

**JAMES, POTTS & WULFERS, INC.**

David W. Wulfers, Esq.  
2600 Mid-Continent Tower  
401 South Boston Avenue  
Tulsa, Oklahoma 74103-4015  
(918) 584-0881 (*telephone*)  
(918) 584-4521 (*facsimile*)

---

**THE BASICS OF A REVOCABLE INTER VIVOS TRUST<sup>®</sup>**

---

**I. INTRODUCTION.**

**1. Definitions.**

(a) "Revocable Inter Vivos Trust" means a Trust created by written instrument during the lifetime of the "Grantor" which may be revoked or amended by the Grantor during his/her lifetime or other designated period. The term "Revocable Living Trust" has the same meaning as Revocable Inter Vivos Trust.

(b) "Grantor" is usually the person who establishes the Trust and whose property makes up the trust corpus. The terms "Grantor" and "Settlor" are synonymous.

(c) "Trustee" means the person or corporation or bank which has the duty and responsibility of administering the Trust.

**2. General.** A Revocable Living Trust is a separate, distinct legal entity recognized by law as having the power through its Trustee to own and administer property, both real and personal. Property transferred to and owned by the Trust is administered and controlled by the Trustee. The Trustee in turn can only act in the manner directed or allowed by the Trust instrument or the law applicable to the Trust. Therefore, a Grantor can, within the bounds of the law, exercise as much or as little control over the actions of the Trustee as he/she desires through his/her power to draft, revoke, or amend the Trust.

**3. Purpose of a Living Trust.** A Revocable Living Trust is usually created to serve as a vehicle for:

- (i) management of property during the Grantor's lifetime;
- (ii) transfer of property to designated beneficiaries at the death of the Grantor without the necessity of probate; and
- (iii) management of property after the death of the Grantor.

#### **4. Alternatives to Trust for Management of Property During a Grantor's Lifetime.**

When an individual desires assistance in the management of all or some portion of his/her assets, a variety of possibilities are available. He/she may give a power of attorney or he/she may transfer the property to a person as agent, such as custodian accounts, safekeeping arrangements, etc. Fundamentally, however, powers of attorney, custodianships, safekeeping arrangements, etc., are all forms of the legal relationship of principal and agent. The authority of the acting party flows from his/her principal and ceases with the death and sometimes, incapacity of the principal.

Another widely used alternative is Joint Tenancy. Joint Tenancy ownership is primarily considered as a means of transferring ownership of property to the surviving Joint Tenant without the necessity of probate. When a Joint Tenant dies, the entire interest of the deceased Tenant passes to the surviving Tenant or Tenants without probate. Many people use Joint Tenancy as a management tool. Since each Joint Tenant presumptively possesses the whole of the property at the same time, when one Joint Tenant becomes incapacitated, the other Joint Tenant could use the property for the benefit of the incapacitated Tenant. This ability of each Tenant to use the whole of the joint property also creates potential dangers. The whole of the joint property is exposed to the claims of the creditors of each Tenant. The whole of the joint property could be withdrawn by one of the Joint Tenants.

In contrast, a Trustee acts as a principal; his/her discretion, authority and power to act continue unabated after the death or incompetency of the Grantor. A Trust, rather than an agency relationship, is generally used when the Grantor desires the powers, discretion, and authority of the acting party to continue uninterrupted by the death or incompetency of the Grantor.

## **II. ADVANTAGES, DISADVANTAGES AND TAX EFFECTS OF A LIVING TRUST DURING THE GRANTOR'S LIFETIME.**

**1. Age as a Reason for a Trust.** One of the factors to be considered concerning lifetime management is the problem of age. The declining ability of the aged to cope with the complexities that are often involved in managing their estates highlights one of the most important uses of the Revocable Living Trust. It is a sad truism that the aged person is usually the last to recognize and accept his/her own increasing tendency to take erroneous or erratic actions, or fails to act when action is in his/her best interests. If the individual possesses substantial property, eventually those close to him/her may have to petition for the appointment of a guardian or conservator. A Revocable Living Trust is not a universal solution to property management for the aged. However, in most cases it is sufficiently preferable to the available alternatives that it warrants investigation.

**2. Revocable Living Trust as a Testing Ground.** A funded Revocable Living Trust allows a trial run of the Trust during the Grantor's lifetime. If he/she is not fully satisfied with the Trust operations, he/she can change Trustees or the administrative provisions or make such other changes as experience indicates, including revocation of the Trust and recovery of the assets of the

Trust. This possibility is not available with a Testamentary Trust (a trust created by a will) for it comes into operation at death, too late to make any changes.

