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Inter Vivos Trusts

1. **General nature:** A trust is a transfer of specific property, real or personal, to another for the use of the beneficiary. Legal title passes to the trustee.
2. **Governing laws:** Trusts are governed by common law fiduciary principles as well as by statute.
3. **Formalities:** A trust may be oral, but the key to the trust's effectiveness for asset management purposes is in the drafting of the trust and the powers given the trustee. The elements of a trust are: a grantor, a beneficiary, a trustee and trust property.
4. **Types of Inter Vivos Trusts:**

A. **Irrevocable Trusts:**

- i) Irrevocable trusts cannot be revoked, altered, changed or modified after their creation.
- ii) Irrevocable trusts have traditionally been used to facilitate tax planning rather than to provide for management of assets upon incapacity.
- iii) Irrevocable trusts are now increasingly used in medicaid planning.

B. **Revocable Trusts:**

A revocable trust can be altered, changed or modified by the grantor while he is living and competent.

- i. **Funding.** The trust may be fully or partially "funded" at the time it is created or it may be funded after the grantor's incapacity through transfers by an agent under a durable power of attorney.
- ii. **Privacy.** The trust is not recorded and the trustee does not have to disclose the trust document to third parties to exercise his authority.
- iii. **Management.** The grantor may serve as his own trustee under a trust "declaration," thereby retaining autonomy until the grantor is incapacitated. Informal procedures may be included for determining the incapacity of the grantor. Upon the grantor's incapacity, the successor trustee manages the assets pursuant to the directions in the trust.

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- iv. **Probate avoidance.** Assets titled in the name of the trust upon the grantor's death do not go through probate. Titling assets in the trust alleviates the need for ancillary administration proceedings for out of state property.

- v. **Challenges.** It may be more difficult to challenge the validity of a trust especially if the trust was funded by the grantor during his lifetime.

- vi. **Successor trustees:**
 - (a) The trust should provide for the resignation, incapacity, death or removal of the trustee, including the nomination of a successor trustee or series of successor trustees. The trust may authorize a person other than the grantor to replace the trustee when the grantor is no longer competent to do so.
 - (b) Informal procedures may be included in the trust document for determining the incapacity of the trustee.

- vii. **Terminating or Revoking a Trust.**
 - (a) **by the Grantor.** The Grantor may reserve the right to revoke the trust, in whole or in part, at any time when he is competent.
 - (b) **by the Trustee.**

Small trust provisions. The terms of the trust may provide that the trustee can terminate the trust if the trust is so small that it is no longer economical to administer. The trustee may petition the circuit court to terminate the trust for "good cause" which by definition can be found when the value of the principal is less than \$100,000. **Tax considerations.**

- viii. **Income taxes.** During the grantor's lifetime, the funded revocable trust is treated as a grantor trust for income tax purposes. There are few, if any, income tax disadvantages to holding property in a revocable trust.

- ix. **Tax return.** If the grantor or the grantor's spouse serves as a trustee of the revocable trust, trust income and deductions are reported directly on the grantor's income tax return. The trust does not require a tax identification number and the trustee is not required to file a fiduciary income tax return (Form 1041).

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- x. Gift taxes.** There is no gift tax upon the transfer of assets to a revocable trust because there is no completed gift. The gift will become complete only upon the death or incapacity of the grantor. Furthermore, there should be no gift tax consequences upon the incapacity of the grantor so long as the primary purpose of the trust as reflected by the trust agreement is to care for the grantor during his lifetime and the grantor retains a power of appointment over the principal. Regs.25.2411-2(b), (c).
- xi. Estate taxes.** At death, the revocable trust assets are includable in the grantor's estate pursuant to Section 2036 (retained life estate) and Section 2038 (power to revoke). If the trust is properly drafted, the assets in the trust can qualify for the marital deduction.