



EP-7-09

## Basic Estate Planning Fact Sheet Series

# Trusts

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In the last fact sheet we talked about a more used estate planning tool, life insurance. Now we will discuss a less used tool, the trust.

### Trusts Created by First to Die

Trusts may be effective tools to assist and make life easier for the surviving spouse and/or be part of a strategy to reduce estate settlement costs. People may do an excellent job of managing their assets when they are active and alert, but when their health fails or they get too old and worried, they may wish to assign management of assets to a trustee through a trust instrument. If the estate of the first to die is large and will flow directly to the surviving spouse, especially if the surviving spouse is elderly and inexperienced in investing and managing assets, a trust may be the most desirable method of meeting the surviving spouse and children's present and future interests.

### What Is a Trust?

A trust is a legal relationship, unlike a corporation, in that it is not considered to exist as a separate entity separate from the people that own it and control it. A trust is created when it is signed or can be created orally. It can be funded anytime. In a trust, assets are entrusted to a trustee, who holds legal title and manages them until they are distributed to the eventual beneficiary. The terms of the trust describe how income from the assets and principal are to be distributed and managed. The trustee may be a bank, trust company, another professional, one or more family members (spouse, son, daughter, or even self), or individuals with whom the creator and family has trust and respect for their business decisions. Usually the trustee is someone trusted by the trust creator (the settlor or grantor), and capable of managing the assets entrusted to him or her

by the creator, until the assets are distributed to the benefactors.

Beneficiaries can receive income from a trust during the trust's existence, and/or receive assets when the trust is dissolved. Often, a surviving spouse receives the income from the assets that are in a trust set up by their spouse, then assets go to the children when the trust is dissolved.

The creator determines the conditions under which the trust will be dissolved when they create the trust. Some creators wish the trust to be dissolved when the child is capable of wisely spending or investing his or her inheritance. Others may have the trust dissolved when the surviving spouse dies. In both instances, the benefactors can receive income from the assets in the trust, and have limited access to the principal, if needed, before the trust is dissolved.

If assets are to be transferred to a trustee, "titled" assets (cars, trucks, stocks, bonds, real estate, savings accounts, checking, certificates of deposit, insurance policies, retirement accounts, etc.) should be retitled. These "titles" need to be changed with each respective titling agency. Some banks will institute an early withdrawal penalty if the title of the certificate of deposit is changed before the certificate matures. Assets without titles need to be signed over to the trust. Then, at the termination of the trust, assets need to be retitled and transferred back to beneficiaries. In essence, the same processes that happen through probate to transfer assets, occurs with a trust. Transferring property through a trust, rather than through the probate process, is not necessarily simpler and may or may not allow the heirs to receive a larger portion of the inheritance. However, transfer of property through a trust is more private, as there is no listing of assets and value of assets in the probate court or newspaper. Because

the trust is a legal relationship, not separate from the people that own and control it, assets transferred to a trust need to be put into the name of the trustee, not in the name of the trust. Even though often done, transfers of title into just the name of the trust may be a void transfer.

## Types of Trusts

Assets can be transferred into a trust directly while one is living (inter-vivos or living trust) or assets can be directed into a trust by one's will (testamentary trust). Living trusts that can be changed or revoked by the settlor are called revocable while those that cannot be changed or revoked are called irrevocable.

### Revocable Living Trusts

Property placed in a revocable living trust can be returned to the creator by revoking the trust. Since the creator has the power to "pull the assets back," assets in a revocable living trust when the creator's estate is settled are inventoried, appraised, and included in both Ohio and federal estate tax calculations.

### Irrevocable Living Trusts

When an irrevocable living trust is created, the creator has given the assets to the trustee. The creator no longer has control over the assets, or the legal right to control them in the future, unless the creator is the trustee. Assets in an irrevocable living trust are not subject to estate taxes, unless the creator is also the trustee or has retained other rights. In essence, the creator makes a gift to the trust when the trust is funded. Unless special provisions are included in an irrevocable trust, gifts to the trust will not qualify for the \$13,000 annual exclusion. Therefore, the unified credit usually available to offset federal estate taxes at death may be reduced by the amount needed to offset gift tax liability. If that is the case, that amount used to offset gift taxes is no longer

available to offset federal estate taxes if needed for assets outside the trust when the estate is settled. Those considering irrevocable living trusts need to seek council to explore tax consequences and strategies. They need to be aware that upon creating an irrevocable living trust, the control of assets placed in the trust has been transferred to the trustee for management until the assets are distributed to the eventual beneficiary.

