



Legal Insurance

# Revocable Trusts: How They Work – and if They're Right for You





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Revocable trusts are also known as living trusts. They're popular because they're flexible, convenient and (when properly funded) can avoid many of the processes and expenses of guardianships and probate.

They can help to:

- ✓ Pass property after death without probate.
- ✓ Keep owner control of the property while alive.
- ✓ Provide for management of the person's property if they become incapacitated.

Trusts also require planning, timely funding and ongoing review. So it's important that you get your revocable trust right. An unattended, ill-fitted and unfunded revocable trust is useless at best and troublesome at worst.

# What Is a Revocable Trust?

A revocable trust is a property management and distribution arrangement. It results from:

- ✓ A person (sometimes referred to as a “settlor”) creating the trust.
- ✓ The selection of people, known as trustees, to manage the trust.
- ✓ The settlor putting some or all of their property under the trustees’ management.

A revocable trust is created by the settlor during their lifetime (as opposed to a testamentary trust, which is set up in a person’s will and goes into effect only after the person’s death). The settlor is the initial trustee (or at least a co-trustee) and sole beneficiary of the trust during their lifetime. When the settlor dies, the trust provides for the distribution of the trust property to the beneficiaries.

During the settlor’s lifetime, the settlor can:

- ✓ Change the terms of the trust instrument.
- ✓ Change the trustees.
- ✓ Change the trust’s ultimate beneficiaries.
- ✓ Add or remove property from the trust.
- ✓ Revoke the trust entirely.

Generally, a revocable trust has a single settlor and contains the settlor’s own property. The advantages of an individual revocable trust arrangement are clarity and simplicity. That’s because the sole settlor decides all details of management and distribution. And they are totally free to amend or end the trust.

set • tlor 

NOUN

a person who makes a settlement, especially of a property







That said, revocable trusts can have multiple settlors. These are typically spouses or domestic partners, especially in community property states. They can be funded with the property of its respective settlors.

In a community property state, all property of a married person is classified as either community property (owned equally by both spouses) or the separate property of one spouse.

These revocable trusts are often called joint trusts or family trusts. Joint living trusts seem attractive since they reflect the living arrangements of the settlors. But settlors need to think through the trust's amendment or revocation provisions – especially when it comes to situations like divorce. Settlor also need to consider options for the survivor after the incapacity and death of one of the settlors.

Once both spouses agree to a distribution plan within the trust, they need to decide if the trust is amendable or non-amendable after the death of the first settlor. In other words, can the plan be changed by the survivor? Can the plan deny the surviving settlor the right to withdraw trust assets?



# How Do You Fund a Revocable Trust?

A revocable trust only controls property specifically subjected to the terms of the trust. That's why the property transfer process to the trust – called funding the trust – is critical.

A settlor needs to transfer property from the settlor's name into the name of the trustee of the revocable trust (even if, as likely, that trustee is the settlor). Property transfer is the only way that property will be subject to the trust's management.

A revocable trust can be funded with any property of the settlor, including the settlor's rights or potential rights to receive property in the future. It can be funded either during the lifetime of the settlor or after the settlor's death (for example, with life insurance proceeds). Others can gift property to the trustees for the benefit of the revocable trust.

Once assets are in the trust, they can be managed by the trustee. When the settlor is also the trustee managing their own property, the settlor-trustee can handle the trust property the same as if it were in the settlor's name as an individual.

## Here's an example.

Let's assume that James Jones is the settlor. He transferred \$5,000 from his bank account into a new checking account for the trust. When he writes checks from that account, he'll sign them in his fiduciary capacity (i.e., as "James Jones, trustee").

The same approach applies to the handling of other assets in the trust. Namely, the settlor-trustee will technically show that they are acting "as trustee." The same rule applies for successor trustees, namely, they sign as trustee.

Generally, when third parties deal with the trustee (even the settlor-trustee), they want to see evidence of the trustee's authority to act for the trust. To do that, the trustee could show the trust document to the third party (who would likely want to make a copy of it for their records).

Or, to guard the privacy of the trust purpose and most terms, the trustee may use a memorandum of trust or certificate of trust. These documents include just the parts of the trust necessary to identify it, including the trustee's appointment and the trust management powers of the trustee.



## Trust amendments

When the settlor wants to change part of the terms of the revocable trust, the resulting document is a trust amendment. Trust amendments are sequential – in the order in which they're made. They're read together with the original trust document so the currently in-force terms are understood.

