the by-pass trust can be paid to the surviving spouse during his or her lifetime, or to other beneficiaries, but the spouse has limited authority over the trust principal so that the principal is not included in the spouse's estate at his or her death. When the surviving spouse passes on, the principal by-passes the deceased spouse's estate and passes to other beneficiaries, such as children of both spouses. A key objective of using this technique is to enable the estate of each spouse to fully use its own exemption equivalent amount. This doubles the amount of property that passes to intended heirs tax-free.

In other cases, terms that describe a trust reflect special features of the trust and such terms often become short-hand expressions for these trusts. For example, a **crummy trust** is a trust in which the beneficiary of the trust is given specific powers to withdraw property from the trust in order to qualify the beneficiary's interest in the trust as a present interest for purposes of the gift tax annual exclusion. The term "crummy" is used to refer to the Ninth Circuit Court of Appeals decision in the case of Crummy v. the Commissioner of the Internal Revenue Service, 397 F.2d. 81 (1968) that recognized this technique as an effective estate planning tool. Another example is a **sprinkling trust**, which is a trust in which the trustee has discretionary authority to distribute funds among several beneficiaries. In other words, the trustee can choose who will be benefited by the distribution.

If a person contributes funds to another person to help the other person purchase property, an **implied resulting trust** can be imposed on the purchased property to protect the interest of contributors whose contribution is not recognized by an ownership interest in the property. A similar concept is found in a **constructive trust**, which involves a person who is persuaded to part with his or her own property by the fraudulent acts of others or the abuse of a confidential relationship. In the case of a constructive trust, imposing the trust becomes a remedy to assist the person who gave up property to get its return or be compensated for its loss. The remedy becomes effective by imposing the trust on property owned by the fraudulent party such that the property is held, in trust, for the benefit of the injured property owner.

In a number of situations **statutory trusts** are imposed on property to protect the interests of special classes of people. The Packers and Stockyards Act, for example, imposes a statutory trust on livestock and poultry sold to livestock and poultry dealers to protect the interests of sellers in receiving payment from the purchasing dealer. By imposing a **statutory trust**, the dealer holds the purchased items in trust for the benefit of the unpaid sellers. Creditors of the

dealer cannot attach the purchased items since the statutory trust takes them out of the category of the property owned by the dealer.

E. Using Trusts in Estate Planning

1. Managing Property

A trust is useful in several estate planning contexts that involve the management of property. As the essence of a trust relationship is the transfer of property to another to manage the property for the benefit of a third person, a trust is an ideal vehicle for managing property of a minor child, a person who is disabled or incompetent, or someone who wants to be free of the personal obligation to manage property. In all three of these situations, the trustee fills the role of the property owner in collecting income, paying bills, and making decisions. Periodically, the trustee accounts to the beneficiary to show the results of the trustee's efforts. In keeping with the grantor's instructions, the trustee may make periodic distributions of the principal portion of trust property to the beneficiary. The circumstances under which such a distribution is made are found in the trust agreement defining the trustee's duties and responsibilities.

In these cases, the benefits of trustee management must be such that the benefits outweigh the cost of having a trustee manage these affairs for the trust grantor. These costs can include the cost to create the revocable living trust and to transfer property to it. If a bank or trust company trustee manages the property, the trustee is likely to charge a fee for the services provided. In calculating this fee, a percentage of the assets under management can be used.

In the case of a person who is disabled such that he or she is unable to deal with their property, the property may be frozen until a person is given the legal authority to act on behalf of the disabled person. Guardianship is the legal procedure that results in appointment of this third person. Guardianship proceedings are frequently used in cases involving property passing to minor children, those under the age of majority in the state where they reside, or disabled individuals who suffer from a physical or mental difficulty that prevents them from managing their affairs. A trust is an alternative means of providing the same protection and management that a guardianship provides. For a trust to be effective as a replacement for a guardianship, a property owner must take steps to influence the situation during his lifetime.

Example: A person who is concerned that advanced age may prevent the person from managing his or her affairs can create a trust during lifetime and transfer property to it. If the person should become disabled at a later date, the owner's property is in the hands of a trustee who should be fully instructed as to the steps to take to protect the owner's interest in his or her property, pay debts and expenses, and generally manage the person's affairs. In the case of a property owner who intends to benefit a minor child with property after the property owner dies, the owner may provide in his or her will that property passing to the child be held in a testamentary trust until the time set by the owner for the distribution of the property to the child. As the age of majority in most states is 18 years, some property owners may not feel that 18 is an appropriate age for someone to receive

significant property and be free to deal with it as he or she pleases. By placing the property in the hands of a trustee, the owner can direct the trustee to hold the property well past the beneficiary's 18th birthday and be distributed at some later time when the beneficiary is presumably better able to manage property.

