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THE REVOCABLE TRUST

The revocable, or “living,” trust is often promoted as a means of avoiding probate and saving taxes at death. The revocable trust has certain advantages over a traditional will, but there are many factors to consider before you decide if a revocable trust is best suited to your overall estate plan.

WHAT IS A REVOCABLE TRUST?

A revocable trust is a document (the “trust agreement”) created by you to manage your assets during your lifetime and distribute the remaining assets after your death. The person who creates a trust is called the “grantor” or “settlor.” The person responsible for the management of the trust assets is the “trustee.” You can serve as trustee, or you may appoint another person, bank or trust company to serve as your trustee. The trust is “revocable” since you may modify or terminate the trust during your lifetime, as long as you are not incapacitated.

During your lifetime the trustee invests and manages the trust property. Most trust agreements allow the grantor to withdraw money or assets from the trust at any time, and in any amount. If you become incapacitated, the trustee is authorized to continue to manage your trust assets, pay your bills, and make investment decisions. This may avoid the need for a court-appointed guardian of your property. This is one of the advantages of a revocable trust.

Upon your death, the trustee (or your successor if you were the initial trustee) is responsible for paying all claims and taxes, and then distributing the assets to your beneficiaries as described in the trust agreement. The trustee’s responsibilities at your death are discussed below.

Your assets, such as bank accounts, real estate and investments, must be formally transferred to the trust before your death to get the maximum benefit from the trust. This process is called “funding” the trust and requires changing the ownership of the assets to the trust. Assets that are not properly transferred to the trust may be subject to probate. However, certain assets should not be transferred to a trust because income tax problems may result. You should consult with your attorney, tax advisor and investment advisor to determine if your assets are appropriate for trust ownership.

WHAT IS PROBATE?

Probate is the court-supervised administration of a decedent’s estate. It is a process created by state

law to transfer assets from the decedent's name to his or her beneficiaries. A personal representative is appointed to handle the estate administration. The probate process ensures that creditors, taxes and expenses are paid before distribution of the estate to the beneficiaries. The personal representative is accountable to the court as well as the estate beneficiaries for his or her actions during the administration. For probate estates having less than \$75,000 of non-exempt assets, Florida law provides a simplified probate procedure, known as summary administration.

ARE ALL ASSETS SUBJECT TO PROBATE?

No, only assets owned by a decedent in his or her individual name require probate. Assets owned jointly as "tenants by the entirety" with a spouse, or "with rights of survivorship" with a spouse or any other person will pass to the surviving owner without probate. This is also true for assets with designated beneficiaries, such as life insurance, retirement accounts, annuities, and bank accounts and investments designated as "pay on death" or "in trust for" a named beneficiary. Assets held in trust will also avoid probate.

HOW DOES A REVOCABLE TRUST AVOID PROBATE?

A revocable trust avoids probate by effecting the transfer of assets during your lifetime to the trustee. This avoids the need to use the probate process to make the transfer after your death. The trustee has immediate authority to manage the trust assets at your death; appointment by the court is not necessary.

The "funding" of a revocable trust is critical to successfully avoid probate. Those persons who do not fully fund their trusts often need both a probate administration for the non-trust assets as well as a trust administration to completely distribute the assets. Because the revocable trust may not completely avoid probate, a simple "pour over" will is needed to transfer any probate assets to the trust after death.

HOW DO I KNOW IF MY ASSETS ARE PROPERLY TITLED TO MY REVOCABLE TRUST?

The account statement, stock certificate, title or deed will make some reference to the trust or to you as trustee. You might also elect to fund your trust by naming the trust as a beneficiary of life insurance or other similar arrangements. Your attorney and financial advisor may assist you with the transfer of assets to your trust. If your trust will own real estate then it is important to have the deed prepared by an attorney. The attorney will consider the impact of existing mortgages, title issues and homestead restrictions when the deed is prepared.

CAN THE TRUST HOLD TITLE TO MY HOMESTEAD?

In some situations your homestead property can be transferred to your trust. Most Florida counties have special requirements to maintain the homestead tax exemption and special language may be required in the trust agreement and the deed. However, homestead property may lose its exemption from creditors when title is held in a revocable trust—the bankruptcy law on this point is unsettled. Your attorney can advise you on whether placing your homestead in your trust is appropriate, and if so, the requirements for a valid transfer.

DO I BENEFIT BY AVOIDING PROBATE?

Avoiding probate may lower the cost of administering your estate and time delays associated with the probate process. However, many of the costs and time delays associated with probate, such as filing a federal estate tax return, will also be necessary with a revocable trust. The administration of a revocable trust after death is similar to a probate administration. The trustee must collect and value the trust assets, determine creditors and beneficiaries, pay taxes and expenses, and ultimately distribute the trust estate. A trustee is entitled to a fee for administration of the trust, as is the personal representative of an estate. To the extent professional services of attorneys, accountants and estate liquidators are used to complete the process, the savings may be marginal.