### **Uses of Trusts to Save Money**

Trusts are most often used to minimize federal estate taxes while providing security to the surviving spouse. One strategy to do this is to create a trust and write the wills of both spouses so that their assets “pour-over” into the trust when the first spouse dies. In other words, the assets are “willed” to a trust, rather than to the surviving spouse. The surviving spouse then gets the income from the trust and has limited rights to the principal, but the property in the trust is not in the surviving spouse’s estate. This is one way to use the \$3,500,000 federal applicable exclusion amount in both the husband’s and wife’s estate, and to permit up to \$7 million to pass federal estate tax-free for the couple.

Another very effective use of trusts is to make the trust the owner and beneficiary of life insurance. Because the proceeds are not subject to Ohio or federal estate taxes in certain cases, to appraisal, to probate costs, and possibly not to attorney fees, this may reduce estate settlement costs. There are numerous other uses of trusts to save estate settlement costs. Consult your attorney for additional ways trusts may work for you.

### **Avoiding Probate for Privacy**

To minimize estate taxes, yet provide for a surviving spouse, a trust may be utilized.

However, if a trust is used to avoid probate, it is important that it is done in the appropriate situations and for the correct reasons. One appropriate reason for living trusts is privacy. When an estate is settled, property being transferred is often listed in the newspaper, along with its appraised value. Also, the public has access to this same information at the county courthouse. However, if the property has already been transferred to a trust, it was not owned by the deceased at the time of death, so is not listed in the newspaper or in the courthouse files.

Living trusts are only one of several ways to avoid probate. Other methods include owning real property with another with rights of survivorship, owning property such as retirement accounts with named beneficiaries, having payable on death (POD) accounts, giving before death and owning life insurance policies with a named beneficiary.

Probate may also be avoided by using Transfer on Death (TOD) designations for stocks, bonds and other securities, real estate and automobiles. Unfortunately, the laws of Ohio are not uniform as to each of these asset categories. For example, with any security, you may specify that if the intended beneficiary predeceases you that the predeceased beneficiary’s share will pass to the beneficiary’s lineal descendants, per stirpes. However, with real estate you have to specifically name the contingent beneficiaries. Accordingly, if one of your children have another child after you set up the deed, you will need to prepare a new deed to reflect a new contingent beneficiary.

If these limitations are not a concern to you, you should be able to avoid probate with all titled assets without going to the expense of a trust.

## Why Avoiding Probate With a Living Trust Doesn't Always Save Money

Avoiding probate to reduce estate settlement costs may or may not be appropriate. Typical probate fees are estimated to be in the range of \$150 to \$400. Probate fees are negligible, so avoiding probate to avoid probate fees may not be appropriate.

Executor fees are another settlement cost. An executor in the probate process performs functions similar to those of a trustee for a trust. In general, the more time spent and the more management required of a trustee, the higher the fees (assuming the fees are accepted). Assuming that family members are the executor or trustee, the fees are not a concern. However, trustee fees may be higher if a bank or trust company performs the function. Avoiding probate to avoid executor fees is not advantageous as trustee fees may be as much as, or higher than, executor fees.

An appraisal is needed if tax forms have to be filed. An appraisal may be necessary when assets are placed into a living irrevocable trust, as gift tax forms may need to be filed. So the appraisal fee is still often incurred even if probate is avoided with a trust instrument.

Attorney fees are often a large portion of estate settlement costs. However, attorney fees will be charged when property is passed on to others through the probate process or through a trust.

Also, to settle an estate some attorneys charge by the hour, some base their fees on a percentage of only probate property, and some attorneys base their fees on probate and non-probate property. Even though the percentage charged for non-probate property is generally lower than the probate percent, one cannot

automatically assume that non-probate property will not be included in the attorney fee calculation.

Attorneys also charge to create and dissolve trusts. Property must be retitled into trusts when they are put in, and out of trusts when trusts are dissolved, which may or may not be included in the fee charged by the attorney to create the trust. Therefore, attorney fees will not necessarily be reduced by avoiding probate by use of a living trust. If you are considering a living trust to save attorney fees, make sure you know the total cost of creating and dissolving the living trust. In general, with a living trust you pay attorney fees “up front,” but pay attorney fees “after death” with a will.

