

## Myths Revealed—The Truth About Living Trusts

There can be little doubt that the revocable living trust has become an extremely popular estate-planning tool over the past several years. There are numerous advantages to having trusts, such as the avoidance of probate, increased privacy, and outside management of your assets. Many individuals, however, are purchasing trusts based on other representations made by the trust merchants—representations that are sometimes false.

The first of these false claims is that all taxes—income, death, or otherwise—can be avoided through the use of a trust. The federal income tax laws provide that if you are the owner of a revocable trust, while you are still living, you are obligated to report all income earned by the revocable trust on your personal income tax return (Form 1040). At your death, any income that your trust earns until the time the assets of the trust are distributed must be reported on a trust income tax return (Form 1041). The same holds true for Indiana's income tax laws.

From a death tax standpoint, while it is true that a trust can help to minimize or eliminate the effects of federal estate tax, this is done primarily through the careful structuring of asset ownership for a married couple and not merely because assets were owned in a revocable trust. The reality, too, is that very few people have to be concerned with the federal estate tax. At the time of the writing of this article, the federal estate tax exemption is \$2.0 million, meaning that a person can leave \$2.0 million at death before the first dollar of federal estate tax is paid. This increased exemption from federal estate tax eliminates the concern of federal estate tax from most people's minds.

This leaves the Indiana inheritance tax which, pursuant to Indiana Code Section 6-4.1-2-4 (and contrary to the claims of many trust merchants), specifically provides a transfer of property by a trust over which the owner retains the right to revoke, alter, or amend the terms of the trust prior to death is subject to Indiana inheritance tax. The reason for this is relatively simple—if you retain the right to change who receives your property, who acts as trustee, or the right to do away with the trust altogether, the Indiana Department of Revenue and the Internal Revenue Service view this the same as direct ownership of the assets.

Another common myth is that if your property is held in a revocable trust and you are forced to enter a nursing home and become eligible for Medicaid, your property will be protected from recovery by the state. While this was the case at

one time, the legislature has closed this gap and any property transferred into trust after May 1, 2002, is no longer protected from recapture by the state at your death. Again, the same logic as with taxes applies—if you can control virtually every aspect of an asset, you are treated as its owner.

Trusts are also frequently touted as a means of reducing costly attorney's fees in the settlement of one's affairs. However, if the attorney chosen to administer an estate charges on a time and effort basis rather than an arbitrary percentage, the difference in fees between settling an estate and trust is negligible. The reality is that even with a trust, most individuals who act as trustee are going to need some legal assistance in settling a trust's affairs. The trustee may need help in transferring assets to a beneficiary, selling real estate, and preparing the necessary tax returns. All of these are steps that would be required in both the trust and estate context that require the services of an attorney. Keep in mind that the initial cost of establishing and funding a trust can be significantly greater than the cost of a basic will.

Trusts also do not provide protection from creditors. Indiana's property laws specifically provide that a creditor can force the personal representative of an estate to go after trust assets if the assets of an estate are insufficient to pay all outstanding creditors.

While trusts are indeed a helpful tool, they must be viewed with a certain degree of caution. The old saying that "if it sounds too good to be true, it probably is" applies equally to revocable trusts.

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