An Overview of Trusts for the Uninitiated

By Matthew W. Gibson

Attorneys and non-attorneys alike seem to mistakenly believe that trusts are only for individuals who are rich or who are on their second or third marriage or who, thanks to the good work of their domestic relations attorney, happen to be rich and on their second or third marriage. Trusts are also generally acknowledged as beneficial to parents of special needs children, parents of minor children or clients who have children outside of their current marriage, to name a few. The main purpose of this article is not to laud the usefulness of trusts in these instances, but rather to address some of the common, yet underappreciated, reasons why a trust can be desirable and ought not be dismissed as an appropriate solution for a client.

Basic Overview of Trusts

A trust is essentially an arrangement among three parties: the grantor, or settlor, who creates the trust; the trustee, who oversees the trust's administration and the beneficiaries, who obviously benefit from the trust. A trust agreement establishes the rights and responsibilities of each party, and the manner in which the parties interact with one another. For instance, the agreement specifies when the beneficiaries are entitled to a distribution and whether the grantor can amend the trust. The agreement should also establish a chain of succession for the roles of trustee and beneficiaries. In a typical revocable living trust arrangement, the same person may start out as the grantor, trustee and beneficiary. If that person becomes incapacitated, someone will replace him or her as the trustee but not necessarily as the beneficiary. If that person dies, someone will replace him or her as the trustee and as the beneficiary.

Underappreciated, Yet Common Usages

Multiple Beneficiaries

Upon an owner's death, most assets in Ohio can now pass outside of probate through beneficiary designations. These assets include checking accounts, retirement accounts, automobiles, real estate and interests in closely held businesses. While this is all well and good, there are many instances where naming multiple beneficiaries on an asset can cause problems. As an example, consider a house that is transferrable on death to an owner's four children. Yes, probate is avoided. But now, all four children—and their spouses because of dower rights—must agree to the sale and sign the deed. Even in the best case scenario, it can be a mess.

A trust offers a better solution. The house can be transferrable on death to the trust, which can have one of the children as the successor trustee and all of the children as equal beneficiaries. As a result, only one child needs to agree to the sale and sign the deed, and none of the children's spouses need to be involved. And frankly, a natural consequence of any good estate plan is avoiding the unwanted involvement of in-laws.

Flexibility to Change During Lifetime

Just as creating an account on Farmers Only does not enable one to immediately find a soulmate, creating a trust does not allow one to immediately avoid probate. They are each steps in a process. A person can create the Farmers Only account, put in some effort and eventually be able to converse with more than just livestock. Likewise, a person can create a trust, put in some effort and eventually have his or her assets avoid probate.

With respect to the effort required to avoid probate, after a trust is created, the ownership of assets and beneficiary designations need to be addressed and updated so that assets pass directly to the trust outside of probate. This step of the process can be tedious. But the good news is that, once the step is completed, an individual can easily make changes to the trust to alter the flow of all of his or her assets. So if an individual decides that he or she wants to make distributions to grandchildren or charities, or if one child has been receiving a little bit more help than the other children and adjustments are warranted, a simple trust amendment is all it takes to make the desired change.

Without a trust, individuals need to be named in the beneficiary designations to make sure the assets avoid probate. If changes become desirable, it can become difficult to identify what assets, or what portion of what assets, should be redirected. When faced with the choice of whether to make the adjustments through a simple one-page trust amendment, or by reviewing and updating beneficiary designations, most people will opt for the trust amendment.

Flexibility to Adapt if Beneficiaries Die

The trust agreement should provide a plan as to what happens to assets if a beneficiary dies, either before the trust share is set aside for the beneficiary or while a trust share is still being administered for the beneficiary. If individuals are named as beneficiaries of assets, the beneficiary designations might need to be updated to avoid undesirable outcomes.

Asset Protection

When a child receives assets in trust, many people assume that the trust was funded in order to protect the child from his or her own immaturity and imprudence, perhaps until the child reaches a certain age. However, even the most mature and prudent children can benefit greatly from a trust.

