



Estate Plan Misconceptions-Trusts (Part 1)

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This article is the third in our series of articles that outlines the risks in preparing one's own estate plan documents. This two-part article will focus on Trusts.

Trusts are probably one of the most overused and misunderstood documents in estate planning. A trust is a written agreement where the person creating the trust (Settlor) gives instructions to the person in charge of the Trust (Trustee) on how to use the assets of the trust for the beneficiary of the trust. I like to analogize a Trust as a basket. The basket can hold a number of assets-real estate, bank accounts, investment accounts, etc. The Settlor creates the basket while the Trustee is charged with maintaining the items in the basket and distributing those items to or on behalf of the beneficiary accordingly.

A myriad of the "types" of trusts exist which vary depending upon the goals of the Settlor and the beneficiary of the trust. We explore trusts that are revocable and trusts that are irrevocable in this part of the article.

The Revocable Living Trust

The revocable living trust is probably the most publicly well-known "type" of trust. A revocable living trust is typically one where the Settlor places his or her own assets in trust for his or her own benefit during his or her lifetime. At the death of the Settlor, the Trustee of the revocable living trust pays remaining trust assets to other persons named in the trust or protective subtrusts for those other persons.

The Settlor is typically the initial Trustee of the trust. Since the Settlor of the revocable living trust, then, is the Trustee and beneficiary, very little changes in regards to the Settlor's assets except for the title to those assets. Consequently, I often refer to such a trust as the Settlor's "alter ego" – same person, different name (think Superman to Clark Kent).

The revocable living trust is "living" because the trust is created during the lifetime of the Settlor. It is "revocable" because the Settlor can change or dissolve the trust at any time during his or her lifetime.

Most individuals create revocable living trusts to ease administration of their assets in the event that he or she becomes incapacitated or upon his or her death. Consequently, the Trust can substitute for financial powers of attorney and a Last Will and Testament. The revocable living trust can also add a layer of privacy to one's estate plan. Unlike a Last Will and Testament, a Trust does not need to be probated and made part of the public record at the death of the Settlor. Also, because the Trust does not need to be probated, the fees and costs associated with the probate process are not spent. Depending upon the complexity of the Settlor's assets and the legal market in which he or she resides, some savings may result in the avoidance of probate.

The revocable living trust can also ease the distribution of the Settlor's assets at his or her death. The revocable living trust can serve as a "holding tank" for all of the Settlor's assets. The Trustee can then re-divide the assets upon the death of the Settlor to the remainder beneficiaries under whatever contingences that may occur at that time (i.e., dividing the share of a deceased remainder beneficiary among the defined contingent beneficiaries).

The revocable living trust can also contain "subtrusts" for the remainder beneficiaries of the Trust. This can be quite useful for remainder beneficiaries who are young, disabled, or struggle with other life issues such as drug addiction or debts.

Revocable living trusts do come with their disadvantages. First, an individual must ensure that the Trust is properly funded. Executing the document is only the first step in successfully using the Trust. The Settlor also has to re-title his or her assets into the name of the Trust or direct assets to the Trust upon his or her death. Without this important step, the Trustee is left with an empty "basket."

Revocable living trusts also do not protect trust assets from a disgruntled beneficiary. If the Settlor wants to eliminate a certain beneficiary from his or her estate plan, a trust, just like a Will, can be challenged by such beneficiary.

Finally, the Court oversight of a probate estate can be advantageous, an advantage that can be lost with a trust. Court oversight provides another level of check on the person in charge of the Settlor's affairs to ensure that that person is doing his job appropriately.

What about an Irrevocable Trust?

An irrevocable trust prohibits the Settlor from dissolving the Trust. However, the Settlor may still retain some authority to make changes to the Trust. Most often, this is the authority to change the remainder beneficiaries of the Trust, substitute trust property, or change the Trustee. Many individuals misunderstand the effect such a Trust has on eligibility for public long-term care benefits which we discuss below.

Medicaid, VA Pension, and Trusts

Medicaid is a program that can assist with care for people in nursing homes and, increasingly, community and in-home alternatives when the person would otherwise require nursing home level of care. Nearly 2/3 of Indiana's nursing home residents are Medicaid recipients.

The Department of Veteran's Affairs (VA) provides a monthly pension (colloquially referred to as "Aid and Attendance" by the public) for qualified wartime veterans or their surviving spouse who are unable to work due to either a non-service connected disability or age.

Both Medicaid and VA Aid and Attendance have a needs-based component to eligibility; that is, an applicant's assets and income must be below a certain threshold in order to qualify for benefits.

Unfortunately, many individuals create trusts, especially revocable living trusts, under the belief that assets of such trusts are exempt in determining eligibility for these public benefit programs. However, all assets owned by a revocable living trust are counted in determining the Settlor's eligibility for Medicaid or VA pension.

Individuals who create an *irrevocable* living trust for their own benefit and name a third party as Trustee, also wrongly assume that such Trust is exempt under public benefits rules. Except in very limited circumstances (see Part II of this article in our next newsletter), a living trust created and funded by the Medicaid applicant is a countable resource in determining that person's Medicaid eligibility no matter the standard of distribution given to the Trustee. So, even if Jane creates an irrevocable trust and names her son, Bill, as Trustee and gives Bill the authority to use trust funds for Jane as Bill sees fit, the Trust assets are still countable resources. Even if Bill refuses to use trust funds for Jane's benefit, the assets in the trust are countable resources when determining Jane's Medicaid eligibility.

Irrevocable Trusts can have their place in Medicaid and VA planning, but only when the beneficiary of such Trust is someone other than the Settlor. Such trusts are common when an individual desires to make a gift to decrease their assets below the maximum resource threshold for Medicaid or VA pension benefits. These trusts can protect transferred assets by what happens in the lives of the Settlor's beneficiaries, such as death, divorce, bankruptcy or disabling illness or injury.

These Trusts are not for the benefit of the Settlor, though. The Settlor relinquishes all rights and control over the assets when he or she places them in the Trust. They are for the benefit of the beneficiaries of the Trust only and distributions to the Settlor from the Trust are not only a breach of the Trustee's fiduciary duty, but can also jeopardize the public benefits eligibility of the Settlor.

The terms of a Trust can be almost limitless. Coordination of the Trust terms with the remainder of the individual's estate plan is essential and only with proper funding and administration will the Settlor's goals be met. To avoid creating a Trust that falls short of meeting the goals of the Settlor and that is potentially harmful to the Settlor, consumers should consider hiring legal counsel for such an important endeavor. To create your estate plan with us, please contact us to schedule an appointment at 317-622-8181.

[SEE PART TWO OF THIS ARTICLE IN OUR NEXT NEWSLETTER-Special Needs Trusts (the Exception to the Living Trust Rules)]

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