Estate Planning

Properly funding a revocable trust:

Making a revocable trust more than just a piece of paper.

Many clients expend significant sums of money to set up a revocable trust ("living trust" or "revocable living trust" [RLT]) as part of their estate plans. Revocable trusts offer many benefits, notably:

- Management by the Trustee in the event of the Settlor's incapacity;
- Privacy in the disposition of the estate;
- Avoidance of probate and freedom from court oversight; and
- Avoidance of expensive ancillary probate (out of state) for property owned in another jurisdiction, such as a vacation home.

However, even after spending top dollar and establishing a sophisticated revocable trust, many clients miss out on these intended advantages because they neglect to properly fund the trust. While some attorneys play an active role in this process, many may not assist clients with this aspect once the documents have been established.

Failure to properly fund

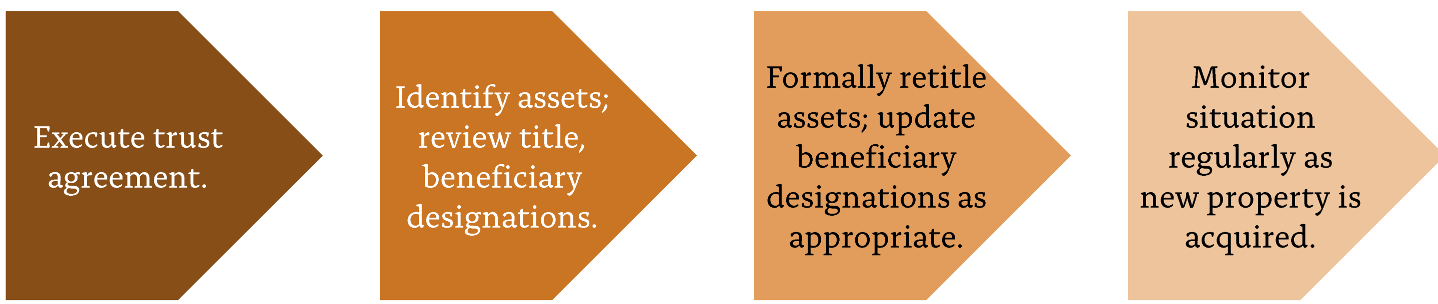
Although assets held outside the trust may still be channeled into the trust through a "pour-over" will that typically accompanies a revocable trust, the advantages and purpose of a revocable trust are all but lost with respect to such property. For example:

- In the event of incapacity, management of one's assets will be effected through a guardianship or designated power of attorney, which is generally more cumbersome to operate under;
- Heirs' access to property at death may be delayed through a lengthy and costly probate process;
- Out of state property can become subject to expensive and cumbersome probate proceedings; and
- All matters involving the estate—assets, values, beneficiaries, etc.—become a matter of public record.

The settlor's failure to properly handle the transfer of "non-probate" assets to the trust may

have even more dire consequences. Non-probate assets include assets that pass by beneficiary designation such as life insurance benefits, or assets that pass by survivorship, such as certain interests in real estate or bank accounts. If beneficiary designation forms or ownership are not properly updated, these assets may be distributed in a manner contrary to the settlor's intent, entirely outside of the revocable trust. They may pass to beneficiaries other than the trust beneficiaries, in proportions different from the trust terms, and may pass outright instead of in trust. A pour-over will is not going to "save" non-probate assets by channeling them into the trust.

RLT Creation and Funding



Funding the trust during life

The transfer of legal title from an individual to his or her RLT is the process by which such Trust is "funded." Normally, this entails a formal title transfer or change of ownership for assets that are recorded (such as vehicles or real property) or otherwise specifically titled in the owner's name (such as bank accounts, securities, and other financial instruments). Once an asset is transferred to the Trustee, it is under the Trustee's management and the asset is held for the benefit of the trust beneficiaries under the trust terms. Of course, for most revocable trusts, the Trustee and Beneficiary is also the original owner of the property, so little has changed from a practical standpoint.

Just because an individual established a revocable trust does not necessarily mean that all his or her assets should be transferred to it. Whether an asset should be transferred is a determination to be made on an asset-by-asset basis. For example, in certain jurisdictions, assets held by husband and wife as tenants by the entirety may enjoy enhanced creditor protection and be protected from the creditors of each spouse (but not from the creditors of both spouses). In such a case, the transfer of the asset to a revocable trust could cause loss of creditor protection. Similarly, naming a revocable trust as beneficiary of a client's retirement plan may result in accelerated distributions and increased taxes in some cases.

Specific steps

To successfully fund a trust in accordance with an overall estate plan, clients will need to work closely with their attorneys and financial advisors to ensure that the right assets are transferred in the proper manner. Commonly transferred assets include:

- Real estate. A deed will generally be required to transfer real estate to a revocable trust. If the property has a mortgage, approval of the mortgage lender is generally required to avoid triggering terms in the mortgage that would accelerate the balance due upon transfer of the property. Additionally, in certain jurisdictions, transfer of real property, even to one's own revocable trust, may result in real property transfer taxes or other fees. If the real property is a primary residence, loss of any homestead exemption for asset protection or tax purposes is also possible; rules governing homestead exemptions should be reviewed by the client's attorney.

- Bank accounts and certificates of deposit. The owner of the account is normally changed to the Trustee in the name of the Trust.
- Retirement benefits. While ownership of a 401(k) plan or an IRA generally cannot be transferred to a trust, a trust may be named as beneficiary. Any attempted transfer of ownership may be treated as a distribution. When naming a trust as beneficiary of a qualified retirement plan or IRA, however, one must pay careful attention to rules governing the extent to which a trust can be a designated beneficiary without resulting in accelerated distributions and income taxes.
- Brokerage accounts. The account is generally re-registered in the name of the Trustee, or the securities may need to be re-issued.
- Life insurance. The Trustee will normally be named as beneficiary of the policies. Transferring ownership of the policies to the Trustee also can be considered.
- Interests in closely held businesses. Ownership will have to be changed to the Trustee. Certificates of stock or membership interests as well as the company's ownership records will need to be updated to reflect the change in ownership. The governing documents of the entity will need to be consulted to ensure that the transfer is in accordance with any ownership transfer restrictions.
- Personal property. Tangible personal property, such as furniture or personal effects, are generally transferred through an assignment document typically drafted at the time the trust is drafted. For more valuable items, such as collectibles, it may make sense to execute a separate assignment referencing the item. For personal property with registered ownership, such as cars or boats, registrations with the appropriate authorities also will need to be updated.

Conclusion

Revocable living trusts are very common and have become an increasingly popular instrument as part of a core estate plan. Without proper funding, however, many (if not all) of the intended advantages of the trust may be lost.

As a result, it is imperative that clients considering or implementing such an arrangement consult with their professional advisors to ensure that property is titled in the name of the trust and that all beneficiary designations and co-ownership arrangements are up to date.