The Role of Trusts in Estate Planning:
Insights from the Philip Seymour Hoffman Estate

From the LOPW Planning Team

When the Oscar-winning actor Philip Seymour Hoffman's life and career abruptly ended in 2014 after passing away from a drug overdose at the age of 46, he left his heirs with a sizable estate valued at $34 million. Hoffman was survived by three children and a long-time partner, Mimi O'Donnell, who was also the mother of his children. Before Hoffman's death, it was reported that he expressed a desire for his children to develop a strong work ethic and to avoid the potential pitfalls associated with being "trust fund kids." Consequently, he bequeathed his entire estate outright to Ms. O'Donnell.

The phrase "trust fund kid" is prevalent in our popular culture, frequently carrying a negative connotation that individuals who benefit from trusts are excessively privileged and may not have to engage in work for their livelihood. In addition, the world of trusts in estate planning can seem complicated and complex and are often portrayed as vehicles that only benefit affluent families. However, trusts serve multiple significant and positive functions in estate planning, many of which contradict common misconceptions in cultural views about trusts.

Common Trust Objectives

For many individuals, a will-only based estate plan may be sufficient to accomplish their goals regarding the distribution of their estate to their designated beneficiaries. However, trusts allow for additional protections and strategies that a will-only based plan cannot offer.

By establishing a trust, the trust creator, also known as the grantor, can achieve a range of objectives. The most common include:

- providing support for family in the event of incapacity, illness, or disability
- avoiding the state-specific probate process and providing privacy for beneficiaries
- reducing a taxable estate, thereby minimizing estate taxes
- protecting assets from creditors and from divorce
- establishing a legacy and supporting a valued charity

The various objectives and purposes of different types of trusts are crucial to understand for anyone considering their estate planning options. There are numerous types of trusts, each designed to fulfill specific needs and goals, such as revocable living trusts, irrevocable trusts, charitable trusts, and special needs trusts, among others. Each type of trust has its unique characteristics, benefits, and limitations, which can significantly influence an individual's decision-making process regarding their estate plan.

Types of Trusts: Revocable vs. Irrevocable Trusts

Trusts can be classified as either revocable or irrevocable. A revocable trust permits the grantor to alter the trust terms during their lifetime while competent, whereas an irrevocable trust does not allow for any changes to the trust terms unless approved by the court or the beneficiaries of the trust.

The grantor's purpose and objectives for establishing a trust determines whether a revocable or irrevocable trust is created. The modifiable nature of revocable trusts provides greater flexibility compared to irrevocable trusts, making them a popular planning option. However, assets held by a revocable trust are included in the grantor's taxable estate and are subject to estate taxes upon the grantor's death. Additionally, revocable trusts do not offer protection against creditor claims and lawsuits involving the grantor. On the other hand, irrevocable trusts cannot be altered once established; however, they can remove assets from the grantor's taxable estate and provide asset protection benefits.

Revocable and irrevocable trusts funded during the grantor's lifetime both provide privacy and avoid probate.

Types of Trusts: Testamentary vs. Living Trusts

Testamentary trusts are established upon the grantor's death. A testamentary trust is created within the terms of the grantor's last will and testament and remains inactive and unfunded until the grantor's death. A grantor can amend their will during lifetime, but after death, any trust created within the will is irrevocable and cannot be changed.

In contrast, a living trust, also referred to as an *inter vivos* trust, is established before a grantor's death and is administered by a trustee during and after the grantor's life. Consequently, living trusts offer the grantor greater control over the management and execution of the trust compared to testamentary trusts, which are established upon the grantor's death. Living trusts can be revocable or irrevocable.

Benefits of Utilizing Trusts

Returning to Philip Seymour Hoffman, what benefits could his estate have recognized if he had included trusts for his heirs in his estate plan?

- **Flexibility to Address the Decedent's Wishes**. Trusts can be tailored with specific provisions surrounding when and how heirs inherit assets, addressing concerns like those of Hoffman about "trust fund kids." For example, a trust might require beneficiaries to earn their own income before receiving distributions, promoting a work ethic and financial independence.

- **Probate Avoidance or Minimization**. Since assets held in trust typically avoid the probate process, it is likely that the Hoffman estate could have avoided the complexities and potential pitfalls associated with probate had he incorporated a revocable trust agreement into his estate plan.

- Holding assets in trust offers more privacy for families, as trust assets typically remain out of public record, unlike those in probate. After Hoffman's will was filed, The New York Post published it, exposing his wishes to the public. Unlike celebrities, most individuals face less scrutiny, but probate allows anyone to access details about a deceased person's assets and beneficiaries, potentially leading to unwanted attention or exploitation.
- The probate process can take months or years to complete. Assets held in trust can continue to be managed without interruption should the grantor or beneficiary die or become disabled. Upon death or disability of the grantor or a beneficiary, the designated trustee would continue to manage the property for the benefit of the successive beneficiaries. According to the New York County Surrogate's Court online database, the Hoffman estate is not yet closed as of this writing, 11 years later.
- The probate process can be expensive due to court costs and legal fees. In North Carolina, the Clerk of Court currently charges probate fees equal to 0.4% (or $4/$1,000) of the value of the estate's probate property (up to a maximum of $6,000).

- **Tax Planning and Efficiency.** Hoffman's estate tax liability, which was approximately $15 million, could have been reduced had assets been placed in trust since the gift to his partner did not qualify for the marital deduction. The U.S. federal tax code allows for the transfer of assets between spouses without incurring estate tax at the first spouse's death, effectively deferring the tax liability until the surviving spouse's death. However, in Hoffman's case, since the recipient of the gift was not a spouse, the transfer would not have met the criteria for the marital deduction.

- **Estate Planning Lock.** The final allocation of Hoffman's wealth to his children will be decided by their mother's estate plan. What does this look like if their mother does not have a will? What is she marries and/or has additional children before her passing? Hoffman clearly believed that the mother of his children would provide for them appropriately; however, trusts offer the flexibility to incorporate these planning decisions into one's own plan so that the plan is locked in at the initial wealth transfer. Following the death of a spouse or partner, life can evolve. Oftentimes when second families are involved, estate planning can become more intricate and nuanced. Trusts can be helpful tools for navigating those intricacies.

Reports indicate that Hoffman's accountant and attorney recommended he designate assets for his children in his estate plan. The reasons behind Hoffman's decision to disregard his advisors' counsel will remain unclear; he was brilliant in his own right and may have wished to avoid the "tax tail from wagging the dog", or simply wanted to uphold his desire that his children would not be overly reliant on inherited wealth while showing his trust in their mother to manage the estate responsibly and in a manner that would benefit their family as a whole. However, other estate planning objectives such as **incapacity planning, privacy, probate avoidance, tax minimization, asset protection, and charitable goals** are important for many. Incorporating a trust as part of your estate plan can help achieve these objectives and provide assurance that your assets will continue to benefit future generations. Trusts can be established in numerous ways, with virtually countless variations available; therefore, the guidance of a qualified estate planning attorney is highly recommended.

Live Oak Private Wealth offers trust and estate planning strategy discussions as an integral component of our comprehensive financial planning services. Should you have any inquiries regarding how various trusts may benefit your family, we would be pleased to discuss this with you.