LAW OFFICES OF

SMITH, LANDMEIER, SKAAR & ELDERS, P.C.

15 NORTH SECOND STREET
P.O. BOX 127
GENEVA, ILLINOIS
60134-0127

ALLEN L. LANDMEIER
JAMES D. SKAAR
VINCENT J. ELDERS

HOWARD E. SMITH, JR.
OF COUNSEL

TEL: (630) 232-2880
FAX: (630) 232-2889
Web Site: www.smithlandmeier.com

A Basic Explanation of LIVING TRUSTS IN ESTATE PLANNING

Confusing and misleading information has been published about the use of "Living Trusts" in estate planning. This summary is intended to provide a basic explanation of how Living Trusts work, and to give you some of the advantages and disadvantages of Living Trusts.

I. USE OF LIVING TRUSTS TO AVOID PROBATE

A "Living Trust" is a trust that you set up during your lifetime. The most common purpose is to avoid probate of your assets when you die.

When you set up a Living Trust, you must transfer ownership of most of your assets from yourself to your Living Trust. For example, title to your home and your investments are transferred from yourself to "the John Doe Living Trust." The person who controls the assets of the trust is called the "trustee," and the person or people who receive the benefits of the trust property are called the "beneficiaries." Initially, you can be both the trustee and the beneficiary of your Living Trust, so you retain full control over the trust property. This is similar to transferring your assets to a corporation, where you are the president, and the only shareholder. When you die, the Living Trust continues to own the assets, so they do not have to go through probate. Instead, the trust directs how the assets will be administered after your death, much like a Will.

The advantages of a Living Trust include:

A. Avoiding Probate: If all of your major assets are put into your Living Trust before your death, your estate does not have to go through probate. Without probate, your affairs can be settled more quickly, and with less cost. Living Trusts are especially helpful if you own property in other states, because probate might otherwise be required in each state.

B. Privacy: Probate documents are public records, so your Will, a list of your heirs, and in some cases an inventory of your assets are available for anyone to read and copy. Your affairs can be settled more privately if you have a Living Trust.

Although Living Trusts can avoid probate, save time and expenses, and maintain your privacy, they do have some disadvantages:

1. Administration: As mentioned above, in order to avoid probate, most of your assets must be transferred into your Living Trust. This involves a deed of your real estate, and changing the name on your bank accounts and investments from your name to "John Doe, as Trustee of the John Doe Living Trust." If you own a lot of different stocks, and you (rather than your account representative) have possession of the stock certificates, each stock must be individually transferred to your Living Trust. However, if you do not buy and sell stocks and bonds frequently, or if they are held by an account representative in a custodial account, then the administration of a Living Trust is relatively simple.

2. Initial Cost: Unlike a Will, which does not take effect until your death, a Living Trust takes effect as soon as you set it up. Consequently, there is more work involved for your attorney, so the fees are more than if you just have a Will.

Setting up a Living Trust generally has no effect on your income taxes, as long as you are acting as the trustee. There are things that you can do in a Living Trust to reduce estate or "inheritance" taxes (see Section B below), but you can accomplish those same things with the right kind of Will.

These are some of the major advantages and disadvantages of Living Trusts. There are other factors and details which you can discuss with your attorney.

II. USE OF TRUSTS TO AVOID ESTATE TAXES

In general, there are no estate or "inheritance" taxes if your total "estate" is less than $1 million. This exemption amount will gradually increase to $3.5 million in 2008. Under the current laws, the estate tax will be repealed in 2009, but will be reinstated at its present level the following year.

In addition to your home, investments and other assets, your "estate" includes all of your life insurance, retirement benefits, property held with someone else in joint tenancy, property that you receive through an inheritance, and any other assets over which you have ownership or control.

Although a husband and wife are each entitled to a $1 million estate tax exemption, without proper estate planning, the exemption of the first spouse to die is <u>wasted</u>. There is no tax due when the first spouse dies, as long as all of the property goes to the surviving spouse. (There are some technical requirements to this "marital exemption.") Without proper estate planning, all assets of the first spouse to die will be included in the estate of the second spouse to die, so inheritance taxes will ordinarily be due where the combined assets of a husband and wife are over $1 million. However, with the right kind of Will or Living Trust, a married couple can "shelter" up to $2 million from estate taxes.

The estate tax starts at about 40% of all assets over $1 million, and increases to a maximum rate of 50%, so the estate tax can be severe. Thus, if a husband and wife have a combined estate of $1.5 million, the estate tax when the second spouse dies would be about $216,500. However, that tax can be entirely avoided with proper estate planning.

A. <u>The Problem with Joint Tenancy</u>: Since each person has an individual exemption from estate taxes, owning property in joint tenancy is wise only if the combined assets of the joint tenants, including the joint tenancy property, life insurance, IRA's, pensions, and all other assets, are less than $1 million.

B. <u>Taking Advantage of Individual Estate Tax Exemptions</u>: In the case of a married couple, there are two basic steps to avoid or minimize estate taxes. First, property should be taken out of joint tenancy, so each spouse owns roughly 50% of the assets. Second, the Will or Living Trust of each spouse should be written to take advantage of the $1 million estate tax exemption of each spouse. Basically, the assets of the first spouse to die can be used for the "support, maintenance and medical care" of the surviving spouse, for as long as he or she lives. Any remaining assets are then distributed to whoever is designated in the Will or Trust. Using these methods, each person can "shelter" up to $1 million from estate taxes, for a total of $2 million passing tax-free from husband and wife.

Of course, this is only a general explanation of how estate taxes can be minimized or avoided. You should discuss these issues with your attorney for specific advice.

III. OTHER INFORMATION ABOUT TRUSTS

Trusts can be created for several other reasons, such as to provide for those who are disabled or incompetent, to pass property on to future generations, and many other reasons, which are not discussed in this summary.

It is very important to remember that setting up a trust will not accomplish your purposes <u>UNLESS</u> your assets are <u>ACTUALLY TRANSFERRED</u> into the trust.

FINALLY, AS STATED ABOVE, THIS IS INTENDED ONLY AS A GENERAL EXPLANATION OF TRUSTS, TO HELP YOU UNDERSTAND SOME OF THE USES OF TRUSTS IN ESTATE PLANNING. YOU SHOULD NOT RELY ON THIS SUMMARY FOR YOUR SPECIFIC LEGAL NEEDS, BUT YOU SHOULD INSTEAD DISCUSS THEM WITH YOUR ATTORNEY.