## Trust restatements

When a trust is going to have major changes, it's usually easier to create a trust restatement. This keeps the trust but restates it in its new terms. This trust restatement completely replaces the original trust and all later amendments.

## What happens when the settlor dies

As long as the settlor is alive and competent, the trust is completely revocable. Upon the settlor's death, the trust becomes irrevocable.

In other words, when the settlor dies, the trust can't be changed. But it continues to exist until its distribution terms are satisfied. However, many states have laws that let beneficiaries and/or trustees seek judicial modification of the trust after the settlor's death.

For example, trustees may want to modify the trust for tax reasons, if there is no longer a need for it, if its original purpose is impossible or impractical or if it's no longer economical to administer.



# Who's Involved?

Every revocable trust has a set of players with distinct roles. Here are the people involved in making and managing a revocable trust.

## Settlor

The most important player is the person who creates the trust, called the settlor. In some states and context, the terms "grantor" or "trustor" are used. The settlor has the following tasks:

- ✓ Determines if a revocable trust is appropriate for the situation
- ✓ Defines what terms direct the trust's management
- ✓ Chooses who will act as either co-trustee with the settlor or as the successor trustee when the settlor cannot act
- ✓ Decides who will get the benefit of the property in the trust after the settlor's death
- ✓ Decides what property is going to be under the trust's management
- ✓ Transfers property to the trust
- ✓ Ensures that the trust's terms are kept current and consistent with the laws of the states where the trust is administered
- ✓ Ensure that the co-trustee or successor trustee is willing and able to serve in the fiduciary role
- ✓ Adjusts the ultimate post-mortem provisions and beneficiaries to reflect the settlor's current estate plan

## Trustee

The person who manages the assets in the revocable trust is the trustee. In a typical revocable trust, the settlor is the initial and primary trustee and the sole beneficiary during the settlor's lifetime. The settlor-trustee can amend the trust instrument at will and can act as they see fit.

## Co-trustee or successor trustee

Every revocable trust has other trustees. The settlor may set up the trust with a co-trustee to act with or in the place of the settlor as designated in the trust instrument. Since the revocable trust is intended to address periods of the settlor's incapacity and the settlor's death, all revocable trusts have one or more successor trustees who get authority once a triggering event happens (as set out in the trust instrument).

The trustee is a fiduciary with enforceable duties to the settlor and the beneficiaries. Each state has some form of trust code in which the powers, duties and liabilities of trustees are spelled out. Some of the powers and duties may be changed by the settlor in the trust instrument.

Trustees are entitled to reimbursement of their expenses and compensation for their services on behalf of the revocable trust. Trustees (other than the settlor) may be challenged in court by the beneficiaries for breaches of duty or of the terms of the trust.

## Beneficiaries

The players who get the benefit of the revocable trust are the beneficiaries. During the settlor's lifetime, the settlor is the beneficiary – although the settlor might name others to receive some benefit during the settlor's lifetime.

This is commonly true in joint or family trusts. All revocable trusts name beneficiaries who will receive the benefit of the trust after the settlor's death. These post-mortem or ultimate beneficiaries may receive an outright distribution from the trust. Or their shares might be administered and distributed over time, depending on the terms the settlor put into the trust document.



# Why Use a Revocable Trust?

There are a lot of reasons for having a revocable trust. The most common reason is to avoid probate. Other reasons include to:

- ✓ Create a formal structure for lifetime management of property.
- ✓ Create an alternative to guardianship or conservatorship in the event of incapacity.
- ✓ Provide a convenient, faster and cheaper alternative to probate.

## Lifetime management of property

Once the settlor's property is transferred to the trust, the settlor-trustee can manage the property just as they did previously. The settlor can also change those terms at any time, just in case more flexibility is needed. When a successor trustee is acting, the same flexibility and discretion exists but without the settlor's ability to change the trust terms or withdraw assets from the trust.

## Trusts not protected from creditors

With the exception of special trusts created in a handful of states (known generally as self-settled domestic asset protection trusts), a settlor's revocable trust doesn't protect assets in the trust from a creditor's valid claims. During the settlor's lifetime, assets in their revocable trust can be reached by creditors unless otherwise exempt by law if owned by the settlor directly.

Other beneficiaries are usually protected, though, from the settlor's debts. This is usually done with "spendthrift" terms included in the revocable trust.