A trial run may be particularly valuable when the assets of the Trust are a going business, stocks, or other investments that require attention, because the Trustee has an opportunity to become familiar with the problems of managing the assets while the Grantor is still available for consultation.

**3. Relief from Responsibility.** The Grantor's reasons for using a Revocable Living Trust often are not only to obtain investment advice and direction during his/her lifetime, but also to be relieved of the technical problems of keeping records, managing property, and preparing tax returns. Relief from the mechanical problems of managing property is particularly welcome when the Grantor is older, ill, retired, or inclined to enjoy traveling or other interests that make management difficult. By creating a Revocable Living Trust and appointing an independent Trustee, the Grantor is then relieved of management and has the opportunity to observe the Trustee's ability to perform.

**4. The Mobile Grantor.** The Revocable Living Trust has substantial advantages for handling the business and financial affairs of a mobile Grantor. For individuals who travel, whose occupations require that they move state-to-state or around the countries of the world, a Revocable Living Trust centralizes management and places authority and responsibility with the Trustee, still reserving the final word to the Grantor through the powers of amendment and revocation. A Revocable Living Trust may also minimize tax problems, particularly as they relate to the Grantor's domicile and residence. Retention of corpus by the Trustee places the assets beyond the jurisdiction of the taxing authorities where the Grantor temporarily resides.

**5. Pre-Death Administration.** A potential disadvantage of a Revocable Living Trust is the pre-death administration. In the case of a Will, no pre-death formalities are required other than the execution of a Will. A Revocable Living Trust necessarily involves a number of pre-death actions. In the usual case, the Trustee must open one or more bank accounts for the Trust, the Grantor must formally transfer assets from his/her name to that of the Trust, and the Trustee should operate the Trust as a legal entity separate and independent from the affairs of the Grantor. The Trustee must retain records of Trust activity.

The extent to which pre-death administration will be a problem depends upon the type of Trust created, the beneficiaries, and the choice of the Trustee. If the individual is willing to name a bank or other professional Trustee, the professional can effectively perform the administrative functions, and the only disadvantage to the Grantor is the cost. If the Grantor wishes to be Trustee himself or to name a friend or relative as Trustee, the administrative requirements may then be a burden.

A majority of our clients appoint themselves and their spouse as Trustees. This allows administration of assets in virtually the same manner as if the Trust were not created, the major difference being that administration of assets is done in the name of the Trust, not the individual. This method of Trust administration is recommended when the client is fully capable and willing to manage his or her assets.

As an alternative, the client may decide the person, bank or trust company the client wishes to be the successor Trustee to be Co-Trustee with the client, since the Co-Trustee will establish a close working relationship with the client during his or her lifetime, and will be familiar with the operations of the Trust and its assets and be in a position to assume the duties of Trustee at the client's incapacity or death.

**6. Amendment of Trust.** A potential disadvantage deals with the amendment of the Trust. If the Grantor of a Revocable Living Trust wishes to change the beneficiaries designated to receive property following his/her death, he/she can readily do so by amendment, but if he/she does not wish the beneficiaries, whose rights have been diminished, to become aware of the previous terms of the Trust, he/she faces a more difficult administrative problem. Generally, the original Trust instrument and any amendments to it are part of the Trust and its history, and the Trust beneficiaries probably have a legal right to them. Therefore, the superseded provision will usually be available to them unless the Grantor exercises his/her rights to completely revoke the prior Trust and go through all the necessary mechanics of creating a new Trust and transferring assets to it.

If this is a problem, the Trust can be drafted so that this problem is diminished or even eliminated by restating the Trust. This means the Trust is rewritten in full including the desired wording thereby eliminating prior wording.

**7. Transfer of Assets.** Another potential disadvantage is that the Grantor, to achieve full benefit of a Revocable Living Trust, must transfer the Grantor's assets to the Trust. If private assets are not transferred to the Trust prior to the death or incapacity of the Grantor, it is probable that a probate or guardianship proceeding will be necessary to deal with those particular assets. We work closely with each client to transfer all assets to the Trust to avoid this possibility. The need to transfer also means the Grantor must expend effort to identify and transfer assets during his or her lifetime. Although this may be a problem, it is significantly less a problem while the Grantor is living, than after the Grantor's death or incapacity.

