

Are Living Trusts The Best Choice? (Part I)

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Introduction

I am going to make a statement that may be considered an act of heresy in some circles: *A living trust is not the answer to every estate planning problem.* There, I said it. Tune out Suze Orman, ignore the seminars, and forget the media hype for just a moment. A living trust is a valuable estate planning tool when used in the right circumstances, but most people simply don't need them. Now, let me tell you why.

Probate Avoidance

The overwhelming popularity of living trusts is due largely to an intense fear of probate that seems to have gripped the entire population. This fear can only be attributed to urban legend because it is certainly not the product of any concrete experience as far as I can tell. On a daily basis, I have a conversation that goes something like this:

Client: "I need a living trust."

Me: "Why?"

Client: "To avoid probate."

Me: "Do you know what probate is?"

Client: "No."

Me: "Then why do you want to avoid it?"

Client: "That is what [Suze Orman / my neighbor / my financial advisor]

said I should do."

Me: "Is she a probate lawyer in Michigan?"

Client: "No."

Me: "What is it about probate that *you think* is so bad?"

Client: "I heard that the government will take all of my money."

I am not sure where all of this started, but I have practiced in probate court for many years, and I have yet to encounter a case in which the government took all of the property formerly owned by some poor deceased soul. In fact, I am happy to report that the probate system in Michigan is quite efficient, and most families report no ill-effects whatsoever from their encounter with the probate court process.

Much of the anti-probate hysteria seems to be generated at living trust seminars being peddled across the state. After attending one of these "informational" presentations, you would leave with a firm belief that the probate system could have only been conceived by the devil himself. *Probate will consume all of the money intended for your children! Probate will take years to complete! And what is left over will be grabbed by the LAWYERS!*

The reason for all of this misinformation is simple. Living trusts are relatively expensive to buy, and easy to sell to an unsuspecting audience. In many cases, the seminar presenters are not lawyers, but salespeople selling document form kits. There are many reported cases in Michigan of highly organized “trust mills” using unethical sale practices to sell form kits to elderly citizens at highly inflated prices. The tactic is always the same: describe the horrors of probate and then sell the solution to avoid it. The problem has become epidemic, and seems to be gaining momentum.

The True Cost of Probate

Don’t get me wrong, I am not against living trusts. On the contrary, I use them frequently in my practice to address specific client needs. Nevertheless, I firmly believe that living trusts are oversold. There are several reasons for my position. However, in this article, I will discuss only the economic aspects of the argument. Next month, we will review how living trusts actually work (or don’t work in many cases).

Let’s address the simple matter of *cost versus benefit*. Most living trusts are sold purely to avoid the costs associated with probate court administration. Therefore, the obvious question should be, “How much does probate actually cost?”

There are three costs involved in probate: administrative fees, inventory fee, and attorney fees. The administrative fees include the filing fee and publication fee. These costs amount to about \$250, and will be assessed in every case. The inventory fee is based upon the value of property that is subject to probate administration, and it is paid to the probate court. This fee will vary in every case. For example, an estate worth \$200,000 would be assessed an inventory fee of \$487.50, and an estate worth \$500,000 would pay \$862.50. Finally, an attorney may be retained for assistance with probate administration. Attorneys must charge by the hour, or a reasonable flat fee—percentage fees are not permissible. Again, there is no statewide average, but a customary fee in my experience is about \$2,500.

Based on these expenses, probate of a typical estate will cost about \$3,500. In many cases, the cost is actually much less. Nevertheless, I will use this figure to illustrate my point. Now, let’s assume that Larry and Lula are married and they purchase a living trust for \$1,500 to avoid probate. Their neighbors are William and Wilma, and they opt to prepare a last will and testament, with associated powers of attorney and health care directives, at a cost of \$600. William and Wilma own all of their property jointly, so they understand that probate will be necessary to pass their property to their children. Who made the better economic choice?

Larry and Lula paid \$900 more than William and Wilma to avoid probate. In other words, they paid \$900 to save \$3,500 at an undetermined future date. On the other hand, William and Wilma invested the \$900 they saved on legal costs in an investment account for 15 years at 6%, and they ended up with extra \$2,200.

Years later, William and Wilma’s children probated their estate at a cost of \$4,000 (assume some increase due to inflation). Larry and Lula’s children received their parent’s trust, but none of them knew how to administer it. So, they hired a lawyer and a CPA to help them. The attorney charged them \$2,000 for trust administration, and the CPA’s fees were \$1,000 for tax returns.

So what happened to the savings realized by avoiding probate? The total cost to administer William and Wilma’s estate was \$4,600, including the cost of their original wills and probate. However, if we reduce the total cost by \$2,200 from their investment account, then the overall cost was actually \$2,400 when compared to Larry and Lula. The out-of-pocket cost for Larry and Lula’s family was \$4,500, including document preparation and administrative fees.

This sort of outcome is not unusual in my experience. Whenever families come to me for assistance to administer a living trust, I wonder how we reached the point where probate is feared, and living trusts are thought to be a solution to every estate planning problem. Even when the argument is

made that probate is not as costly as it seems, and living trusts are not appropriate for everyone, some people still argue that lawyers are trying to generate probate fees for themselves. Since many of my clients are younger than me, I certainly hope that I have retired long before the opportunity to earn those fees comes around.

The important point to bear in mind that estate planning is a process, not just document preparation. What works for one family may be totally inappropriate for another. And every option has advantages and disadvantages. Many promoters of living trusts are merely pushing a *product* for their personal gain, and not for the benefit of their clients.

The real irony in all of this is that living trusts are not the only way to avoid probate in Michigan. In fact, there are other techniques that can be employed to avoid probate at a much lower cost, and with much less complexity. I will tackle that subject in a future article.

Next month, we will consider other pros and cons of living trusts, including complexity, privacy, funding, and post-death administration. But for now, please keep in mind that living trusts are just one of many tools that can be used to plan your estate. Try to look beyond the sales pitches and hype, and consider how they actually work. More to follow. JPT.



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