## Incapacity alternative to guardianship or conservatorship

When a person becomes incapacitated, someone needs to take responsibility for managing that person's property. But establishing a guardianship or conservatorship for the person's property can be pricey. And it could end up with the court choosing the guardian or conservator and then keeping oversight.

A durable power of attorney (DPOA) can avoid this by appointing an agent to act on the person's behalf. The DPOA isn't used just for medical or mental incapacity – but also if the person is traveling for an extended period or is otherwise unavailable.

The DPOA clarifies what authority the agent has. But it doesn't offer much guidance on how the principal wants the agent to act.

A revocable trust, on the other hand, lets the settlor define and set measurements for the events that would trigger the authority of a successor trustee. It also can set out why, how and when the successor trustee is to distribute trust income or principal for the benefit of the settlor – and, if set out in the trust instrument, for the benefit of the settlor's beneficiaries.

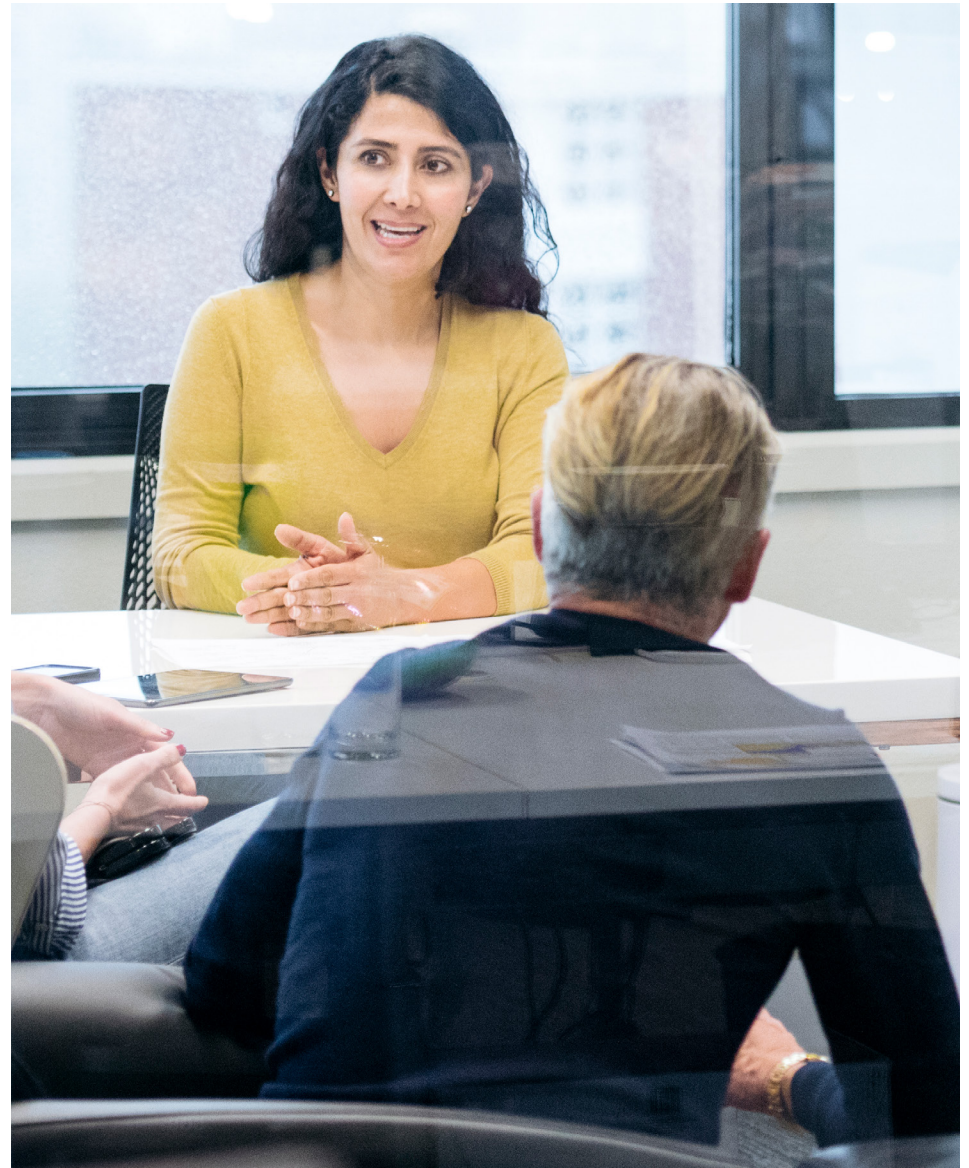
All these property management and distribution activities of the successor trustee can occur without advance permission of any court. That's unless, of course, a proper claim of breach of the successor trustee's obligations is made (for example, by a qualified representative of the settlor or the beneficiaries).

