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The modern revocable trust

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The high federal estate tax exemption may have reduced the urgency of estate tax planning, but it does not reduce its critical importance. Herewith, an examination of the broad utility of modern revocable trusts, including:

- The traditional vs. modern revocable trust
- Trustee, protector, and other positions
- Drafting changes
- The new planning environment
- Ancillary steps

A New Perspective on Revocable Trusts

Revocable trusts have been the focus of hype by some, often non-lawyers capitalizing on consumer fears of probate, and derision by others in the legal community as simply unnecessary. In some states revocable trusts are *de rigueur*. In other states they are rarely used. The reality is quite different from both extreme positions. A modern revocable trust document and plan can provide the foundation for a robust estate and financial plan that can address a number of significant legal, personal, financial and other needs vital to planning for several significant categories of clients. To accomplish these objectives, the trust document and ancillary planning must be handled in a manner quite different from the traditional revocable trust.

This *Study* will explain and illustrate a modern application of the revocable trust that can benefit clients in new ways. For practitioners this application can provide a valuable tool to remain relevant and even vital to clients now that the importance of the estate tax has waned for all but the high-net-worth client.

The Traditional Revocable Trust

Reviewing key aspects of a traditional revocable trust will help contrast the changes in a modern revocable trust. They are significant, as this article will explain. The traditional revocable trust typically has the following attributes, each of which has potentially significant drawbacks:

• It focused on avoiding probate. Although that can be useful, there are many other ways

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to minimize or avoid probate, with which practitioners are well familiar: Pay on Death (POD) accounts; Joint Tenants With Rights of Survivorship (JTWROS); beneficiary designations for retirement accounts and life insurance.

• Names the client/grantor as the sole initial trustee and as a current beneficiary. Although this is certainly simple, it may not provide the protection that an aging or infirm client may require. It is also a very simplistic approach, as a single trustee as the only fiduciary or person named in any capacity in the trust forgoes the many options that can be used to build in checks and balances to protect the aging client.

• Operates using the client's Social Security Number. There may be a better option to minimize the risks of identity theft that have become so prevalent.

• Often remained unfunded and served as a standby receptacle for assets poured over by the client's will on death. On the client's death, the use of the pourover will would transfer assets to the client's trust and thereby avoid probate. The modern revocable trust is a much more versatile and comprehensive planning tool, focused more on protecting the client as he or she ages, or faces chronic illness or other health challenges. As such, it should be funded with all appropriate assets as soon as possible after funding.

The traditional revocable trust does not suffice to address many of the problems that clients face in today's environment. These issues are reviewed below, and then the steps to modify traditional revocable trust planning so as to address current client challenges will be explained.

The New Planning Environment

Introduction: Estate planning has changed, but most revocable trusts have not. Many revocable trusts remain too simplistic to provide many of the benefits that this technique can provide to address the evolving environment:

• Clients are aging and living longer. The needs of clients living for two or three decades past retirement, or longer, are quite different from those on which estate planning historically has focused.

• Families are more fractured than ever. The nuclear family, which had been assumed to exist in traditional planning, is now the anomaly. As clients live longer, they often outlive not only spouses but also siblings and sometimes children, making the determination as to who can be a fiduciary more difficult, especially in terms of succession considerations for long-lived clients.

• Identity theft and elder financial abuse have grown in recent years. Planning to minimize these hazards is something estate planning has not historically considered, but now must.

• Clients and their families are increasingly mobile, and flexibility to move trusts to different jurisdictions is more important than in the past. The increased aggressiveness of many state tax authorities has made this point even more significant for planning.

Isolated Clients, Changing Family Dynamics: More clients are isolated. Traditional planning presumes that clients have a list of trusted family members to name in various fiduciary capacities. But this is increasingly not the case. The family unit has disintegrated and spread geographically. Clients are outliving family members who used to be named in such capacities.

For example, by age 85 women will outnumber men by 4 to 1. As a result, planning for the elderly will focus largely on the unique perspectives and concerns of elderly women whose husbands have predeceased them. Female life expectancy in the U.S. has increased from 78.0 years in 1985 to 80.9 years in 2010, and male life expectancy increased from 71.0 years in 1985 to 76.3 years in 2010. In 1985 the gap between female and male life expectancy was 7.0 years; this narrowed progressively, beginning in 2002, to only 4.6 years in 2010. But in planning terms that is still a potentially significant time gap.