The property owner who places property in the trust is not free to indefinitely delay distribution of it to the beneficiary. In many states, a legal requirement, known as the Rule Against Perpetuities, requires the property owner to provide for distribution of property from the trust within a period that is measured by the lifetimes of all beneficiaries who are alive when the property is transferred to trust, plus an additional 21 years.

2. Speed the Transfer and Continuous Management of Assets After the Grantor's Death

a. Management Considerations

The second major use of trusts is to speed the transfer of property after a property owner's death while continuing to manage those assets in the post-death period. In the opinion of some property owners, the process of transferring property after an owner's death is too long, drawn out, and expensive. Fees must be paid to personal representatives of estates, accountants, appraisers, auctioneers, and attorneys who represent the personal representative and the Register of Wills (as filing fees to probate a person's will or to appoint an administrator for someone who dies without a will). Individuals who own property in several states also face the need to file the deceased person's will in each of the states where real or tangible personal property is located when the decedent died. This further complicates the costs and expenses involved in settling an estate of this kind.

An alternative to the transfer of property under a will or without a will is to create a trust during the owner's lifetime, transfer property to it when the trust is created, add property to it afterward, and instruct the trustee to transfer the property held by the trust to designated beneficiaries after the owner's death. In many situations where this technique is used, the property owner retains significant rights in the property during his or her lifetime, including the right to income from the property, the right to use the trust principal if necessary, and the right to terminate the trust if the owner changes his or her mind about using this technique. Trusts of this type are *revocable living trusts*. If such a trust is created, at the owner's death the trustee exercising his or her authority will transfer the property to the designated beneficiary to fulfill the terms of the trust agreement. The trustee is responsible for filing any inheritance or estate tax returns. If all of the decedent's property is transferred under a living trust, the trustee will be responsible for paying the debts and expenses of the decedent. The use of a living trust is particularly helpful in situations where property is located in several states. By transferring out-of-state property to the trustee and providing for the distribution of the property after the original owner's death, the owner can bypass the probate process in these other states. This may not eliminate the need to file inheritance or death transfer taxes in each of the states where property is located, but it will enable the transfer to be completed in less time. Since the trustee owns the property and has the required instructions regarding the disposition of the property after the original owner's death, the trustee is fully authorized to complete the transfer to a designated person.

In regard to the time needed to transfer property under a will compared to a revocable living trust, most delays in transferring estate property relate to valuing assets, resolving disputes with creditors or debtors of the estate, awaiting acceptance of filed inheritance and estate tax returns and resolving disputes between the estate and unhappy heirs. As a revocable living trust can be challenged on grounds of the grantor's competence at the time of creating the trust or acts that unduly influenced a grantor to create a specific type of living trust, many of the same factors that delay the distribution of an estate can delay the distribution of a trust. The person who is responsible for filing returns and paying federal estate and state inheritance tax is personally responsible for the proper payment of these taxes. If estate funds are distributed before assurance is received that the tax paid is accepted as the full amount due, and it is later determined that additional tax is due, the personal representative has the choice of either collecting the needed additional money from heirs or paying the tax from his or her own pocket. In most cases, the time needed to transfer property under a will and through a living trust will be the same.

b. Privacy Considerations

When a will or petition is filed in the office of the register of wills or some other local official, the documents are items of public record. Anyone interested in reviewing public records is free to do so, just as any other public record in the court house. In regard to privacy, the living trust agreement is not filed in the office of the register of wills in the county where the deceased property owner resided at the time of his death. If the trustee is directed to transfer real estate from the trust after the trust grantor's death, however, it may be necessary to file the trust agreement in the office where land ownership records are retained to establish the trustee's authority to transfer the property. Filing a document in the land records office makes the document an item of public record and available for inspection thereby losing this measure of privacy.

A second aspect of the revocable living trust privacy issue is the fact that a living trust can be challenged on grounds that the trust grantor lacked the mental capacity to create the trust, or that the trust was procured by fraud or undue influence of another. If state law recognizes that a living trust is subject to a surviving spouse's right to elect against the provisions of the living trust for the surviving spouse and to claim the share the surviving spouse is entitled to by statute, the living trust will not shelter the trust from these claims.

