

**A BEGINNER'S GUIDE:
Estate Planning Through Revocable Trusts**
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In recent years revocable trusts have become a popular and quite common estate planning tool. Many people, both young and old, utilize revocable trusts to pass their assets to their spouse and the next generation free from probate, to plan for incapacity, and in some cases to minimize estate tax liability.

A "trust" is an agreement, usually in writing, between two parties. The first party is the Settlor, or the person who "sets up" the trust, and the second party is the Trustee, or the person who manages the trust and holds legal title to the assets. In most revocable trusts, the Settlor and the Trustee are the same person. The beneficiary of the trust is typically the Settlor during his or her lifetime, and at the Settlor's death the trust provides for the disposition of the assets to the Settlor's spouse if he or she is living, and if not to the Settlor's children (or whomever the Settlor directs in the trust agreement). The disposition of assets can be as simple as equal distributions to the children or as complex as providing for long-term trusts to provide income payments to the beneficiaries and distributions at specified ages, or generation-skipping provisions to pass assets to beneficiaries two or more generations below that of the Settlor.

In order for a revocable trust to be effective, however, it is important that the ownership or title to the Settlor's assets be transferred to the trust (known in the legal world as "funding" the trust). This includes transferring the ownership or title to real property (or land), mineral interests, personal property such as vehicles, bank accounts, investments, stocks, bonds, etc. For example, to transfer the ownership of the Settlor's home to the trust, the Settlor would execute and record a deed conveying the property from the Settlor individually to the Trustee of the revocable trust (i.e., John Doe, Trustee of the John Doe Revocable Trust).

In the introductory paragraph, we said that revocable trusts are used to pass assets to the beneficiaries free from probate. This is accomplished by changing the "legal title" of the Settlor's assets from the Settlor individually to the Trustee (funding). If all of the assets are transferred to the revocable trust prior to death, at the time of death the Settlor legally owns no assets in his or her individual name and therefore avoids the need for "probate."

Revocable trusts are also used to plan for incapacity in that they enable the Settlor to name an individual to take over the management of the trust property should the Settlor become disabled or otherwise unable to act on his or her own behalf. The language of the revocable trust agreement should outline how the Settlor's disability or incapacity is to be determined.

In some cases, the use of a revocable trust could enable the Settlor to reduce or eliminate his or her estate tax liability. By "stacking" their Unified Credits (defined below) in the year 2009, a married couple could pass \$7,000,000 to the next generation free from estate tax. This is accomplished by the Revocable Trust providing for a Credit Shelter Trust or Family Trust to come into existence upon the Settlor's death. At the death of the first spouse, \$3,500,000 worth of assets are transferred to the Family Trust to benefit the surviving spouse and children. The

balance of the assets pass to the surviving spouse through a Marital Trust, taking advantage of the Marital Deduction (defined below). Therefore, at the first death, no estate tax is due. At the second death, the assets that were transferred to the Family Trust of the first spouse to die (\$3,500,000, including any appreciation) would pass to the contingent beneficiaries - usually the Settlor's children - estate tax free. The surviving spouse can then utilize his or her Applicable Exemption to shelter the first \$3,500,000 of asset value from estate tax. This, of course, is a brief summary of how a Credit Shelter or Family Trust works and you should consult your estate planning professional to determine how this type of estate plan might work for you.

Any time we talk about this estate planning and revocable trusts we need to consider tax planning as well. The types of tax we should consider in our estate planning, include estate tax, gift tax and generation-skipping tax.

Estate tax is a tax imposed by the Federal government and most states on assets owned by an individual at the time of his or her death. Gift tax is imposed on transfers which take place during an individual's life, and generation-skipping tax is imposed on transfers made to individuals two or more generations below the donor. Estate tax and gift tax are both progressive tax structures, that is to say the first dollars are taxed at the lowest rates and as the taxable amount increases so does the tax rate. Generation-skipping tax is different however and is taxed at a flat rate of 45% (for 2009) and is in addition to estate and gift tax. OUCH! The Federal government does, however, allow a lifetime exemption from generation-skipping tax. In 2009, an individual can pass \$3,500,000 to persons two or more generations below their own free from generation-skipping tax.

There are a number of deductions and credits allowed by the Internal Revenue Code to help reduce an individual's estate and/or gift tax liability. The Marital Deduction is the most common deduction. This deduction is unlimited and allows a husband and wife to pass assets to their surviving spouse estate and gift tax free. The Internal Revenue Code also allows an unlimited estate tax deduction for amounts given to charity. Another deduction is for claims against the estate and expenses incurred in the administration of the estate of a deceased individual. This includes, but is not limited to, funeral expenses, debts of the decedent, expenses in preserving and managing the estate, legal fees, accounting fees, court costs, etc.

The Internal Revenue Code also allows several types of credits to further reduce estate and/or gift tax liability. One such credit is the Applicable Exclusion. The Applicable Exclusion applies to transfers during lifetime or at death and is available to every individual. The current Applicable Exclusion amount that can pass estate and gift tax free is \$3,500,000. The estate tax Applicable Exclusion amount is scheduled to be repealed for one year in 2010, and the estate tax and the Applicable Exclusion of \$1,000,000 is set to return in 2011.

Another way to further reduce your estate tax liability is to gift some of your assets away during your lifetime, thereby reducing the value of your estate and resulting estate tax at your death. Any person can gift up to \$13,000 per year (for 2009) to any other person free of gift tax. This gift tax exemption is known as the Annual Exclusion. Over time, gifts to family members of assets qualifying for the Annual Exclusion can substantially reduce the size of the donor's estate for estate tax purposes.

Estate planning can be an important part of planning for your future and the future of your spouse and children. Utilizing an estate plan developed specifically for your unique situation by an experienced professional can help preserve the wealth you have worked so hard to accumulate. Your estate plan can be simple or complex. No matter what the value of your estate, your family will certainly benefit if you use some of the estate planning tools mentioned in this article.

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