Clients should not cavalierly name a neighbor, nephew or second cousin to be in charge of their finances if they need help in later years, just because they have no one else to name. If a client does not have that presumed safety net of trusted people, there are better alternatives. A modern revocable trust can provide a technique to build an incredible safety net so that it will be ready when the client needs it. This will require rethinking, not only of the office of trustee but also of other steps, as explained below.

It is often assumed that aging clients can rely on their children to provide care as they age. The statistics suggest otherwise. In 1950, 78% of families consisted of a married couple. By 2010 that figure had declined to merely 48%. The married family with children, the presumed paradigm for most estate planning discussions, was the norm in 1950 with nearly half, or 43%, of families fitting that description. By 2010 only 20% of families could be described as married with children.

Divorce: It is often suggested that approximately half of marriages end in divorce. For second and later unions, the failure rate is much higher. The segment of the population experiencing the fastest growth in divorce is those over age 65. Since 1990 the divorce rate for Americans over the age of 50 has doubled, and more than doubled for those over the age of 65. The trend has become so pronounced that it has been dubbed "silver divorce." Although a revocable trust does not provide protection from the claims of a client's ex-spouse, it can serve as an inexpensive tool to segregate premarital, gift and inherited assets from marital assets and thus reduce the risk that a spouse might succeed in a claim to those assets under state law. Retaining assets under trust name, and under a separate trust tax identification number rather than the client's Social Security Number, may serve to maintain the integrity of the immune nature of those assets.

Identity Theft: Identity theft has grown significantly in recent years. It seems that regularly a major government agency or corporation announces that its data base has been hacked and confidential information stolen. In many cases identity thieves use Social Security Numbers to unlock illicit access to client assets. Using a revocable trust with a distinct tax identification number might make it more difficult for a criminal to pilfer accounts.

Aging: There are 75 million baby boomers (those born during the years from 1946 to 1964). Boomers are an integral component of the aging population. Those over age 65 comprised 12.4% of the population in 2000. Those over 65 will grow to 19% of the population by 2030. Every day since 2011 more than 10,000 people have turned age 65. Making the two, three or more decades of post-retirement life these clients will have as secure as possible can be helped by a properly structured revocable trust plan. The fastest-growing demographic cohort in the U.S. is single women age 85 and over. For these older clients, this planning is even more important. Planning for these later years or decades of life is referred to as later life planning.

Later life planning is the future of estate planning for the aging client who is not subject to federal estate tax. The phrase "later life" planning is much broader than merely estate or retirement planning. It will include all of the traditional planning steps of retirement planning (investment planning, budgeting, projections) and estate planning (creating powers of attorney, health proxies, etc.), but also much more. A modern revocable trust can help address the challenges of these later years.

Elder Financial Abuse: Elder financial abuse is a significant problem for the aging client, and as more clients continue to age, the statistics will grow worse, absent proper planning. Major financial exploitation has occurred at a rate of 41 per 1,000. Practitioners need to proactively help clients build a planning team and address this risk. A common tool used in committing elder financial abuse is the ubiquitous power of attorney. In many cases after the agent has made transfers or payments, it is uncertain whether the principal intended those transactions or not. When the agent's actions were inappropriate, redress is often impractical or impossible. Creating a broader-based and more comprehensive plan may offer the needed protection, not only for the vulnerable or isolated client but also for all clients. This is important to consider because there is no certainty as to which client will become vulnerable, or when.

A New York power of attorney/elder financial abuse case illustrates the challenges that aging clients face. In this particular case, the agent closed out multiple Totten trust accounts (so cash deposits in the decedent's name passed under the will to different beneficiaries); sold property that was specifically bequeathed under the decedent's will; paid for the renovation of one of the agent's homes; and paid herself compensation for her services as agent.

Although the court noted that an agent must act in the utmost good faith and undivided loyalty toward the principal, and must act in accordance with the highest principles of morality, fidelity, loyalty and fair dealing, not all actions of the agent were undone. *In the Matter of the Accounting by Joan K. Conklin, as Attorney–in–Fact For Julius Gargani, Deceased,* No. 2010–363395/E, March 31, 2015, 2015 N.Y. Slip Op. 25094.

What could be done differently to protect the client/principal? A modern revocable trust with the checks and balances discussed later in this article may have prevented the abuse by the agent in the above case, abuse that was not fully redressed in the case.