**8. Tax Effects.** Creation of a Revocable Living Trust generally has no substantive income tax effects during the Grantor's lifetime. Because the Grantor has retained the power to revoke, he/she is treated as the owner of the Trust and therefore the income, credits, and deduction of the Trust are reported in the Grantor's individual tax return. The Revocable Living Trust does not file a separate income tax return. The bottom line is that, in a vast majority of cases, the Grantor will file an individual income tax return as if the Trust were not in existence. All income, credits and deductions of the Trust are treated as income, credits and deductions of the Grantor.

### III. ADVANTAGES, DISADVANTAGES, AND TAX EFFECTS OF A LIVING TRUST AFTER THE GRANTOR'S DEATH.

1. **General.** Use of a Revocable Living Trust is frequently urged as a means of avoiding probate at the death of the Grantor. If title to property has been transferred to a Revocable Living Trust before death, the property (if retained by the Trust) is not subject to probate as part of the Grantor's estate, even if he/she was the Trustee at the time of death. Although the avoidance of probate is a factor to be considered, there are numerous additional benefits.

2. **Avoiding Delay in Transferring Assets to Beneficiaries.** The speed with which assets may be distributed to a beneficiary after death is dependent, primarily, on the provisions of Oklahoma law permitting distributions and, secondarily, on the provisions of federal or state law that may make the fiduciary liable for death taxes, unpaid income taxes of the decedent, or claims of the decedent's creditors if the effect of the distribution is to leave inadequate property to pay those taxes and claims.

If the Trustee is the sole beneficiary, or enjoys a relationship with the other beneficiaries such that his/her potential liability for unpaid taxes or claims is unimportant to him/her, a Revocable Living Trust will allow most of Grantor's property to be distributed to his/her beneficiaries within a short time after his/her death. As an example, if the sole beneficiary is the surviving spouse, distribution from the Revocable Living Trust to the surviving spouse can be immediate. In contrast, except for family allowance to dependents, distribution of a probate estate cannot usually be made to the beneficiaries until an order of distribution is entered by the probate court which is usually many months, even years, after death.

When the Trustee is not the sole beneficiary and is concerned about his/her possible liability to the various taxing authorities and creditors, major distribution generally should not be made from a Revocable Living Trust any sooner than they could be made from a probate estate. Even though there may be limitations upon the distribution of the corpus from a Revocable Living Trust because of the foregoing considerations, income generated by the Trust assets can be currently distributed to the beneficiaries, in most instances the surviving spouse, with immediate availability of income from the assets of the Trust. This immediate availability may not be the case if the estate must be probated.

3. **Costs of Administration.** Whether the executor's commissions in a probate estate will exceed the fees of the Trustee of a Revocable Living Trust depends on the circumstances of the particular case, including the amount of property involved, the period of administration, and whether administration will be followed with a continuing Trust. The executor's commissions in Oklahoma are fixed by law. Trustees' fees are not fixed by law, but must be reasonable. The fees of banks and trust companies are generally published by them and is a guide for "reasonable" fees to be charged by individuals. Trustees' fees, in the aggregate, may be greater than executors' fees, depending on the length of time the Trustee must act, the property in the Trust, and other factors. If the Trustee did not act prior to the Grantor's death, some banks request an acceptance fee for accepting the Trust

assets, but we usually draft our trusts so that the bank will not be required to impose an acceptance fee and, in exchange for that, the bank will not be liable for any action or inaction of the predecessor Trustee. In most cases, the spouse and/or children of the Grantor are successor Trustees and therefore Trustee fees are not an issue.

**4. Attorneys' Fees.** Attorneys' fees for probating an estate are generally negotiated. Many attorneys will charge a reasonable fee for the services actually rendered in a probate based on time expended, nature of services required, responsibility assumed, and results produced. It is our experience that attorney fees for the most simple probate will be \$3,000 to \$5,000. Since property transferred to the Trust does not require probate, it is reasonable to assume that attorney fees in connection with the transfer of property upon death when the property is in a Trust will be less than if the property required probate. This does not mean that attorney fees will not be incurred if property is transferred by a Trust, because the same problems such as tax problems, disputes between heirs and beneficiaries, etc., can arise even though the property is in Trust. If these problems do arise, attorney fees will be incurred but they should not be any greater than if those problems arose during the probate administration of an estate.

The attorney fees for creating a Revocable Living Trust and companion Will are more than the fee of preparing a Will alone, so that pre-death legal expenses are greater with the Revocable Living Trust.

