

HOW DOES A LIVING TRUST WORK?

A living trust permits the passing of property without any probate proceeding in court. It also allows for management of property when the trustors or settlors (those who establish the trust and put their property into it) are ill or incompetent. But, how does it work?

A trust is a legal arrangement and set of relationships. The trustors transfer property to the trustee. The trustee holds the property for the benefit of (fbo) the beneficiaries. The trust document establishes the identity of the trustors, trustee, and beneficiaries. It instructs the trustee regarding how to manage the property and when or under what circumstances to use the property for the benefit of the beneficiaries.

The trustee is a person or company (i.e. trust department of a bank). The person or company which serves as the trustee can change. The trustee may be and, in fact, usually is, the same person(s) as the trustors when the trust is first established. Later, when the trustors/initial trustees become incompetent or die, a successor trustee assumes the duties of the trustee for the trust. The beneficiaries can also change. Typically, the trustors designate themselves as the beneficiaries during their lifetimes. However, upon their death, their heirs, usually family members, become the new beneficiaries.

An analogy or two may help simplify the explanation. Like a corporation, a trust does not depend upon the life of any particular individual for the trust to continue to exist. If the president of Ford Motor Company dies, the company Board of Directors chooses a new president. The company continues with the new president. Likewise, if the trustee dies, the successor trustee takes over the management of the trust and the trust continues. The successor trustee has full power to liquidate the property and, according to the terms of the trust, is directed to hold or distribute the property or the proceeds from its liquidation to the beneficiaries. Because the successor trustees have these powers, there is no need for a court to empower an administrator or executor to manage a decedent's property as occurs when a will is probated in a judicial proceeding.

Another analogy would be to a cargo ship. The trustors and their attorney "build" the ship when the Declaration of Trust is prepared and executed. Next, the "cargo" is loaded on the ship. This is a process

whereby the title to property is transferred from the trustors as individuals to the trustee. A typical example would be the trustors, John and Mary Doe, would deed their home to themselves, John and Mary Doe, as trustees of the Doe Family Trust. When recorded, such a deed "loads" the family residence onto the "cargo ship". Investment accounts, CDs, money market funds, savings, stocks, bonds, partnership interests, and even vehicles can be "loaded" onto the "cargo ship" in this manner. John and Mary Doe then install themselves as the "co-captains" (trustees) of the ship and sail it according to their whim and fancy during their lifetimes. In the event of incompetency, a new trustee can be "airlifted" onto the ship to serve as a new "captain". Likewise, upon the death of the original trustees, they can be replaced as the captains of the ship, generally by family members who have been chosen to act as successor trustees. The ship would remain afloat through any and all of these events with the property safely on board. The new "captain" receives instructions from the trust document about where to "deliver" the cargo, usually in equal shares to the trustors' children. Once the cargo ship is empty, it is abandoned.

Just because a trust permits avoidance of probate proceedings in court does not mean that the courts are unavailable to persons interested in the trust. If a successor trustee is not managing the property wisely or starts treating beneficiaries differently so one is favored and another does not receive a fair distribution, the courts remain available to remedy any such wrongs. For this reason, the choice of successor trustee is a critical decision. Many families choose to have two successor trustees serve as co-trustees as a guard against any impropriety. Occasionally, a bank trust department is utilized to obtain professional management of assets and address concerns about possible unfairness or favoritism.

Generally, using a living trust "cargo ship" to pass your property saves significant amounts in administration fees. Fees for the attorney and executor in a probate proceeding are calculated on a percentage basis and are often approximately 5% of the value of the estate. A simple living trust can be established for approximately \$1,250 and there will be very little, if any, administrative or professional fees or expenses after the death of the trustors. Living trusts which are designed to save estate taxes are modestly more expensive (e.g. \$2,500) but can

save tens or hundreds of thousands of dollars if an estate is sufficiently large.

By: Christopher P. Schlies
Attorney at Law
699 Peters Ave., Suite B
Pleasanton, CA 94566
(925) 462-0444
(925) 462-0837 (Fax)
chris@schlieslaw.com
www.schlieslaw.com