A modern revocable trust can help protect clients as they age. It can protect them from elder financial abuse and identity theft, all while keeping the client in maximum control of his or her financial and legal decisions.

Chronic Illness: There are 130 million Americans living with chronic illness. Some 5.4 million people in the United States have Alzheimer's disease (AD). In 2010, 2.5 million traumatic brain injuries occurred either as an isolated injury or along with other injuries. 400,000 Americans are living with multiple sclerosis (MS). One million Americans are living with Parkinson's disease (PD). A modern revocable trust can provide, with some modest modifications in the document and some practical ancillary steps, a tool to protect the client from current or future challenges of aging and many health issues.

If a client is, for example, living with Multiple Sclerosis, a modern revocable trust can ensure the continued management of financial affairs before during and after an exacerbation (attack). If a client has been diagnosed with Alzheimer's disease, a modern revocable trust and plan, with proper ancillary steps (see below), can keep the client in control of his or her financial affairs as long as possible (and perhaps much longer than many might realize) with a secure safety net for the transitions as the client's capacity wanes. If a client is living with rheumatoid arthritis, a modern revocable trust and plan can minimize physical activities, while ensuring that one remains in full decision-making control. There are many ways that a revocable trust can be tailored to address whatever chronic disease or disability a client or loved one has.

Trustee and Other Positions

The traditional revocable trust often names the client as sole initial trustee and a child or other individual as successor. A modern revocable trust should take a broader perspective on the fiduciary positions in the revocable trust.

No Standing to Sue the Trustee: There is a significant flaw in the laws governing the application of revocable trusts to protecting aging or infirm clients. This gap in the protection that a traditional revocable trust can provide is significant and must be addressed in the modern revocable trust. The law treats a revocable trust as a will substitute. UTC Sec. 603. As a result, the remainder (successor) beneficiaries cannot obtain an accounting or otherwise question the use of revocable trust assets. The UTC, and many cases, provide that while the settlor is alive, the trustee has no obligation to report to remainder beneficiaries. *Tseng v. Tseng,* 352 P.3d 74 (Or. Ct. App. 2015). The state of the law makes it difficult for interested parties to protect the grantor or the grantor's wishes. This is contrary to the application of revocable trusts to safeguard aging or infirm clients.

What if a grantor is incompetent? Perhaps an interested party or remainder beneficiary could request that a court appoint a guardian to raise issues on behalf of the settlor, but this is cumbersome and costly and could take a long time. Furthermore, the current trustee of the settlor's revocable trust may well expend trust assets to convince a court that he or she should be so named or that there is no basis to name a guardian.

Proactive steps should be taken when planning and drafting a modern revocable trust to address this shortcoming in the law and thereby ensure that while a settlor/beneficiary is alive but "fading" that protection is in place. Consider perhaps an institutional trustee or co-trustee, a CPA in a formal role as monitor, and especially naming a trust protector to serve in a fiduciary capacity. This latter step is a significant and vital change in the application of a modern revocable trust. If a trust protector is appointed, consider expressly designating that person to serve in a fiduciary capacity. Although many commentators believe protectors always act in a fiduciary capacity, the law is not fully clear, so specifying this can avoid any issue as to status. This is discussed later in this article. The protector, as a fiduciary, should have standing to sue and protect the grantor from improper acts of a successor trustee.

The Case for the Institutional Trustee: The growing importance of addressing later life planning should be reflected in a more detailed discussion as to who should be named trustee and the structure of the fiduciary positions in the trust. The typical default approach of simply naming the client as sole initial trustee often will be inadequate to protect an isolated or vulnerable client. With growing fractionalization or disintegration of family units, longevity, silver divorce, and other dynamics, for many clients the safest approach for trustee may be to name the client as co-trustee with an institutional trustee, or at minimum to name an institutional successor trustee. An institutional or corporate trustee can provide independence, internal processes, controls and safeguards, and an array of ancillary services that can be useful to aging clients.

One of the problems to be wary of is naming an institution as a successor rather than current trustee for an aging client. If the institution is named as co-trustee from inception, the potential problems of "passing the baton" from the client as trustee to the institution can be obviated. It is often those transition points, e.g., when a client's capacity has waned sufficiently to affect investment decisions but not sufficiently to have the client fully manage his or her own affairs, that are most difficult.