To understand how this works, take the case of the beacon of childhood wisdom and maturity: Doogie Howser. Most everybody remembers Doogie, the fictional character who graduated from Princeton at age 10, finished medical school at age 14 and had his show canceled somewhere around age 19. Well let's suppose that Doogie's parents, Dr. David Howser and Katherine Howser, need an estate plan and come to you now that Doogie is 42-years-old.[1]

If David and Katherine were to suddenly pass away, they stand to leave Doogie around $2,000,000.[2] They are extremely confident that Doogie would have no problem managing this amount of money. In fact, Doogie is fast accumulating his own fortune.

Conventional wisdom might say that assets can be left outright to Doogie, either through a will or beneficiary designations. However, a trust is likely the better option. If David and Katherine leave their assets in a trust for Doogie, then Doogie can serve as the trustee of that trust, receive income generated by the trust, access principal as he sees fit for health, education, maintenance and support and redirect the trust assets to whomever he likes upon his death. Even with this extensive control, the trust assets cannot be reached by Doogie's creditors and will not be subject to estate tax at his death.

These asset protection and tax planning features could be of considerable value. With respect to the asset protection, Doogie has been performing surgeries since his teenage years, and his risk of being targeted in litigation is acutely high. If a creditor obtains a judgment against Doogie, the trust assets are protected. Doogie can even use them to pay his own bills.[3] With respect to the tax planning, nobody can reasonably predict what might happen to the estate tax exemption in 20, 30, even 40 or more years. But if we assume Doogie's own assets will cause him to reach the estate tax exemption, and the estate tax rate is 40 percent, then the $2,000,000, if received outright, would have been subject to an $800,000 tax. By placing it into the trust, his inheritance, along with its appreciation, will avoid tax altogether.

Fees

The greatly exaggerated and tremendously pejorative misconception about trusts is that they are expensive. For the vast majority of my clients, a trust adds $300 to $400 to the overall cost of the estate plan, which almost always falls below $1,200, and generally falls below $1,000. In instances where the trust is more complicated, either due to financial factors or family factors, the cost can be higher. But in those instances, the trust planning is particularly important and the added fee is easily justified.

Conclusion

Trusts were a mystery to me before I became a lawyer, and I think they remain a mystery to many non-attorneys and attorneys who do not practice estate planning. But they are an extremely useful tool. If you do not practice in estate planning, you may want to keep the usefulness of trusts in mind the next time you have a discussion with a friend or client about estate planning.

1. Doogie was 16-years-old when the show first aired in 1989, so he would be 42-years-old today.
2. When term life insurance policies are taken into consideration, which they absolutely should be for purposes of this discussion, there are a surprisingly high number of clients who need to plan as though their children might be millionaires.
3. For those familiar with charging orders, this flow of assets out of the trust works much better, as far as the beneficiary is concerned, than the flow of assets out of an LLC when a creditor has attached a charging order.

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And when the CBA got into its own legal jams (stuff occureth), up would step the Grand Knights of the legal community and General Counsel to tilt against and smote our external foes. What a wonder of selflessness to behold. The cost of their unbillable hours would sustain a small country.

Best of all for me though was the daily dose of being in the lush coop on the 11th floor with the grandest collection of multitalented, goofy yet professional, frolicsome, devoted, unclickish and productive birds ever assembled – the CBA staff. And back in the southwest corner of CBA Land, I was constantly baffled as to why the nonpareil lawyers, paralegals and law school externs who staffed my department over the years were willing to tolerate the likes of me without once (at least to my knowledge) attempting a coup d'é tat. Such a special, precious lot they are.

I will not try to single out here all the folks to whom I am beholden for my idyllic time in the Bar Counsel seat; the list would be expansive and likely incomplete. I only hope you all know how monumentally grateful I am.

One last thought: Honk! Grunt! Honk! Grunt! And, what the heck, Hissssssss!

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