## Alternative to probate

For settlors who die with all their property in a revocable trust, probate processes will be unnecessary in most states. Instead, the successor trustee will follow the directions for after-death management and distribution. The property will be distributed to the settlor's intended beneficiaries simply and directly.

## What is probate?

If a person dies without contractual arrangements to pass their property to someone else, then the post-mortem estate settlement processes of the deceased's home state will be followed. This is commonly known as probate. It can be a long, expensive and complicated process.



# What Documents Are Needed to Create a Trust?

Here are the documents you need to create an effective and surviving revocable trust.

## The revocable trust instrument (either a declaration of trust or a trust agreement)

The most important document is the trust document. It identifies the trust, the settlor, the trustees, the beneficiaries and the terms under which the trust will be governed.

The trust document includes provisions on:

- ✓ The settlor's rights to amend and revoke the trust.
- ✓ How the trust is to be administered if the settlor becomes incapacitated.
- ✓ How the trust is to be distributed to beneficiaries after the settlor's death.

## Memorandum of trust or certificate of trust

Third parties – like banks, securities firms, lenders and public officials – want proof that the trustee has the authority to deal with the trust property. While a copy of the revocable trust instrument can meet that need, most settlors don't want to reveal personal information about who's inheriting different property.

To preserve the settlor's privacy (and to have a shorter document for presentation and recording purposes), settlors usually have a signed and witnessed document called a "memorandum of trust" or "certificate of trust." It identifies the trust, the settlor and trustees. And it includes the grant of powers to the trustees.

## Affidavit of asset transfer

A revocable trust has to be funded with at least some of the settlor's property. A settlor also needs an affidavit of asset transfer to let others know that personal property has moved to the trust.

An affidavit of asset transfer is the settlor's signed, sworn and notarized document. It lists specific items of property that have been transferred to the trustee of the revocable trust. It can list items in detail (for example, "my collection of Ernest Hemingway first editions") or in more general terms ("my collection of books, magazines, manuscripts and periodicals" or "my recordings, music, videos and video games").







### Pour-over will

The chances that the settlor will have transferred all property to the trust by the time of death are usually slim. Settlers generally die with property still in their own names – property that was intended to be disposed of according to the revocable trust’s terms. A “pour-over will” acts as a final clean-up tool for the settlor.

The pour-over will does what its name describes. It “pours over” the assets in the settlor’s estate into the settlor’s revocable trust. Other functions of the pour-over will include:

- ✓ Names who may become guardians of the settlor’s minor or special-needs children
- ✓ Leaves certain property outright without the trustee’s involvement
- ✓ Takes advantage of a probate law’s shorter time limits for presenting and ending creditor claims

### Durable power of attorney

The durable power of attorney lets the settlor name an agent, grant specific powers and define the circumstances that trigger the agent’s authority to act. For example, if the settlor intends to transfer property to the revocable trust but becomes incapacitated, the DPOA would allow an agent to make the transfer.

The agent named could be the same as the successor trustee or another person. In essence, the DPOA acts as a settlor’s revocable trust facilitator. Keep in mind that the DPOA becomes ineffective when the settlor dies – so the DPOA agent would have to act before the death.



# How Is Property Transferred to the Trust?

The revocable trust only affects property that's subjected to its terms. But how is property made subject to the trust?

Property has to be transferred by the owner of the property to the person acting as trustee of the trust. The trustee doesn't become the owner of the transferred property as an individual. Instead, the trustee takes title "on behalf of the beneficiaries of the trust."

Legally, this means that a trustee holds bare legal title and the beneficiaries' equitable title to the trust assets. The beneficiaries are the effective owners of the trust assets – because they can compel the trustee to manage those assets solely in their interests.

## Example

James Jones, as the settlor, wants to transfer his vacation lot to his own revocable trust. The deed Mr. Jones would have prepared would describe the grantee in such words as "James Jones, trustee of the James Jones revocable trust, UDT dated 12/1/23."