In today's investment environment, if the client is already paying a wealth manager based on a percentage of assets to professionally manage his or her portfolio, the incremental cost of having an institution manage assets and serve as co-trustee may not be significant. It will be preferable to have an institution appointed before problems occur. If the client agrees with the concept of naming an institutional trustee, but prefers not to have the institution serve until necessary, the risks of "passing the baton" can be reduced by consolidating assets with that institution now before the need to transition becomes critical.

Some clients may feel some sense of discomfort with an institutional trustee. Educating clients as to the benefits of a professional trustee is an important step. As a client ages, is it really fair to impose the responsibility of paying bills and handling other administrative tasks on a family member, assuming that the client even has one capable of these tasks? Too often clients do not evaluate the time and responsibility imposed on a family member by tasks that might be better handled by a professional trustee. Is it really appropriate to burden a family member with investment decisions? Has the client realistically considered the burdens all this will place on a loved one? Paying bills, investing and other fiduciary tasks are often not so simple.

Even assuming a family member has the knowledge to make investment decisions, if there are other heirs, there is liability exposure. Saddling one heir with investment decisions could create significant exposure. Many individual trustees do not adhere to the processes and procedures that institutional trustees have to comply with under the Prudent Investor Act and other trust formalities. Helping an aging client understand the additional safeguards that an institution can bring, the potential to eliminate issues that might cause family strife, and the reduction or elimination of burdens and responsibilities for heirs may create comfort with what might be a better approach.

A bank or trust company can, with proper planning, provide for significant services and benefits to an aging, infirm or isolated client. An institution can assist not only with investment management but also with financial forecasting to ensure that the client's financial goals will be met, maximize assets to be bequeathed to intended heirs, and also help with many other aspects of that client's finances, such as bill paying, credit card management, and more as is appropriate for any particular phase of the client's aging, incapacity, or disease.

The family members who traditionally might have been named as a successor trustee might then serve in the capacity of trust protector as discussed later in this article. This approach can transform the protective features that a revocable trust can provide to an aging, infirm or at-risk client. This can retain family, friends or others in vital fiduciary positions, reduce the responsibilities and demands that they face, and better protect clients. Individuals serving as a trust protector with the unfettered right to terminate and replace the institutional trustee provide a powerful check and balance on any institutional trustee, and this mechanism alone may resolve the concerns that some clients have over naming an institution.

Care Manager: Integrating a care manager provision into a revocable trust can provide important safeguards for aging or infirm clients. Care managers are typically social workers, registered nurses (RNs) or comparable service professionals. They can comprehensively evaluate an individual's physical health and wellness, memory and mental health status, functional abilities, informal and formal social support networks, financial resources and living environment. They can make recommendations for care based on the information gathered from the assessment, coupled with an understanding of the client's wishes. Care managers can be knowledgeable about the resources available to the client and the economic impact of the care required over time. Care managers can coordinate the experts in different specialties so as to establish a comprehensive plan of care for the client.

This input can be valuable to the estate planner in crafting a plan or guiding a family on implementing a plan, because it provides professional expertise to tackle issues that financial and legal service professionals don't have the expertise to address. In addition, care managers can assist in ensuring that the client receives eligible benefits. In particular, a modern revocable trust might include a mandate that the trustee must provide, perhaps once per year but more frequently if called for, that an independent care manager evaluate the client/settlor and issue a written report to the trustee, trust protector and perhaps even one or more family members. This can provide independent verification of the status of the grantor/client and detect a range of problems that otherwise might not be noted.

Trust Protector and Other Protections: Trust protectors have become more common in recent years, but primarily in the context of complex irrevocable trusts. Applying the trust protector concept to a revocable trust can create a vital check and balance for aging or infirm clients and counter the legal issues of a lack of standing to challenge a trustee discussed above. A family member or friend might serve as co-trustee to mitigate some client's worries over the perceived impersonal nature of a corporate trustee. In this capacity the friend/family member's ability to undermine the security of the plan is protected by the policies and procedures of the corporate trustee so that this approach may be much safer than merely naming a friend or family member as sole trustee. Naming a trust protector (and successor) to monitor the institutional trustee and to have the right to remove and replace that institutional trustee provides balance in the other direction.