On the other hand, avoiding probate in multiple states is a definite benefit. Because of the nature of real estate, probate is usually required in every state in which you own real estate. This can usually be avoided by transferring ownership of the real estate to your trust during your lifetime.

HOW ARE CREDITORS SATISFIED?

Florida's trust law does not have a specific procedure for identifying and paying creditors at death. The creditors have up to 2 years from the decedent's death to file claims against the estate. The trustee may be reluctant to distribute the trust assets to the beneficiaries until he or she is satisfied that all claims have been paid, and 2 years is a long time to wait. For this reason, some clients choose to open a probate estate in addition to the trust administration to take advantage of the probate claim process. The probate law limits the time for creditors to file claims against the estate (generally 3 months from the date of notice), and also provides a process for objecting to claims.

DOES THE TRUST PROVIDE PROTECTION FROM CREDITOR CLAIMS?

In Florida, the trust assets are not protected from the claims of your creditors. During your lifetime the assets in a revocable trust are treated as owned by you, and subject to the claims of your creditor as if you owned them in your personal name. If the trust assets remain in trust after your death, the interests of the beneficiaries may be protected from their creditors by a "spendthrift" provision in the trust agreement. Florida law provides special protection for many types of assets, including assets owned by a husband and wife as "tenants by the entirety." Consideration should be given to these assets when you decide how to fund your revocable trust. Your attorney can advise you on the types of assets that offer creditor protection and the effect of funding your trust with them.

DOES THE TRUST PROVIDE PROTECTION FROM THE ELECTIVE SHARE?

Florida law provides that a surviving spouse is entitled to a minimum portion of the decedent's estate. This elective share is equal to 30% of the estate, including certain assets passing outside of probate. Generally, assets held in a revocable trust will be subject to the elective share. There are some exceptions to the elective share, and the right to receive an elective share can be waived by the spouse. You should consult with your attorney regarding the application of the elective share to your particular situation.

WHO PAYS FEDERAL INCOME TAX ON TRUST INCOME?

In most instances, the revocable trust is ignored for federal income tax purposes during the grantor's lifetime. The income and deductions are reported directly on your individual income tax

return. The trust will use your social security number as its tax identification number.

A revocable trust becomes a separate entity for federal income tax purposes when it becomes irrevocable, or stops reporting income under your social security number for any other reason. The trustee is then required to file an annual fiduciary income tax return. Taxable income, deductions and credits are determined in much the same way as for an individual. Trusts are also allowed a deduction for distributions to beneficiaries. In this way, the trust passes on income and deductions to the beneficiaries to be taxed on their personal income tax returns. Income that is not distributed to the beneficiaries is taxable to the trust.

DOES A REVOCABLE TRUST SAVE ESTATE TAXES?

Revocable trusts are often credited with saving estate taxes, but this is not entirely accurate. Your retained interest and power over the trust assets will cause the trust to be included in your taxable estate at death. The trust can be drafted to minimize the effect of estate taxes, but the same estate planning techniques are available to persons who choose to use a will as those who choose a revocable trust.

WHAT ARE THE TRUSTEE'S RESPONSIBILITIES?

Serving as trustee is no simple task. While very important, the prudent investment of trust assets is not a trustee's only responsibility. Your trustee's exact powers and duties will depend on the instructions in your trust agreement. But, in general, your trustee will:

- # Hold trust property
- # Invest the trust assets
- # Distribute trust income and/or principal to the beneficiaries, as directed in the trust agreement
- # Make tax decisions concerning the trust
- # Keep records of all trust transactions
- # Issue statements of account and tax reports to the trust beneficiaries
- # Answer any questions you and the beneficiaries may have concerning the trust

Your trustee may have broad powers or very limited powers. In either case, your trustee is a fiduciary and must follow a strict standard of care when performing trust functions.

WHO MAY ACT AS TRUSTEE OR SUCCESSOR TRUSTEE?

The choice of a trustee is extremely important, and may have tax consequences. You can name almost anyone as your trustee. Unlike the appointment of a personal representative of a probate estate, a trustee does not have to live in Florida or be related to you. You can name yourself or any other individual (subject to tax considerations), or a corporate trustee, such as a bank or trust company. The individual trustee can be a family member, friend or professional advisor. Many individuals appoint family members or friends as successor trustee, to assume responsibility for the trust management and distribution after their death. When a family member or friend is chosen, consideration must be given to the person's qualifications, the potential for friction with other beneficiaries, and the potential burden you are placing on that individual. The trust agreement should allow these individuals to hire qualified professionals to assist them in their duties, such as attorneys, accountants and financial advisors.