**5. Administration of Assets after Death.** When a Revocable Living Trust is used, the Trustee can continue to exercise all investment and other administrative powers given it by the Trust instrument, without court approval. Those powers are not interrupted by the death of the Grantor unless he/she was the Trustee. Even if the Grantor were the Trustee, if the successor Trustee is designated and is willing to serve, no court proceedings will be required and the successor Trustee can act immediately. In contrast, there is generally some delay in having an executor appointed.

**6. Multi-State Assets.** An important advantage of a Revocable Living Trust is the avoidance of ancillary administration when the Grantor owns real property in several states. Ancillary administration is usually expensive in that it requires a duplication of many of the efforts in the main probate. In some instances, it may be advisable to create a Revocable Living Trust just to hold the multi-state assets.

**7. Publicity.** Freedom from publicity is an advantage of a Revocable Living Trust. Wills and probate administrations are matters of public record. The principal provisions in the Wills of prominent persons are frequently published in the newspapers. Inventory of assets for a probate estate, showing the nature and the value of the decedent's estate, is also generally a matter of public record. Although a Revocable Living Trust is not entirely private, since copies must be filed with taxing authorities and certain transfer agents require submission of copies of the Trust, it is definitely a more private method of administering and passing a person's property on death than probate.

**8. Contest of the Trust.** The legal requirements for contesting a Revocable Living Trust are generally similar to those for a Will contest, *e.g.*, mental competence or undue influence. There may, however, be a difference in time limitations within which the instrument must be contested, the period being shorter for a Will than for a Trust. But, it may be more difficult to contest a Revocable Living Trust that has been in active operation for a period prior to the Grantor's death as compared to the contest of a Will.

**9. Taxability of Income of the Trust.** Generally, a decedent's estate and a Trust are treated in the same manner for federal income tax purposes except that during normal administration, the income of a probate estate is taxable to the estate, except for distributions actually made to the beneficiaries, which are taxable to them. The Executor, by timing some distributions, can affect the income tax liabilities of the estate and its beneficiaries. However, a Trustee may not be able to do so, because trust income that must be distributed to beneficiaries currently is taxable to them whether or not it is actually distributed. Accordingly, there is less flexibility in income tax planning for a Trust and its beneficiaries than for an estate and its beneficiaries.

**10. Basis of Property in the Trust.** For federal tax purposes, property placed in a Revocable Living Trust receives on death the same treatment as to basis as property of the same character which passes by Will. For 2011 and 2012, property acquired from a decedent, including property of Revocable Living Trusts, receives a new basis equal to its fair market value at the date of death or at the alternate evaluation date.

**11. Estate Tax.** Separate property transferred to a Revocable Living Trust is included in the Grantor's gross estate for estate tax purposes. The use of a Revocable Living Trust, therefore, does not affect the taxability of the property and any estate tax advantage, which can be obtained by the use of a Will, can be obtained by the use of a Revocable Living Trust.

#### **IV. PLANNING THE TRUST.**

**1. Selection of Trustee.** The appointment of a Trustee must meet certain minimal legal requirements. Because the Trustee must deal with the Trust property, he/she must be legally competent to hold title and to contract. Appointment of a guardian or conservator of the Trustee's person or estate generally vacates the office. A Grantor is not prohibited from acting as Trustee, but this situation has disadvantages which must be considered, especially with a funded Trust. Thus, when the Grantor acts as Trustee, use of the Trust as a testing ground is lost. Although the cost of maintaining and administering the Trust is reduced, it may be more difficult to find a qualified successor Trustee willing to act because of possible liability for failure to discover and redress breaches committed by his/her predecessor. Although this has been a problem in some localities, we have not found this to be a problem with our clients. Also, when the successor Trustee is the Grantor's spouse and/or children, the foregoing is not a problem.

A beneficiary may act as Trustee. However, when a beneficiary acts as Trustee, conflicts of interest may develop because of his/her rights as beneficiary are affected by his/her acts as Trustee.

This situation arises, for example, when a parent is a life tenant and children are remaindermen, or when one sibling is Trustee for himself and other siblings. The conflict of interest problem may be met in several ways, such as defining Trustee powers or the appointment of a Co-Trustee. Furthermore, when a beneficiary is a Trustee, certain income and estate tax problems may arise which would be adverse to the interests of the Trustee/beneficiary. However, if this is a problem the Trust can be drafted to avoid the problem.