3. Tax Planning and Saving

The third major reason for the use of trusts in estate planning is the opportunity it provides for tax planning and saving. In this context, it is not that trusts are eligible for tax benefits that other types of ownership are not entitled to, but rather that the special form of ownership under a trust allows an owner to achieve an intended purpose while still achieving tax benefits. One of the most familiar types of trust used in estate planning is the commonly called **A-B Trust, or marital trust/by-pass trust arrangement**. The purpose of this technique is to allow an owner to take advantage of passing a portion of property to a surviving spouse under the marital trust by virtue of the marital deduction in the estate of the first spouse to die. The remaining portion of

the owner's property passes to beneficiaries under the by-pass trust after first allowing the surviving spouse to have a limited interest for the spouse's lifetime. In this case the surviving spouse's entitlement under the trust must be such that the trust principal is not considered under the control of the surviving spouse and not part of the surviving spouse's estate at his or her death. For example, an interest in only the income generated by the trust is a limited interest that ends at the spouse's death. The purpose of using this technique is to provide the surviving spouse with a limited interest in the by-pass trust that will provide financial protection and security, but limited access to principal which would unnecessarily increase the size of the spouse's own gross estate for federal estate tax purposes. The spouse's limited interest would end at his or her death and the remaining portion of the property will then be distributed to other beneficiaries with out another tax being imposed.

Example: Consider the situation of an individual who maintains an investment inventory of \$3,000,000. If the individual intends to use this fund to provide financial security for a surviving spouse with an eventual gift to children of the owner, the owner has two choices. The first choice is to own all of the property as tenants by the entirety so that at the death of the first spouse all of the property passes to the surviving spouse. The surviving spouse can provide that the property transfer to the children after the spouse's death. Under state inheritance tax law the transfer of ownership to the surviving spouse as the surviving tenant by the entirety could be exempt from tax. The marital deduction for federal estate taxes removes the fear of federal estate taxes in the estate of the first spouse to die. At the surviving spouse's death, the spouse's estate will include the entire value of the property for state inheritance and federal estate taxes. If only an exclusion equivalent and a state death tax credit are available to offset potential federal estate taxes, a federal estate tax of some amount will be due.

As an alternative, the owner could transfer the property under two trusts, the first of which would be equal to the deceased owner's exclusion equivalent. The first trust provides the surviving spouse with a limited income interest for the spouse's life and passes the remainder of the property to the children after the spouse's death. The second trust would equal the balance of the separate property of the decedent. The second trust would provide the surviving spouse with an income interest in the trust and the right to invade the principal of the trust as the spouse deems necessary to satisfy the spouse's needs. As the surviving spouse has extensive power over the second trust, it will be included in the second spouse's estate for federal estate tax purposes. For federal estate tax purposes, the first estate will be protected from tax by the decedent's exclusion equivalent. The second trust will be protected from federal estate tax in the estate of the first spouse to die because of the unlimited marital deduction. Since the property will be included in the second spouse's estate at death, the spouse can use his or her own exclusion equivalent to offset federal estate tax at the death of the second spouse. If the value of the surviving spouse's property is greater than the exclusion equivalent to the spouse's

unified credit, federal estate tax may be imposed at the second spouse's death. As a result of using this technique, the property owner can expect to pass a greater portion of the \$3,000,000 in property to his or her children by using the A-B or marital trust/by-pass trust approach and eliminate the threat of federal estate taxes imposed at the death of the second spouse. The key to this result is that at the death of each spouse, the exclusion equivalent was fully used by the decedent.

F. Review of Inheritance and Estate Tax Impacts of Trusts

The tax impacts of using trusts in estate planning relate to the situation in which the trust is employed. If a property owner retains the right to revoke a trust created during lifetime or retains a right to income from the trust property, the property could be subject to state inheritance tax and would be included in the decedent's gross estate for federal estate tax purposes. These impacts refer to the general categories of property that are subject to inheritance and estate taxation.

If an owner wants to avoid having the property included in his or her gross estate for federal estate taxes, the owner can create an irrevocable trust. By doing so the owner makes a gift for federal gift tax purposes of the value of the trust interest which is created for the benefit of other beneficiaries. Through use of the annual exclusion for gifts of present interests and the exemption equivalent of the unified credit, the impact of federal estate and gift taxes can be managed. For state inheritance taxes, an irrevocable gift of property in trust made within one year of the owner's death may be subject to inheritance tax.

If a property owner wishes to transfer property in a way that qualifies for the marital deduction, the owner has several choices to design a trust that gives the spouse an interest to such a degree that the property qualifies for it. These choices include a trust with broad authority over the trust principal or a "qualified terminable interest property" trust. Such a trust must provide that the spouse is entitled for life to all of the income from the property, payable at least annually. No person, including the surviving spouse may have the power to appoint any part of the transferred property to any person other than the surviving spouse during the surviving spouse's life. Any power over the property must be exercisable after the spouse's death.