In some instances it might be advisable to limit the trust protector's replacement power to solely naming a successor institutional trustee to avoid the risk of the protector appointing himself or herself or someone who will do his or her bidding, thereby undermining the safety of the client's plan. Also, consider having a CPA named as a monitor to receive regular reports and to report any issues identified to the corporate trustee and trust protector.

Ancillary Steps

Merger Clauses and Change in Situs: For clients particularly concerned about asset protection or state taxation, or for wealthy clients who have formed intervivos irrevocable trusts in trust friendly jurisdictions (e.g., Nevada, South Dakota, Delaware, or Alaska), revocable trusts can provide another important planning benefit. Trusts formed under a will, testamentary trusts, are formed under the laws of the client's home state and by the action of the client's home state court. It can be more difficult to move a testamentary trust to a better jurisdiction. In contrast, trusts for heirs created under a modern revocable trust should not require the action of the client's home state courts and can specify in the trust agreement that the laws of a better state will apply. This will be particularly useful if a client has trusts with merger provisions so that after death the trusts formed after the client's death can more readily be merged into the existing irrevocable trusts in the trust friendly jurisdictions. This same planning might be useful to move a trust formed at death of the client to a lower tax state.

Consolidate Assets: Merely creating a well-crafted trust document will not suffice to ensure that a client can meet his or her goals. From a practical perspective, if client assets are scattered among a large number of investment firms, banks and institutions, it could be difficult for a successor trustee or monitor to protect the client from errors, identity theft and other risks that affect many aging clients. Clients should, therefore, be guided to consolidate assets into one or a few institutions. In addition, especially in light of the risks of cognitive issues as clients age or disease worsens, clients may benefit from creating checking and other accounts in the name of the revocable trust and transferring appropriate assets (e.g., non-retirement accounts) to the trust. Ideally, client assets and accounts should be consolidated, if applicable, at the institution named as a successor trustee. This will make it easier for the corporate successor trustee, especially a corporate trustee, to step in to assist the client in an emergency. In some instances the client might benefit from switching credit cards to ones issued by the institution named as successor trustee to create a readily available record of transactions for the institution as a successor trustee. Identifying what a "standard of living" means or what the phrase "donations to charities to which principal historically made gifts" becomes an easier process when all the information is available because of the consolidation process.

Automate: Clients who have not automated their checkbook and other financial records should be guided into doing so. This will create a detailed and accessible record of charitable giving, lifestyle and gifts to family and others that will be invaluable as the client ages. If an institutional trustee is named this information could be invaluable in ensuring that the client's lifestyle is maintained and wishes carried out. If an institution or CPA will have to take over bill paying and other administrative functions at some point, as the client's health fades or simply as the client becomes frail, automated financial records will be important. Tackling these issues before it becomes necessary can help keep the client in control of his or her finances and affairs for a longer period and minimize the potential risks of "passing the baton" to a successor trustee.

Power of Attorney: Some isolated clients will not have family, friends, or others to appropriately name as agent under a durable power of attorney. In such instances, a fully funded modern revocable trust with an institutional trustee may be the cornerstone of the plan and client safety net. Corporate fiduciaries are generally not comfortable operating as agent under a typical power of attorney. No institution is anxious to serve as an agent (many have policies not to serve at all), so a fully funded revocable trust with the institution as a current or successor trustee or co-trustee may have to be the keystone of that client's estate plan. This can limit the need and likely use of the power of attorney. Still creating a durable power to catch assets or matters that were not transferred to the revocable trust is essential. Some institutions, if named as trustee or co-trustee of a fully funded revocable trust, may be willing to assume a limited role as agent under the power of attorney.

Residential Real Estate and the Revocable Trust: For a vulnerable isolated client having his or her home held in the trust may facilitate the institutional trustee in protecting the client. Include express language permitting the trust to hold personal use assets and indemnify the corporate trustee for doing so. If the institutional trustee is based in a different state from the state where the home is located, consider a single member limited liability company (LLC) to own the home. The residential property might then be deemed an intangible asset and not be subject to the laws of a state other than where the corporate trustee is based. Because a single member LLC is disregarded for tax purposes, this will have no negative income tax impact (although it might adversely affect a senior citizen's property tax discount).

Conclusion

The modern revocable trust, when appropriate for a client and the client's circumstances, can provide valuable benefits to safeguard aging and infirm clients as well as address a range of legal, tax, personal, financial and other issues. It is more robust, flexible and comprehensive than the traditional revocable trust.

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