**2. What Property Should be Transferred to Trust.** The Grantor who establishes the Trust must determine at the outset whether all or only part of the property is to be transferred to the Trust. Because the Grantor of a Revocable Living Trust is considered the owner of the Trust property for income tax purposes, he/she need not concern himself with many tax considerations, such as the effect of transferring property with low basis. Nevertheless, tax considerations do play a role, *e.g.*, in the transfer of stock of a Sub-Chapter S corporation the election may be lost, or the transfer of stock options to the Revocable Living Trust has disadvantages. A point to remember is that if all property subject to probate is not transferred to the Trust, the advantage of avoiding probate is lost.

The following is a general discussion of factors considered when transferring specific property to a Trust:

**(a) Installment Notes Receivable.** The Grantor's assets may include installment notes from an earlier sale of assets on which the Grantor has deferred income under the Installment Sale provisions of the Internal Revenue Code. The Internal Revenue Service has ruled that a transfer to a Revocable Living Trust is not such a disposition and, therefore, does not accelerate income because, for tax purposes, the Grantor is treated as the owner of the Trust.

**(b) Nonproductive Property.** Nonproductive property, such as stock in a closely held corporation or unproductive land, is an appealing asset for transfer to a Revocable Living Trust. The inconveniences that normally arise during the Grantor's lifetime, such as need for separate trusts, bank accounts, and tax returns are absent with this type of property.

**(c) Encumbered Property.** When encumbered property is transferred to a Trust, an analysis should be made to determine whether the property is likely to be self-supporting and produce sufficient income to continue payments on the encumbrance.

**(d) Property Subject to Restrictive Agreements.** Among the assets being considered for transfer to a Revocable Living Trust may be shares of stock in a closely held corporation or interest in a partnership or limited liability company that are subject to an agreement restricting their sale or disposition. The agreement should be examined to determine if it permits transfer of the interest to a Trust during the owner's lifetime.

**(e) Interests in Professional Partnerships and Corporations.** The Grantor may be a member of a professional or commercial partnership. The interest in the professional partnership, *e.g.*, law or medical partnership, cannot usually be transferred to

a Revocable Living Trust because each partner must be a licensed member of the profession. There is generally a similar restriction on professional corporations. However, the Grantor's interest in property used by the corporation or partnership and death benefits may be properly transferred to the Trust, just as any other asset.

(f) **Out-of-State Real Property.** Transfer to a Trust of real property located in another state eliminates the need for ancillary probate proceedings when the Grantor dies.

**3. Powers of the Trustee.** The powers and duties of a Trustee are governed by the Trust and state law. Oklahoma law is not overly restrictive in the powers and duties which it allows the Trustee, and in most instances, allows the Trust instrument to expand upon the powers granted by law. Therefore, within reason, the powers and duties of a Trustee can be drafted in the Trust to suit the particular needs and desires of each Grantor.

**4. Distribution of Trust Assets.** Since the Trust assets may be distributed to beneficiaries to the same extent as one could do by Will, the Grantor of a Trust needs to make the same decisions concerning distribution of his/her assets as he/she would in making a Will. In addition to the flexibility, the management and distribution can be controlled after death by the terms of the Trust. After death, management and distribution is, in many instances, one of the primary reasons for the creation of a Trust.

## V. CONCLUSION.

It is hoped that the foregoing will be helpful in making the decision of whether an estate plan should include a Revocable Living Trust. A Revocable Living Trust is a tool that should be seriously considered in most estate plans.

**U.S. TREASURY CIRCULAR 230 REQUIRES THAT JAMES, POTTS & WULFERS, INC. PROMINENTLY ADVISE YOU THAT THE ABOVE DOES NOT CONSTITUTE TAX ADVICE AND (1) NOTHING CONTAINED ABOVE WAS INTENDED OR WRITTEN TO BE USED, CAN BE USED BY ANY TAXPAYER OR MAY BE RELIED UPON OR USED BY ANY TAXPAYER FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE IMPOSED ON THE TAXPAYER UNDER THE INTERNAL REVENUE CODE OF 1986, AS AMENDED, (2) ANY WRITTEN STATEMENT CONTAINED IN THE ABOVE RELATING TO ANY FEDERAL TAX TRANSACTION OR MATTER MAY NOT BE USED BY ANY PERSON TO SUPPORT THE PROMOTION OR MARKETING OF OR TO RECOMMEND ANY FEDERAL TAX TRANSACTION(S) OR MATTER(S) ADDRESSED ABOVE, AND (3) ANY TAXPAYER SHOULD SEEK ADVICE BASED ON THE TAXPAYER'S PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR WITH RESPECT TO ANY FEDERAL TAX TRANSACTION OR MATTER CONTAINED IN THE ABOVE.**