If an owner desires to transfer a remainder interest in property in trust to a qualified charity, the trust can be structured as either a charitable remainder annuity trust or unitrust. An annuity trust pays designated beneficiaries a specified amount annually, which is at least 5% of the initial fair market value of the property. A unitrust pays designated beneficiaries a fixed percentage, which is at least 5% of the net fair market value of trust assets as valued each year.

G. Use of Trusts in Forest and Woodland Estate Planning

In planning a forest or woodland estate, trusts can fill any of the roles that trusts play in other estates. As in other situations, if an estate planning objective of the property owner can be accomplished through the use of a trust, then a trust should be considered as part of the estate

plan. The important question to ask is, "What will be accomplished in my estate plan if I place any of my assets in trust?" If use of a trust does not achieve an objective, or makes it more difficult to achieve the goals and objectives previously set, there should be little or no reason to use it or any other device that does not contribute to the success of the plan.

Unlike other estates the typical forest or woodland estate owned by a private landowner may consist of one large asset in the form of land and several other assets in the form of machinery and equipment. If the forest activity is part of some other enterprise, then a whole set of issues and questions regarding these other business assets may arise. The decision to place real estate assets in a trust is an important one. If the purpose of doing so is to improve investment performance and maintain the business for eventual distribution to heirs who want to continue it, accomplishing those goals will depend on whether a trustee can be found with the background and knowledge to understand it and operate the business profitably. Since many investment managers are more adept at managing financial investments that are easily converted to cash, running a forest or woodland business to maximize its income potential is often a difficult challenge. Land dedicated to timber production has a considerable period of time before the investment in the growing trees will pay off. Managers of such properties must have considerable skill, excellent sense of timing, and considerable business acumen to obtain top market values when the timber is eventually sold.

Institutional trustees, such as banks, managing businesses placed in trust often require that someone familiar with the business operation be named co-trustee with the bank. If a trustee considers the trustee's obligation to be to maximize the income potential of property placed in the trustee's care, the trustee may want to be protected from legal challenges by beneficiaries who could claim that the trustee failed to protect their interest by failing to maximize income. This protection may come in the form of specific instructions to the trustee to maintain a business.

H. Revocable Living Trusts

Although revocable living trusts are discussed in various places throughout this chapter, this section is intended to pull together various comments and considerations regarding use of such trusts. As a popular estate planning device many people consider these trusts as part of their estate plans and this discussion becomes important.

This device is promoted as a simple, inexpensive and private way to avoid the delay and cost of transferring property under a will and, in many cases, it can deliver those benefits. A revocable living trust is also a beneficial way to continue effective asset management if the property owner becomes disabled or incapacitated. Privacy is also an important issue to many people, but the privacy issue may be lost if it is necessary to record the trust agreement in a public office to confirm the authority of the trustee to sell real estate or to take other action where proof of such authority is required.

In regard to saving expenses by creating a living trust, the principal savings come in two areas, filing fees incurred in the probate system and less need for professional services to complete the transfers. While the need for services may be lower, most trustees will incur some expenses in

transferring property after the grantor's death. Certain other steps that will undoubtedly incur some expenses will have to be taken. For example, if inheritance and estate tax returns must be filed after the grantor's death, the trustee may incur legal expense for gathering the information needed to prepare and file the returns. Transferring property may also require legal fees to prepare the necessary documents to complete the transfer. If legal fees are based on time and effort spent providing service to either a trustee or a personal representative, the fees charged should be a fair reflection of both cost to the payer of the fee and benefit received from the service.

On the fee question, whatever fees are saved in transferring property under a revocable living trust will be offset by costs incurred to prepare the trust documents, transfer property to it, and monitor the assets in the trust throughout the owners. Typically the process of drafting a living trust also includes drafting a will and possibly other documents to authorize people to act on behalf of someone else in cases where the person is unable to act on his or her own. This is done to ensure that there is some document drafted by the owner that controls the disposition of his or her property after death. In the event that an item of property is purchased but not owned by the trust, the owner's will becomes the vehicle that provides for its transfer, with the beneficiary often being the trustee of the trust.

The fee savings question becomes one of incurring lifetime expenses to save post-death expenses. Some people argue that drafting any of these documents does not require professional assistance, and fill-in-the-blank forms are readily available. As you have progressed through this topic to this point you appreciate the complexity of the issues. Do you feel that the complexity makes it advisable for people to use professional services although not required to do so? Decisions to create revocable living trusts motivated solely by a desire to save fees and expenses in transferring property after death will be more effective if the decisions are made with a full understanding of the fees to be charged and the method by which they will be calculated.