## Situations Where Avoiding Probate Saves Money

Totally avoiding the probate process with all property may be appropriate for those with estates smaller than \$338,000, as no tax forms need to be filed and no Ohio estate taxes are due. Because no tax returns need to be filed for estates less than \$338,000, an appraisal would not be necessary and attorney costs to file tax returns would not occur. So, a simple, inexpensive probate avoidance procedure can save money for very small estates, but *all* property needs to avoid probate.

Also, it may be appropriate to avoid probate when real estate property is held in two or more states. Out-of-state or country real estate requires what is called an ancillary proceeding in the state or country where the real estate is located. This is expensive, time consuming, and a hassle in most states. Ancillary proceedings can be avoided by not having such property pass through the probate process. Therefore, one should consider transferring real estate outside his or her state of residence

by a living trust, holding such property with rights of survivorship or utilizing other probate avoidance procedures.

## 2007 Trust Code

Effective January 1, 2007, Ohio has a new set of statutes based upon the Uniform Trust Code. These laws are based upon the national model, but have been modified to more closely resemble Ohio law. Up to this point, Ohio has had very few statutes dealing with trusts, leaving some issues open to some uncertainty.

Some of the issues addressed in the new laws include the following:

The Trust statutes may be overridden by the terms of the trust except for issues such as the requirements for creating a trust, the duty of the trustee to act in good faith, the requirement of a lawful purpose for the trust, the right of courts to have certain rights over the trust, certain obligations of disclosure and statute of limitations. Some of the disclosure obligations can be avoided if a beneficiary surrogate is named to receive the information in their place.

Although a handful of states allow creditor protection benefits for the person establishing the trust, Ohio still allows creditors to reach any retained interest of the person establishing the trust. Strong creditor protection is available for other beneficiaries of the trust. The only creditors that will be able to reach an interest in the trust will be a child or a current spouse with a court order for support, the State of Ohio and the United States. A former spouse has no right to attach an interest in the trust.

The Trustee will also be required to provide certain notices, accountings and a copy of the trust agreement in certain circumstances.

## Concluding Remarks

This concludes a very brief discussion about the uses and concept of trusts. There are additional uses and kinds of trusts not discussed here. We leave it up to you and your attorney to decide if a trust is appropriate for your situation; and if so, the kind of trust to use.

These fact sheets should in no manner be considered as a replacement for consulting with estate planning professionals, nor should the general principles in these fact sheets be applied to specific situations without consulting with an attorney.

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## Your Response

### Fact Sheet 7

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1. Trusts can, to a certain extent, allow the best of both worlds. A trust can allow the assets of a married person who dies to pass indirectly to their children. This can result in the assets being liable to estate settlement costs only once instead of a second time in the surviving spouse's estate. However, the surviving spouse can have income from the assets and even can have limited access to the principal, if needed.

True \_\_\_\_\_ False \_\_\_\_\_

2. The difference between a funded living trust and a testamentary trust is the living trust is funded or comes into being during the creator's lifetime while a testamentary trust is funded by assets passing through the will.

True \_\_\_\_\_ False \_\_\_\_\_

3. When assets are put into a trust they need to be retitled or "signed over" to the trust by putting them in the name of the trustee.

True \_\_\_\_\_ False \_\_\_\_\_

4. An advantage of a funded living trust is that the assets do not pass through probate, thus do not become "public knowledge."

True \_\_\_\_\_ False \_\_\_\_\_

5. One advantage of a revocable living trust is that the creator can change or revoke the trust and get back the assets placed in the trust.

True \_\_\_\_\_ False \_\_\_\_\_

6. An advantage of an irrevocable living trust is that assets placed in the trust may not be subject to Ohio or federal estate taxes.

True \_\_\_\_\_ False \_\_\_\_\_

7. With an irrevocable living trust the creator usually loses control of the assets placed in the trust.

True \_\_\_\_\_ False \_\_\_\_\_

8. With an irrevocable living trust, there may be gift tax liability and/or reduction of the federal unified credit.

True \_\_\_\_\_ False \_\_\_\_\_

9. Probate can be avoided by:

- living trusts
- owning property with another with the right of survivorship (JTRS)
- having assets in a retirement account or in a life insurance policy with a named beneficiary
- giving property directly, before death

True \_\_\_\_\_ False \_\_\_\_\_

10. It may be appropriate to avoid probate with *all* assets if your estate value is less than \$338,334.

True \_\_\_\_\_ False \_\_\_\_\_

11. It's appropriate to avoid probate with the property you own in another state, assuming your primary residence and the majority of the assets you own are in Ohio.

