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FUNDING LIVING TRUSTS: MORE (AND LESS) THAN AVOIDING PROBATE

A frequently asked question is whether I should fund my living trust during my lifetime. Placing assets in the trust ("funding" the trust) during lifetime is generally advisable for valuable, easy-to-transfer assets. For some, it's wise to take the necessary steps to avoid probate altogether. Probate is the post-death legal process by which your assets are administered and eventually retitled in the name of the beneficiary you designate in your will. Fortunately, Michigan's probate process includes modern streamlined procedures, but all probate involves some cost and public notice.

Probate Avoidance. Assets in a living trust avoid probate because you don't own them anymore; the trust does. Only property in your own name at death has to go through probate. Assets in joint name with rights of survivorship and contractual assets payable to a named beneficiary also avoid probate.

Transferring Title to Assets. To fund your trust, you transfer title to assets in your own name to your trust. The effort involved will depend on the number and types of assets you own. Motor vehicles and boats registered in Michigan are best left in an individual name because a sales tax may be imposed on their value if title is changed to your trust.

Management. As creator of the trust, and possibly as trustee, you maintain control of the assets during your lifetime. Upon your incapacity, your successor trustee takes over and manages the assets for you during your lifetime. This arrangement avoids having to go to probate court and have a conservator appointed for you. A durable power of attorney can accomplish this same goal by naming someone as your agent to handle your financial affairs upon your incapacity. If you have a durable power of attorney, your agent can fund your trust upon your incapacity to avoid probate upon your death.

Creditor Rights. Placing assets in your revocable living trust will not protect the assets from your creditors. In fact, placing all your assets in your trust could have the disadvantage of extending the time after your death for your creditors to present their claims against your assets. If you are indebted to a large degree, own assets that have the potential for litigated claims, or are involved in a profession where claims may be asserted against you or your estate, you may be better served leaving some assets in your individual name to be probated and thereby shorten the creditors' claims period.

Avoiding Publicity. Funding your trust during your lifetime maintains confidentiality with respect to the size and nature of your assets because a trust is a private document that is protected from review by third parties. After your death, your will, on the other hand, is filed with the probate court and becomes a matter of public record that can be reviewed by the general public upon request. In addition, while disclosure of the estate assets is not required in Michigan's streamlined independent probate, in a supervised proceeding detailed inventories and accounts are part of the court file and therefore a public record. As a practical matter, people rarely take the time to review a probate file unless they have a substantial interest in your affairs, but that risk is totally avoided if you fund your trust.

Avoiding Family Disputes. Generally, the same rules apply to funded living trusts and wills in a contest by family members. Thus, funding your trust during your lifetime will not prohibit a challenge to your planning by family members. Nonetheless, funding your living trust during your lifetime may, as a practical matter, reduce challenges by beneficiaries because there is no requirement to notify your heirs of your will. For some it is important to avoid this notice.

Taxes. There are no significant income tax advantages or disadvantages to funding your trust during lifetime. A living trust is taxable to you during your lifetime and all items of income, deduction, and credit are reported on your individual tax return. If you are the trustee or co-trustee, the trust can avoid filing a separate tax return. If you are not a trustee or co-trustee, the trust must file a separate tax return. There is no death tax advantage to funding your trust during your lifetime. All assets in your trust are taxable in your estate for death tax purposes.

Conclusion. In summary, funding your trust during lifetime avoids probate, its cost, and public notice. That advantage must be weighed against the expense and effort that you must undertake yourself to transfer the assets to your trust. Fully avoiding probate, especially given Michigan's streamlined probate procedures, is not for everyone but should be considered as part of your planning.