Some items of property may require special consideration before being transferred to revocable living trusts. Real property subject to a mortgage, or whose equity is needed to finance an activity, may find that the trustee's ownership of the property is objectionable. Since a trustee's representative capacity differs from the trustee's individual capacity, the trustee's only income sources may come from private sources. This will complicate the decision whether to grant the requested loan. Motor vehicles owned by the trust that require liability insurance may require the insurer to question whose driving record is rated for premium purposes, the actual driver or the trustee?

I. Student Exercises

Multiple-Choice Questions

Please read the questions carefully, then select one of the four choices following the question that correctly answers the question asked.

1. Which of the following terms describes a trust that **cannot** be canceled after it is created?

- a. A testamentary trust
 - b. A constructive trust
 - c. An irrevocable trust
 - d. A resulting trust
2. In creating a trust, several elements are necessary. Which of the following statements is not one of these elements?
- a. The intent of the trust grantor
 - b. Identification of a trustee and/or successor trustee
 - c. Trust property transferred to the trustee
 - d. A taxpayer identification number
3. Trusts are used in estate planning to achieve important planning objectives. Which of the following objectives is not an objective that the use of a trust can achieve?
- a. Obtain an estate tax advantage that is not available to any other form of ownership.
 - b. Avoid the need for creating a guardianship if the trust grantor becomes disabled during lifetime.
 - c. Provide a vehicle for the transfer of the grantor's property after the grantor's death.
 - d. Transfer property for the benefit of a minor child in a way that protects the property until the minor is able to deal with the property.
4. In comparing the transfer of property after death through an estate to the transfer of property under a revocable living trust, which of the following statements would be a correct statement?
- a. The role of a personal representative of an estate is similar to the role of a trustee of a trust.
 - b. Transfer of all property from a trust is accomplished in one-half of the time it takes for the transfer of property from an estate.
 - c. Transfers of property through an estate are subject to legal expenses, while transfers from a trust are not.
 - d. Transfers of property from an estate are subject to fees of the personal representative, while trustees are not permitted to charge fees for their services.
5. Which of the following transfers in trust is subject to a federal gift tax at the time the trust is created?
- a. Resulting trusts
 - b. Testamentary trusts
 - c. Q-TIP trusts
 - d. Irrevocable trusts

Short Essay Questions

Please read each question carefully and then respond to what is asked for at the end of the question. Your answer need not be long or involved, but it should be as clear and concise as possible. If you want to refer to important facts in your response, please feel free to do so.

6. Evelyn owns approximately \$1,555,000 in separately owned property. She is married to Ralph, who is her second husband. Evelyn and Ralph have two children from their marriage, Richard and Robert. Evelyn has been sick for a number of years and Ralph is in excellent health. If Evelyn were to pass away before Ralph, Ralph's accumulated retirement funds will enable him to live comfortably without using any of Evelyn's money. After they both pass away, Evelyn and Robert would like their estate plan to get as much of Evelyn's separate property to their children as they can without paying a large amount in inheritance and estate tax.

Based on our discussions of trusts, what trust techniques might Evelyn and Ralph use to accomplish their goal?

7. Continue with Evelyn and Ralph's situation. Evelyn is considering transferring one half of her property during lifetime to her revocable living trust. The trust will be managed by Evelyn during her lifetime. If she becomes disabled or incapacitated, Ralph is the successor trustee. During her lifetime, Evelyn has the right to all income from the trust. At her death, Ralph is entitled to income from the trust for the rest of his life. At his death, Richard becomes the trustee and he is instructed to distribute the remaining portion of property in the trust equally to himself and his brother.

If Evelyn takes this step rather than have her property pass under her will, what advantages, if any, will she gain by doing so?

8. Geralyn has just been approached by someone in her family to act as trustee under of a testamentary trust that includes an active farm operation that has a considerable stand of timber that consists of northern hardwoods and a considerable stand of black cherry. Geralyn grew up on a dairy farm and is a graduate of a College of Agricultural Sciences with a degree in Agricultural Business Management. While in that degree program, Geralyn took several forest management courses that give her a working knowledge of forest management concepts and ideas. If Geralyn asks for your advice regarding whether she should accept the appointment, how would you counsel Geralyn about the legal relationship a trustee has under a trust to the grantor and the beneficiaries? Identify any special problems you feel she may have as trustee of this trust.