This shows that James Jones doesn't receive the title outright. He receives it as a trustee. This titling arrangement also shows that the specific trust for which the trustee is taking title, namely Mr. Jones's revocable trust, is shown under declaration of trust dated December 1, 2023.

## Re-titling documents

The specific document used to transfer property depends on the formal evidence used to show ownership of the property. Assets that are "titled" (that is, ownership is reflected by a formal document like a deed, an account agreement or a security certificate) are transferred to the revocable trust. This is done by re-titling the asset from the name of the settlor as an individual to that of the settlor (or other trustee) as a trustee of the revocable trust.

- ✓ For land, this will mean a deed.
- ✓ For securities accounts and bank accounts, it will mean whatever document the institution uses (for example, account holder agreements or signature cards).
- ✓ For individually owned stocks or bonds, it will mean the certificate and register.
- ✓ For titled personal property (e.g., cars, boats), it will mean the certificate of title.





# Is a Revocable Trust Right for You?

The answer varies with the amount, the location and the type of your assets. It also depends on your concerns and discipline.

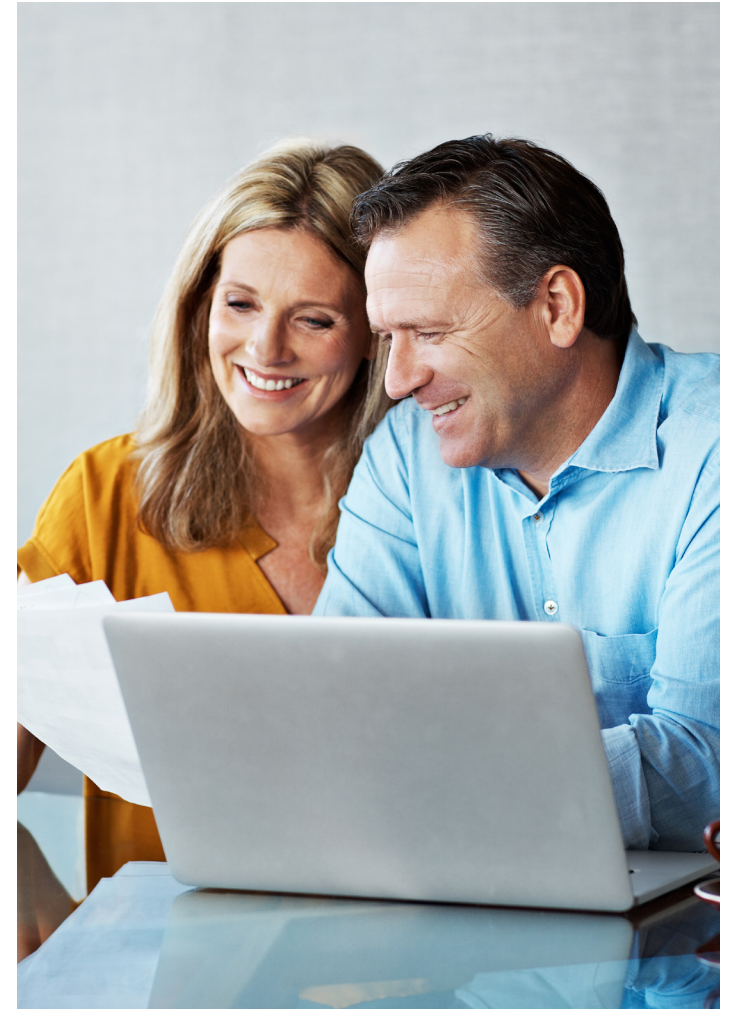
One thing to keep in mind is that creating a revocable trust creates an artificial entity (almost like creating a corporation). And you'll have to play a role in that entity for the rest of your life.

That role requires keeping good records, being disciplined in transferring and managing assets in the revocable trust and keeping trust documents up to date. Creating a revocable trust means creating a document package that fits you and your needs. Managing a revocable trust means exercising good judgment about the people who will help you.

The legal issues involved in any trust are complicated. And there are legal issues "on the ground" in the application of the trust. For example:

- If your state grants you special tax benefits for certain real estate you own and use, do you know if those benefits will continue if you transfer that property to a revocable trust?
- Will you be able to use trust assets to get a personal loan such as a mortgage?

A planning consultation with an attorney on the specifics of your situation is the absolute minimum if you're considering a revocable trust. Even if you create the trust documents yourself, you should have an attorney review them with you to make sure they fit your situation.



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