True \_\_\_\_\_ False \_\_\_\_\_

## Answers

### Fact Sheet 7

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1. Trusts can, to a certain extent, allow the best of both worlds. A trust can allow the assets of a married person who dies to pass directly to their children. This can result in the assets being liable to estate settlement costs only once instead of a second time in the surviving spouse's estate. However, the surviving spouse can have income from the assets and even can have limited access to the principal, if needed.

True   X  

False \_\_\_\_\_

**All questions on the response sheet are true, and summarize some of the key advantages of trusts.**

2. The difference between a funded living trust and a testamentary trust is the living trust is funded or comes into being during the creator's lifetime while a testamentary trust is funded by assets passing through the will.

True   X  

False \_\_\_\_\_

**Think of a funded living trust as one that is living or in existence while one is living. Think of testamentary trust as one created by one's last will and testament (a will).**

3. When assets are put into a trust they need to be retitled or "signed over" to the trust by putting them in the name of the trustee.

True   X  

False \_\_\_\_\_

**Creating and funding a living trust is not without hassle. If all assets are transferred to the trust, checks are written from the trust account rather than from the creator's personal account.**

4. An advantage of a funded living trust is that the assets do not pass through probate, thus do not become "public knowledge."

True   X  

False \_\_\_\_\_

**Assets in a living trust do not pass through probate, thus are not listed in the newspaper or in court.**

5. One advantage of a revocable living trust is that the creator can change or revoke the trust and get back the assets placed in the trust.

True   X  

False \_\_\_\_\_

**Revocable means that the creator can dissolve the trust if he or she sees fit. If the creator changes his or her mind, or if circumstances change, the trust can be terminated and the creator can regain ownership of the assets placed in trust.**

6. An advantage of an irrevocable living trust is that assets placed in the trust may not be subject to Ohio or federal estate taxes.

True   X  

False \_\_\_\_\_

**If the creator no longer owns, has a beneficial interest in or has control over the assets, those assets are not subject to Ohio or federal estate taxes. However, unless properly planned, the initial transfer to the trust will have used part of the federal estate tax exclusion, thus can result in higher federal estate taxes.**

7. With an irrevocable living trust the creator usually loses control of the assets placed in the trust.

True   X                        False \_\_\_\_\_

**If the creator is not the trustee, and cannot revoke the trust, he or she loses direct and legal control of the assets in trust.**

8. With an irrevocable living trust, there may be gift tax liability or reduction of the federal unified credit.

True   X                        False \_\_\_\_\_

**Since funding of an irrevocable living trust involves giving of assets to the trust, the transfer of assets are considered a gift for tax purposes. If the gift is more than \$13,000 per person per year or the trust is not properly drafted, a gift tax form may need to be filed. The gift tax may be offset by using the federal unified credit, but the credit used will no longer be available to offset estate taxes, if needed when the creator's estate is settled. If the total of lifetime gifts over \$13,000 per person per year exceed \$1 million, gift tax may be due.**

9. Probate can be avoided by:

- living trusts
- owning property with another with the right of survivorship (JTRS)
- having assets in a retirement account or in a life insurance policy with a named beneficiary
- gifting property directly before death

True   X                        False \_\_\_\_\_

**A living trust is not the only way to avoid probate. All the other items listed are ways to avoid probate.**

10. It may be appropriate to avoid probate with *all* assets if your estate value is less than \$338,334.

True   X                        False \_\_\_\_\_

**If one's estate is less than \$338,334 due to: 1) all other property has been "given" away prior to 3 years before death or 2) because the original estate is less than \$338,334, no Ohio or federal tax forms need to be filed so no appraisal is necessary. Attorney fees may be lower.**

11. It's appropriate to avoid probate with the property you own in another state, assuming your primary residence and the majority of the assets you own are in Ohio.

True   X                        False \_\_\_\_\_

**If one owns property in multiple states or countries, probate property will require going through an additional probate process. Ancillary proceedings in other states or countries are expensive and time consuming. Ancillary proceedings can be avoided if the property in the non resident state or country is held in such a way as to avoid probate. The property could be held as Joint Tenants with Right of survivorship, in a living trust, etc.**